2018 Annual Conference

City Attorneys' Department Track

Long Beach Convention Center
Long Beach, California

September 12 – 14, 2018

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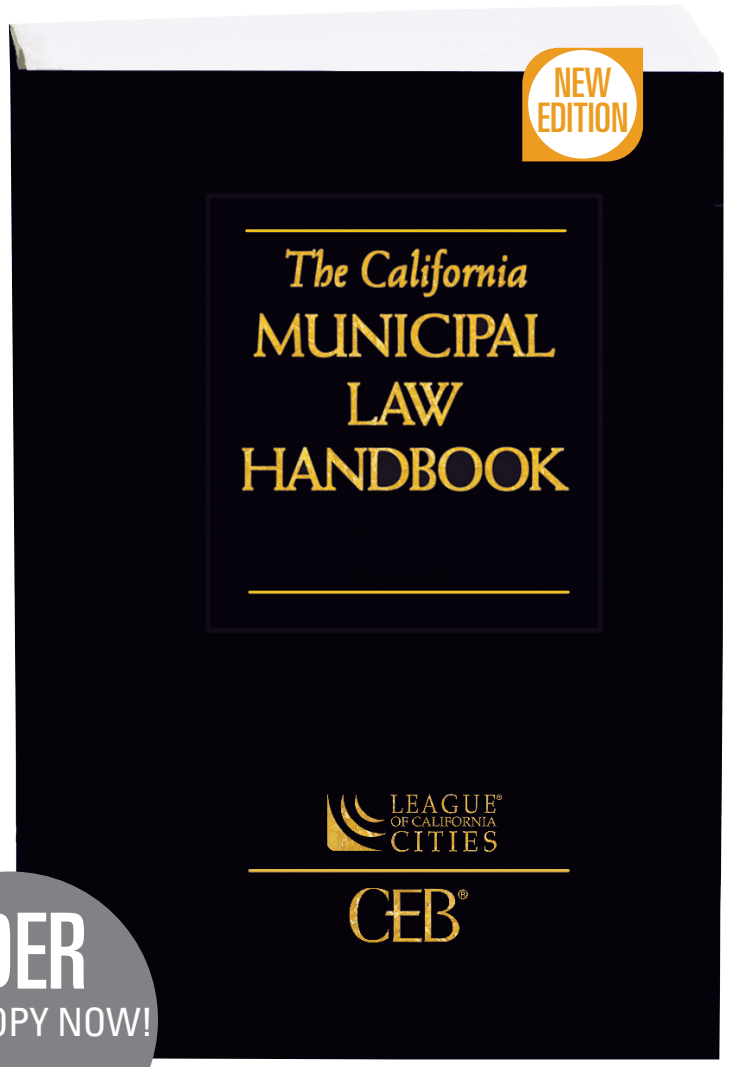

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City Attorneys' Department

2018 Annual Conference: City Attorneys' Track

Program Materials

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III. Program Materials *(continued)*

MCLE Information

The League of California Cities® is a State Bar-certified minimum continuing legal education (MCLE) provider. This activity is approved for 11 hours of MCLE credit, which includes 1 hour of MCLE specialty credit for Legal Ethics sub-field credit.

Registration Check-In

MCLE credit is being tracked through your registration for the conference and the receipt of your conference materials. At the time that you receive your conference materials, please verify your State Bar number for accuracy as it will serve as proof of your attendance.

Certificate of Attendance

Certificates of attendance are available on the materials table at the back of the City Attorneys' session room until the conclusion of the conference. ***Please make sure you pick up your attendance certificate.*** You only need one attendance certificate for all of the City Attorney sessions at this conference.

Evaluations

PLEASE TELL US WHAT YOU THINK! We value your feedback. Hard copy evaluation forms for the MCLE-approved sessions are available at the tables located in the back of the room. An electronic (mobile device compatible) version of the evaluation is available at: http://www.cacities.org/caevaluations and will also be emailed after the conference. Please tell us what you liked, what you didn't, and what we can do to improve this learning experience.

2018 ANNUAL CONFERENCE

Wednesday, September 12 - Friday, September 14
Long Beach Convention Center

CITY ATTORNEYS' DEPARTMENT TRACK

2017-2018 City Attorneys' Department Officers

President – Christine Dietrick, City Attorney, San Luis Obispo
1st Vice President – Damien Brower, City Attorney, Brentwood
2nd Vice President – Celia Brewer, City Attorney, Carlsbad
Department Director – Michelle Marchetta Kenyon, City Attorney, Rohnert Park, Pacifica, Piedmont, Moraga and Calistoga

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Wednesday—September 12

8:00 a.m. – 6:00 p.m. **Registration Open**
Long Beach Convention Center - Promenade Lobby (1st Floor)

1:30p – 3:30 p.m. **Opening General Session (Whole Conference; No City Attorneys' Programming)**
Long Beach Convention Center - Terrace Theater

3:30 – 5:00 p.m. **General Session**
Long Beach Convention Center - Room 104 BC

Moderator: Christine Dietrick, City Attorney, San Luis Obispo

45 min. **Mastering the Art of Leasing for Public Entities**
Speakers: Janna Aldrete, Property Manager, City of Monterey
Nancy A. Park, Best Best & Krieger

40 min. **New CPUC Regulation of Community Choice Aggregators**
Speaker: Megan Somogyi, Partner, Goodin, MacBride, Squeri & Day, LLP

5:00 – 7:00 p.m. **Grand Opening Expo Hall & Host City Reception**
Long Beach Convention Center - Exhibit Hall A & B

Thursday—September 13

7:00 a.m. – 4:00 p.m. **Registration Open**
Long Beach Convention Center - Promenade Lobby (1st Floor)

8:00 – 9:30 a.m. **General Session**
Long Beach Convention Center - Room 104 BC

Moderator: Christine Dietrick, City Attorney, San Luis Obispo

25 min. **Department Business Meeting**
– President's Report (Christine Dietrick)
– Director's Report (Michelle Marchetta Kenyon)
– City Attorneys' Bylaw Amendment (Christine Dietrick)
– Nominating Committee Report (2nd VP Nominee) (Greg Stepanicich)
– Election of Department Officers (President, 1st VP, 2nd VP, Director) (Christine Dietrick)

5 min. **Welcoming Remarks**
Speaker: Charles Parkin, City Attorney, Long Beach

15 min. **FPPC Update**
Speaker: Daniel G. Sodergren, City Attorney, Pleasanton

40 min. **Navigating Conflict Issues in Engaging Professional Consultants**
Speaker: Michael N. Conneran, Partner, Hanson Bridgett LLP

9:45 – 11:45 a.m. **General Session (Whole Conference; No City Attorneys' Programming)**
Long Beach Convention Center - Terrace Theater

11:30 a.m. – 1:00 p.m. **Attendee Lunch in Expo Hall (Whole Conference; No City Attorneys' Programming)**
Long Beach Convention Center - Exhibit Hall A & B

1:00 – 2:30 p.m. **General Session**
Long Beach Convention Center - Room 104 BC

Moderator: Michelle Marchetta Kenyon, City Attorney, Rohnert Park, Pacifica, Piedmont, Moraga and Calistoga

40 min. **General Municipal Litigation Update**
Speaker: Javan N. Rad, Chief Assistant City Attorney, Pasadena

45 min. **Prevailing Wage Compliance Monitoring: Practical Advice for City Officials**
Speakers: Michael J. Maurer, City Attorney, La Habra Heights and San Jacinto
Kevin Wang, Attorney, Best Best & Krieger

Thursday—September 13

(Continued)

2:45 – 4:00 p.m. **General Session**

Long Beach Convention Center - Room 104 BC

Moderator: Celia Brewer, City Attorney, Carlsbad

45 min. **Municipal Tort and Civil Rights Litigation Update**

Speaker: Timothy T. Coates, Managing Partner, Greines, Martin, Stein & Richland

25 min. **Massage: Eradicating Illicit Conduct Using Revocable Registration**

Speaker: David A. Silberman, Assistant County Counsel, San Mateo County

4:15 – 5:30 p.m. **General Session**

Long Beach Convention Center - Room 104 BC

Moderator: Damien Brower, City Attorney, Brentwood

40 min. **Labor and Employment Litigation Update**

Speaker: Stacey N. Sheston, Partner, Best Best & Krieger

30 min. **Facebook vs. The First Amendment**

Speakers: Traci I. Park, Partner, Burke, Williams & Sorensen, LLP
Kelly A. Trainer, Partner, Burke, Williams & Sorensen, LLP

6:45 p.m. **Evening On Your Own**

Friday—September 14

7:30 – 10:00 a.m. **Registration Open**
Long Beach Convention Center - Promenade Lobby (1st Floor)

8:00 – 10:00 a.m. **General Session**
Long Beach Convention Center - Room 104 BC

Moderator: Celia Brewer, City Attorney, Carlsbad

40 min. **Land Use and CEQA Litigation Update**
Speaker: Whitman F. Manley, Senior Partner, Remy Moose Manley

40 min. **"A Cloud on Every Decision": Nollan/Dolan and Legislative Exactions**
Speaker: Glen Hansen, Senior Counsel, Abbott & Kindermann, Inc.

35 min. **How SGMA Will Affect Municipal Groundwater Supplies**
Speaker: Russell M. McGlothlin, Shareholder, Brownstein Hyatt Farber Schreck

10:15 a.m. – 12:15 p.m. **General Session**
Long Beach Convention Center - Room 104 BC

Moderator: Damien Brower, City Attorney, Brentwood

30 min. **Lessons from the San Bernardino Bankruptcy for City Attorneys**
Speakers: Paul R. Glassman, Chair of Bankruptcy & Restructuring Practice, Stradling Yocca Carlson & Rauth, P.C.
Gary D. Saenz, City Attorney, San Bernardino

30 min. **After a Natural Disaster: Government Communications and Actions**
Speaker: David N. Bruce, Partner, Savitt Bruce & Willey, LLP

60 min. ***(MCLE Specialty Credit – Legal Ethics)***
Rules of Professional Conduct: Almost 70 New Ways to be More Ethical!
Speaker: Joseph M. Montes, City Attorney, Alhambra, Santa Clarita and Assistant City Attorney, Rosemead

12:30 p.m. – 2:30 p.m. **Closing Luncheon with Voting Delegates & General Assembly**
Long Beach Convention Center - Exhibit Hall A

MCLE Credit – 11 Hours
The League of California Cities[1] is a Multiple Activity Provider for California State Bar approved minimum continuing legal education (MCLE) and certifies this activity meets the standards for MCLE credit by the State Bar of California in the total amount of **11** hours, including **1 hour of Legal Ethics sub-field credit.**

[1] *Provider No. 1985*

Mastering the Art of Leasing for Public Entities

Wednesday, September 12, 2018 General Session; 3:30 – 5:00 p.m.

Janna Aldrete, Property Manager, City of Monterey
Nancy A. Park, Best Best & Krieger

Notes:

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Mastering the Art of Leasing for Public Entities

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League of California Cities
2018 Annual Conference
Presentation Date: September 12, 2018

MASTERING THE ART OF LEASING FOR PUBLIC ENTITIES

It is often necessary for public entities to lease land or building space to conduct public business or to utilize real estate investments to their highest potential. The purpose of this paper is to address common issues that arise when leasing properties, with special notes on issues faced by public entities, either from the tenant or landlord perspective.

I. What is the context?

Context in a deal is understanding the relative position and leverage to the market and the other party. Often, the landlord is the one with the greatest leverage, though this is not always the case. The context will give guidance in balancing the client's interests against the market and in resolving issues with common compromises. Understanding whether there is any bargaining power will also determine how much time, energy and legal fees are spent on issues which are a waste of time. A small tenant needs to focus on expenses and deal breakers, not rights and terms which only a large tenant will be able to achieve.

When acting as tenant, ask what the public entity client needs from the deal. What will the building/land be used for? Communicate or meet with key staff to understand completely what the use will be on that site. Will members of the public be allowed on site? Are there other feasible alternatives for location of the intended use?

A letter of intent is often used by parties to agree on initial business terms. Review the letter of intent carefully with the client. The best case scenario is to be involved with the client in drafting the letter of intent to ensure that it includes all critical business terms.

As tenant, it is most advantageous to push property responsibilities and costs to the landlord. Landlord's goal is to find a tenant that will take care of the property and pay rent on time. Conversely to tenant's position, a landlord will prefer the tenant to cover as many maintenance costs as possible to maximize revenue. The parties are free to decide how to split costs and responsibilities—there is no one right way, but the critical point is that the parties have decided and the rent reflects the inclusion or not of such costs.

II. Communicate, communicate, communicate

While parties may be tempted to conduct reviews and communications over e-mail, an in-person meeting can help the parties understand the issues, concerns and real business needs. Whatever the format, a lease requires much input and careful review to ensure it is as flexible and accurate as possible. A letter of intent, staff reports, and background on the property will ensure key terms are included for the party who is reviewing or drafting the lease.

Timing of lease commencement depends on many factors. Move-out deadlines, lease expirations, construction requirements and funding requirements all add or influence start dates in leases. Work backwards in time to come to an estimated framework that the clients agree is realistic, and build extra time into the timeline for contingencies, if possible. Ironically (for this audience), uncertainty regarding permitting for construction of tenant improvements causes delays in start time. With the City acting as landlord, it can be challenging for tenants to distinguish between the City as landlord and the City acting in its role as a local agency

regulator. City leasing staff should work closely with the tenant and other City departments to assist tenant with permit processing, if necessary.

III. Control the Drafting Process; Use Tools

Controlling the lease draft creates a position of strength because the lease will be negotiated from the beginning position, and, depending on relative budgets, negotiation position and time, may not move very far from this initial draft. It is useful to have at least two lease templates for use: one drafted to use when the entity is tenant, and the other drafted to be more friendly when acting as landlord. Having these templates will save time and money in lease drafting and in familiarity with the form. A template used by the City of Monterey for its Fisherman's Wharf retail premises is included at the end of this paper. Use of a template always requires careful review to extract property or deal specific terms. In this case, references to piling repair and closure of the wharf are two examples of property specific provisions, but there are others. The template is offered as a good example of a master retail lease for a particular property, and not as a general retail form to use everywhere.

Also provided at this paper's end is a checklist for landlords to use when drafting or reviewing leases. The landlord checklist is an excellent tool to use for most types of leases, as it contains discussion of most lease terms and what to look for, as well as a summary of public entity issues at the end. It is extremely useful for those not familiar with lease terms or who review leases infrequently as it contains reminders of issues to consider. It was developed over time in conjunction with a client who acquired multiple properties and needed extensive lease reviews completed, but it has served as a useful training tool for new lawyers learning the art of leasing. The Practical Real Estate Lawyer, a legal publication. also publishes useful checklists for leases, in particular, a series called the Tenant's Silent Lease Issues, which is extremely useful as well, however the articles have a private focus so public entity issues are not addressed. Nonetheless, tools like these can be helpful for staff and lawyers to consistently address and review their documents to ensure they consider the critical issues.

Sometimes form leases are proposed, such as AIREA or California Association of Realtors (CAR) forms. These are not recommended, except in certain circumstances. The AIREA form can be expedient, but must be carefully read to ensure all terms are applicable, or modified when not. Addenda can be added to cover special terms. Because both forms are drafted by brokers/realtors, be sure to watch for broker favorable terms such as mandatory mediation, arbitration, third party beneficiary language benefiting brokers and collection remedies for the broker fees.

Broker terms should generally be covered in a listing agreement or other contract dealing with the payment of any fee. There is no harm in omitting or deleting these terms from the lease, since if the public entity has the relationship with the broker, it has likely dealt with these terms in a consultant contract, and if the broker represents the other party, that party should have their own agreement. Brokers serve a valuable purpose in many transactions, proving market date, bringing parties together, and negotiating terms. They work for free until a deal is consummated, and they should not be asked to forgo their fee or be shut out of a transaction where they found the property or the tenant. However they do not need to be a party to the lease or be a third party beneficiary of the lease when their fee can be handled in a short term listing or commission agreement.

Property uses will often dictate the form:

- Residential: It may make sense to use a CAR form. Generally, these are updated regularly for compliance with laws. However, they are drafted by realtors and not for public entities. Careful review is necessary when using a standard printed form.

- Office: Consider creation of a master lease agreement that is standardized for the property (for landlord). Multiple leases on the same form for the same property makes administration and property management more efficient.

- Retail: The most common arrangement is that tenant be responsible for: most expenses such as: real estate taxes, building insurance, and maintenance (aka "triple net").

- Industrial: Consider any environmental concerns for site and how these should be handled (warnings, disclosures, indemnity by landlord for pre-existing haz mats, and indemnity by tenant for any exacerbation) in the lease. There should be stronger environmental clauses for tenants who are "dirty" users. Industrial users usually follow a triple net expense arrangement. Landlord might want to consider a baseline soils study for any existing hazardous materials before another user takes occupancy, or on a clean property with a user who might have potential to be a possible polluter.

Also consider whether to use a shorter, less complex lease form; this might work for a short term lease, or a tenant with a previous relationship. A longer, more detailed lease agreement could be used if the tenant is long term, has uses which require restrictions, or special terms or if there is complicated financing.

Some counterparties may have a policy of refusing to negotiate contract terms; this is especially true with certain governmental entities and utilities. If possible, ask in advance for a copy of any key lease terms or mandatory lease form and make sure the client is willing to agree to those terms. Also, ask if any exceptions have been made in the past to "required" boilerplate language. A landlord or tenant who is inflexible at lease negotiation will not make a long-term leasing relationship very pleasant, so rigid inflexibility could be a good reason to advise pursuing other alternatives if reasonably available. If a public entity has certain "sacred cow" type provisions which are truly critical to their community or positions which are non-negotiable, these should always be disclosed in the letter of intent stage to the other party, so that the parties can know up front about issues that might be a deal breaker or just infeasible for the other party. Also, if there is additional flexibility that can be offered as a mitigating factor, it is good to show these cards early on as goodwill, to help the party take the good with the bad. Again, deal breaker terms should be disclosed in the letter of intent or summary of terms stage to avoid wasting time on parties that just won't work with the required terms.

IV. Premises

The lease must include a full, accurate, and specific description of the premises. This description should include the street address, suite or floor number, floor plan (as an exhibit), space plan (as an exhibit), and exact or approximate figures depicting the rentable and usable square footage of the premises (as applicable). A legal description is not generally necessary,

unless no other description is available. Because public entities are exempt from the Subdivision Map Act for creating parcels (Government Code 66428(a)(2) less than an entire parcel can be leased in a ground lease.

A floor plan is the location of premises in a building. A space plan shows walls, cabinetry, doors, electrical and more, and specifications for these items. A space plan is critical for spaces that are to be built out, but it is not necessary if there is not any construction or tenant improvements.

The premises paragraph should address whether the premises includes any specifically described areas; whether the tenant may access and use areas other than the premises (e.g., common areas, parking, loading, storage, easements); whether tenant accepts the premises in their "as-is" condition; and establish an agreed-upon standard for calculating rentable and usable area. Rentable area is a calculation which includes an allocation for common hallways and lobbies. Usable area is the actual measurement of the space.

V. Term

The lease must identify a term. Typically, the term is described as a specific number of full calendar months or years (e.g., 12 months from January 1, 2019 through December 31, 2019) during which the tenant may occupy the premises. All leases must identify a commencement and termination date. Sometimes, parties define the commencement date as a date certain. Other times, parties define the commencement date as the date on which a specified event occurs (e.g., the tenant opens for business on the premises or landlord substantially completes tenant improvements). In the alternative, parties may define the commencement date as the earlier of a particular calendar date or a specified event (e.g., "the lease will commence upon the earlier of January 1, 2019 or substantial completion of tenant improvements"). Terms should not begin until the lease has been approved by City Council.

The lease should address whether the tenant may occupy the premises prior to the commencement date. Landlord should not permit the tenant to possess the premises prior to the commencement date without insurance and a security deposit. Commencement dates are often triggered by the completion of construction by the landlord, which sometimes takes longer than anticipated. The parties often will agree to a grace period, such as 30 or 60 days, to complete the construction, after which the landlord might grant a rent concession such as 2 for 1 rent credit, or after which the tenant might insist on a cancellation right. Landlords will strongly resist the cancellation right, as the worst positon a landlord can be in is to fully improve premises and then the tenant cancels. If a tenant is granted early occupancy rights, the parties should agree upon what terms that is (with payment of expenses, delay of rent, or other agreements). If the occupancy begins prior to the commencement date, the lease should provide that all other terms apply except for rent and that the lease is otherwise in full force and effect from the first date of occupancy or from execution, whichever is more applicable given the circumstances.

If the parties agree to abate rent for a certain period of time at the beginning of the lease term, the lease must also identify a rent commencement date. Under these circumstances, the lease commencement date will differ from the rent commencement date. Rent abatement often triggers prevailing wage issues for tenants, as it may be considered a subsidy, even if it is otherwise a market term. Unfortunately for tenants, even though the market might indicate that free rent or free tenant improvements are the norm for similar space, these terms trigger

prevailing wages for public entities, creating a non-market term for the public entity landlord and thus a disadvantageous situation for the public entity when competing for tenants with other properties who do not pay prevailing wage. There is no way around this requirement for prevailing wage other than the tenant paying for the improvements, again which may not be market.

In addition, the landlord may grant tenant an option to extend the lease term. If so, the option to extend should establish the number of times that tenant may extend the lease and the duration of each subsequent extension. Before exercising any option to extend, tenant should be required to give the landlord written notice within a set period of time. Tenant should not be permitted to extend the lease term when in default of any provision. An option typically benefits the tenant more than the landlord because tenant then controls what happens to the property. Some public entity landlords allow a tenant to exercise an option but then require the public entity to approve also. Many public entities include a 90 or 180 day termination clause in the event of a loss in funding, on the tenant side, or if the property is to be re-purposed, on the landlord side. Lease term including all options should not exceed the maximum legal term (51 years for ag leases (CCC 718); 55 years for city properties (CCC 718), but if the rent is reviewed periodically, among other requirements, the term can be up to 99 years; (CCC 719); tidelands can't exceed 66 years(CC 718)).

VI. Rent

Rent is the landlord's primary benefit and the tenant's primary burden under the lease. For that reason, clear and precise terms are important for base rent and additional rent for operating expenses and taxes. Failure to define base rent clearly can lead to significant loss for either party.

The base rent clause should specify a specific dollar value to be charged as rent, establish when the obligation to pay rent commences, and state when rent is due during the lease term (e.g., due in twelve equal monthly installments, each in advance of the first day of each calendar month). It should also specify whether any rent must be prepaid in the form of a security deposit and whether there will be a free rent period (i.e., an abated rent period). First month's rent should be paid at lease execution, even if a period is abated. The security deposit should never be offered as credit for last month's rent, but the amount of the deposit is often set at that level. Security deposits are to be used for potential defaults, so a deposit that is earmarked for rent, will not be available if the tenant leaves the property damaged on move out or who fails to pay direct expenses.

Typically, landlords increase base rent over the term of a lease to account for rising market conditions, sometimes with periodic fixed price increases, or alternatively, annual increases pursuant to the Consumer Price Index. Public entities tend to use the CPI, even though the CPI does not bear a direct relationship to the real estate market. However, it is convenient and understandable. There isn't a more appropriate index, but knowledgeable real estate parties will use a periodic reset to fair market value on renewal to ensure that the rent keeps up with the market. As a landlord, this is smart business, but as a tenant, it means that the tenant may be priced out of a quickly appreciating market, while the landlord may set a floor to protect against a declining market. As tenant, avoiding the floor and asking for periodic resets while at least ensure that the CPI or percentage increases do not outpace the market. It is a guessing game, so hard to bet on one way versus another.

Sometimes, one public agency will lease space to another public agency in a mutually beneficial leasing relationship for a nominal amount like $1 per year. When rent is set at such a low level, agencies must document which party is responsible for certain expenses that may arise during the lease relationship, especially capital improvements (e.g., roof repairs). Disputes can and do arise in these situations. Everyone benefits from a well-crafted lease that clearly delineates responsibilities and liabilities.

VII. Taxes

The lease should describe responsibility for all taxes associated with the premises. These may be included in the rent or paid separately. The lease should state whether and which taxes, if any, are included in the value of base rent. Similarly, the parties should clearly establish whether the tenant is responsible for paying any taxes that are not included in the value of base rent (i.e., if the tenant must pay certain taxes in addition to base rent). The tenant might not be held responsible for paying taxes unless that responsibility is stated in the lease.

California Revenue and Taxation Code Section 107.6 establishes requirements unique to public entities. Under that section, any lease between a private party tenant and a public entity landlord must include a statement that (i) the property may be subject to possessory interest tax and (ii) the tenant may be required to pay the property tax levied on the tenant's interest in the leased premises. When a public entity is tenant, the property tax is not abated except in certain specific statutory property tax exemptions (e.g. schools, community colleges, etc.).

VIII. Expenses & Capital Expenses

Tenants commonly agree to assume responsibility for additional expenses in the form of operating costs, repair and maintenance costs, or taxes. The lease should clearly state which expenses tenant is responsible for, whether tenant's responsibility for such expenses is capped at a certain dollar value, and when tenant should pay such expenses. Tenant is often responsible for expenses associated with maintenance and repair of the premises while landlord covers maintenance and repair of common areas and the building's structural elements (e.g., foundation, roof). The lease should specify whether tenant is responsible for repairs and/or replacements. Parties sometimes request the right to audit one another's expenses.

Landlords often seek to pass capital expenditures or compliance with laws expenses through to tenants and agree to amortize (i.e., spread out) such expenses over the useful life of the improvement. By amortizing such expenses, tenants can avoid unanticipated bills. Parties should discuss expenses that are likely to arise from deferred maintenance and agree upon an allocation of costs. Aging buildings can have costly upgrades to comply with ADA or to keep an aging roof or HVAC system in good condition. In the $1 rent lease example mentioned earlier (See Section VI), neither entity thought that they should have to pay. Reviewing the status of these items before entering into a lease as tenant will trigger a discussion on who should warrant or cover these expenses during the term.

Under a triple net lease, tenant must pay rent and also reimburse the landlord (or pay directly) for all operating expenses and taxes. Alternatively, a tenant under a full service lease may not be required to reimburse the landlord for all operating expenses and tax costs (because these are included in the base rent), but may be required to pay increases in operating expenses and tax costs over the base year of the lease (i.e., the first full year of the lease term). In the latter case, the lease must clearly state the base year and the calculation of expenses.

IX. Utilities

The purpose of the utilities and services clause is to specify the types, quantities, and standards of delivery of the utilities and services that landlord shall provide to the premises. The utilities and services clause should identify who is responsible for paying the cost of utility services. It should also describe the scope of each party's remedies if the other party fails to provide the requisite utilities and services.

Typically, the lease will provide that landlord is not liable in damages or otherwise for any interruption in utility or other services to the premises and that such failure would not entitle tenant to terminate the lease or abate rent. Many public entities also provide certain services or utilities so an abatement might be more appropriate in such case.

When the tenant is responsible for paying for utility services, the landlord may bill the tenant (i) for tenant's pro rata share of the building's total utility bill or (ii) if separate metering is available, for tenant's individual use of utility services. If tenant is billed for its pro rata share of utility services, the lease should specify a method for determining that share.

X. Tenant Improvements & Surrender

Many tenants need to alter or improve the leased premises to meet their unique needs before assuming occupancy. These alterations and improvements are one of the first and largest up-front costs for landlords and tenants in the leasing process. For that reason, the terms governing alterations and improvements are very important. These terms influence various clauses, such as tenant improvements, condition of the premises, and alterations and improvements. Public entities often have special needs and improvements, which some landlords may require to be removed upon surrender, which can be expensive. Many public entity landlords have special properties which have special rules or needs (public halls, historic buildings, etc.).

Responsibility for the cost and implementation of initial tenant improvements varies by deal. Sometimes, the landlord agrees to cover the cost of initial tenant improvements up to a certain dollar value and is the one who implements the improvements (a "tenant allowance"). In such cases, tenants typically agree to reimburse the landlord for above-allowance work. This agreement is generally memorialized in a work letter attached to the lease as an exhibit. The parties should be aware that the tenant allowance can trigger prevailing wage issues. City staff find that negotiating a deal in which prevailing wage requirements apply to tenant improvements being completed by the tenant can hinder completion of the deal. Tenants can often complete the improvements for a cost less than prevailing wage. Competitive bidding, though a different legal standard than prevailing wages (different statutes, different case law, different definitions of what constitutes a "public works project"), may also be required. There are many different requirements for competitive bidding but the most important factor is if the public entity owns

the property. Other times, the tenant agrees to cover the costs and implementation of initial tenant improvements (subject to the landlord's approval).

As needs arise during the lease term, the tenant may need to make additional alterations and improvements to the premises. Any material tenant improvement requires a detailed plan and the landlord's prior approval, unless the parties agree that the tenant may make certain minor work without landlord's prior approval (e.g., work valued at less than a certain dollar threshold). In either case, the tenant must comply with all applicable laws and regulations when performing work on the premises. All work should be performed by a qualified and licensed contractor. Works considered public works will trigger prevailing wage.

Typically, ground leases provide that all improvements upon the premises made by either party revert to the landlord at the end of the term, unless otherwise specified. Sometimes, such leases provide that, at the end of the lease term, landlord may elect to keep the improvements or require tenant to remove them and repair any damage. Generally, a failure to state the ownership would result in the improvements reverting to the landlord. Other lease types often have special arrangements (e.g., cell tower leases) or restoration clauses.

XI. Assignment & Subletting

Unless the lease states otherwise, a tenant is free to transfer its leasehold interest to a third party. The term "transfer" can be defined to mean an assignment, sublease, mortgage, hypothecation, or change in ownership or organization of the tenant.

Landlords commonly restrict tenants' right to transfer. This is one of the most commonly negotiated terms. Most often, the lease will provide that tenant may not transfer its leasehold interest without landlord's prior written consent. The lease should grant landlord sufficient time to evaluate the request and grant or deny approval. Many public entities want to use a sole discretion standard or absolute prohibition on assignment. There may be unique reasons for doing this (e.g. sensitive premises, unique services, exclusivity), but by doing so, landlord should be made aware that it loses a default remedy under California Civil Code Section 1951.4. This remedy allows a landlord to keep the lease in place and sue for the rent as it becomes due. If the tenant is a commercially viable entity that has financial strength (i.e. a credit tenant or one which a good credit record) the continuing obligation for rent can be a burden on the tenant. Of course, the landlord must allow assignment or sublease to a qualified entity so that tenant may mitigate its rent obligation. However, under this remedy, landlord has no obligation or find a new tenant or mitigate damages. The responsibility is all on tenant. It allows landlord to get the benefit of the original lease income and not have the burden to lease the vacant space, which might be critical in a recessionary economy. In general, the lease should provide that landlord will act reasonably when deciding whether to grant or withhold consent to a transfer. Public entities should avoid "deemed" approval- where the assignment or sublease would be automatically approved if the entity fails to approve or deny an assignment within a period of time. Any timeframe for approval should include enough time to analyze the information presented and properly agendize any necessary decision to the City Council, say 30-45 days. This is not popular with tenants who wish to move their business sale or sublease forward, but it is a necessary time frame to properly review the issue and transaction. These minimum time periods should be set forth in any lease template used by public entity landlords. This time period for public hearings for any decisions should be included in any decision required by either landlord or tenant parties throughout the lease.

Tenants may charge the new subtenant a rent that exceeds the rent paid under the lease (i.e., tenant charges subtenant $150/month under the sublease but landlord only charges tenant $100/month under the lease). Leases often provide that, should this situation arise, the tenant must share with landlord a certain percentage of any excess rent collected from the subtenant. The usual private party compromise is a 50-50 split between landlord and tenant. However, landlords that are public entities typically collect more than 50 percent (often 90-100%) on the premise that private party tenants should not profit from public resources.

The assignment and subletting provision generally establish the conditions under which tenant may transfer its interest (e.g., the proposed transferee must be at least as creditworthy as tenant; the monthly rental may not be less than rental under the lease; any additional security deposit required by the new tenant must be qualified to run the business it is assuming or buying) and the legal implications of that transfer (e.g., tenant shall not be released from its obligations under the lease by transferring its interest to a third party). The more extensive these requirements, the less flexibility tenant will have to transfer its leasehold interest, but the greater control landlord has in keeping a quality property with well qualified tenants. Public entities don't often assign leases as tenants but they often sublease. Both situations should be covered carefully to preserve exit strategies (i.e. to mitigate expenses or damages) for the public entity.

XII. Indemnity

The indemnity clause shifts financial and legal risk from one party to the other. It is an essential element of any lease. Prudent landlords and tenants do not treat the indemnity clause as lawyers' boilerplate. Instead, they carefully review the clause to ensure that it is well-crafted and meets their individual needs.

The lease should always include a tenant indemnity of landlord. Typically, the indemnity clause will state that tenant agrees to indemnify, defend, protect, and hold harmless the landlord from claims related to (i) tenant's use of the premises, (ii) any breach or default by tenant, (iii) any hazardous materials on the premises caused by tenant, and (iv) any act or omission of tenant. The premise is that tenant controls the premises and landlord should not be liable for things caused by tenant's use or activities under the lease.

Tenant sometimes request landlord indemnify the tenant. Where landlord is a public entity, landlord should not agree to indemnify tenant for anything, unless there is a specific risk tenant is undertaking due to the lease that would not otherwise be their risk in operating their business. In addition, many public clients refuse to indemnify counterparties—or should. City staff are advised to check with their city attorney to confirm local policy on this point. At most, landlord should only indemnify for landlord's activities on site, not the exact reciprocal of tenant's indemnity.

XIII. Casualty / Insurance

Landlords should safeguard investments in leased property and insure against risks associated with leases by requiring tenants to meet certain insurance specifications and requirements. Typically, landlords require tenants to maintain general liability, automobile liability, employer's liability, all-risk property, and workers' compensation insurance policies with minimum coverage set at a value specified in the lease. Some large tenants may ask to self-insure. In such cases, it is advisable to include a net worth standard such as $50 million and limit the option to the most well-qualified entities.

Except in ground leases, landlord generally obtains insurance on the building. Tenant generally pays for insurance on the leased premises and its furniture, fixtures, and equipment. Sometimes, tenant is required to reimburse landlord for tenant's pro rata share of insurance payments made by landlord (e.g., tenant's pro rata share of building insurance). Those payments may be considered additional rent. Public entity tenants need to ensure that any coverage provided by a risk pool or self-insurance is allowed by the insurance clause.

Landlords should ensure that any insurance requirements are specifically made applicable to contractors and subcontractors. In addition, both parties are always advised to have a risk manager review the casualty and insurance provision.

XIV. Late Fees, Interest, and Hold-Over Rent

The lease may establish late fees, interest, and holdover fees to be imposed when one party misses a payment deadline. Late fees are negotiated by the parties and typically range from five to ten percent. Unlike late fees, interest rates may not exceed certain legal limits. The lease should include a savings clause to avoid usury claims (e.g., "10% or the maximum legal rate").

When a tenant stays at the premises after the lease expires, whether due to lease termination or a default, the tenant is considered a "holdover tenant." The lease should include a provision stating how the landlord will assess rent upon a holdover tenant. Typically, landlords will charge holdover tenants more rent than regular tenants. Holdover rent often ranges from 125 percent to 200 percent of rent at the time of lease expiration.

XV. Events of Default / Termination by Landlord

Every lease should include a default and remedies clause. This clause governs the parties' rights and responsibilities if the lease breaks down—which can and does happen. A detailed clause can mitigate uncertainty and reduce the cost of litigation. Lease remedies in California are well settled and closely track the Civil Code (1951 et seq.).

Default may occur for various reasons: nonpayment of rent or other financial obligations; habitually late payments; violation of any lease term (e.g., a non-permitted assignment); bankruptcy; prohibited use of the premises; failure to continuously operate the premises (if the lease contains a continuous operation covenant); or another deal-specific reason. Public entities might want to include compliance with business license statutes and payments of any mandatory municipal fees as an event of default.

Defaults fall into a few categories: monetary and non-monetary, non-curable and other. Monetary defaults should have a short time frame until default (3-5 days) with or without notice; non-monetary defaults allow for longer notice and cure such as 10-30 days. Non-curable defaults include bankruptcy, assignment, or insolvency and may have different notice and cure periods, but are essentially non-curable.

XVI. Remedies

The lease should establish that certain remedies are available in the event of default by either party. In the event of a default, the non-defaulting party may pursue remedies established in the lease, as well as any other remedies available at law or in equity.

Leases typically provide that in the event of tenant's default, landlord may immediately terminate the lease and recover any unpaid rent (often after a notice and cure period). Tenant may reduce landlord's recovery of unpaid rent by proving that landlord failed to make a reasonable effort to mitigate damages after tenant's default. In California, this remedy is established by Civil Code section 1951.2. Lease drafters should refer to this statute to ensure that the remedies clause mirrors the statute.

Leases also commonly state that landlord shall have the remedy established by California Civil Code section 1951.4. This remedy is only available if specifically included in the lease using language substantially similar to the statute. The statute provides, in essence, that when a tenant has the right to sublet or assign (subject only to reasonable consent and limitations), landlord may continue the lease in effect after the tenant's breach and abandonment and recover rent as it becomes due.

Although some leases state that landlord has a right to retake possession of the premises upon tenant's default, landlord may only do so after first obtaining a judgment for possession. Without such a judgment, a landlord that takes possession may be liable for forcible entry under Code of Civil Procedure 1159. There are no legal self-help rights for landlords wishing to remove a tenant.

Generally, a mandatory arbitration provision for lease disputes is inappropriate in a lease because the remedies for default are already well settled under the law and expedited processes are available. Landlord-tenant law and leases themselves establish clear remedies for events of default. Arbitration is appropriate for settling disputes over renewal lease rates (appraisal arbitration, not legal arbitration) or to settle construction disputes (due to critical timing issues).

XVII. Hazardous Substances

Environmental remediation and damages can be extremely expensive. For this reason and others, landlords typically prohibit tenants from bringing hazardous materials onto and using hazardous materials upon the premises. The lease should establish a definition of and clarify expectations regarding hazardous materials. These provisions should be consistent with state and federal environmental laws. Typically, leases use strict language to prohibit any hazardous material uses upon the premises. In addition, the lease should include a comprehensive indemnity provision under which tenant indemnifies landlord for any occurrences relating to hazardous materials. Public entity landlords should ensure they understand the use to which their properties are being put and should limit the permitted use to that named use. . Nonetheless, the

parties may agree to permit the use of certain materials that would normally be considered hazardous (e.g., batteries, certain office cleaning supplies). Any such agreement should be codified in the lease or an amendment thereto. Since property owners are liable for hazardous materials which occur during their ownership, they will want to shift the liability to the actual party who contaminated the property during that time. Tenant should be legally responsible in the lease for any hazardous materials which result from Tenant's actions, and ideally, for any third party actions which may occur while tenant is in occupancy (i.e. an unrelated third party dumper). A sophisticated tenant will limit its liability only to its own actions, and carve out any haz mats caused by landlord or third parties. Landlord's argument is that Tenant is the one in control of the property and is the one most able to control any rogue third party dumpers; Tenant will argue that Tenant will only be responsible for its own actions, and can't control others. Any hazardous materials indemnity should survive the termination of the Lease to ensure later enforcement of these obligations.

XVIII. The Even Finer Print

In addition to the topics discussed above, a well-drafted lease should address the following topics:

- Attorney fees
- Broker/agent fees (Many public agencies do not use brokers, but the other party may.)
- CASp disclosure (Certified Access Specialist disclosure. Civ. Code 1938)
- Governing law and venue
- Confidentiality (but strike or modify for public agencies to expressly acknowledge obligations under public records disclosure and public meeting laws)
- Entire agreement
- Notices
- Authority/approval (City council approval should be contingency of lease)
- Mortgage subordination – Landlords should never subordinate their fee simple interest to a mortgage unless there is actual intent to risk losing the property, and there is significant economic benefit to doing so. Tenants should not subordinate unless they receive an assurance of non-disturbance from the lender so long as the tenant performs under the lease.
- Limitation on landlord's liability (no general fund liability as landlord; limit to interest in property)
- Signage
- Amendments
- Exhibits (be sure attached and complete)
- Tenant waiver of Civil Codes (CC 1932, 1933, 1941, 1942, 1943)

XIX. Silent Lease Issues

Omissions can be as deadly as included language. While leases typically focus on the amount of rent, the lease term, and maintenance, there are many other issues on which the lease may be silent. Here are some common "silent" lease issues:

- Alterations: does the landlord want a list of acceptable contractors? To what extent will tenant be allowed to alter inside or outside of the building? What about signage and use of tenant name on the building?
- Assignment/Subletting: Does it require landlord approval? What is the consent standard for assignment? Post 1980 leases which are silent on consent standards are presumed to be a "not to be unreasonably withheld" standard.
- Landlord default- what happens if landlord does not fulfil its responsibilities? What are tenant's remedies- this is probably one of the most important clauses for tenant to ensure is included in the lease. Landlords will want to ensure proper notice and cure rights. A savvy tenant will insist on self-help rights if Landlord fails to maintain or perform other duties, and may require rent offsets in such case. Self help and rent offsets are common and allowed by statute in residential contexts, but commercial leases must include such a right in order for tenant to exercise such a remedy.
- Security: Does the tenant need building security or a manned lobby? Who will provide and how will costs be allocated?
- Defaults: Are there actions that trigger a default? Will there be any nonmonetary defaults? Does a bankruptcy filing trigger a default? Will the tenant be offered an opportunity to cure any defaults? Is tenant responsible for any fees should a default occur?
- Condemnation: What happens in the case of a condemnation?
- Estoppel Certificates: Who must provide? Landlord, tenant, or both? Should an acceptable form be attached to the lease?
- Surrender at End of Lease Term: Is there a duty to restore on the part of the tenant? In what condition must the premises be returned?
- Utilities/HVAC: What controls are spelled out for adequate billing? Does wattage need to be spelled out? Is there discussion of back-up generator? What is the level of HVAC service? What about after hours and weekends? Is there a charge and if so, how much?
- Other: Does force majeure provision apply? Does it protect the landlord or tenant or both? What is the scope of landlord's access to the premises? Does the tenant anticipate entering into any other financing arrangements that might affect the landlord, the lease, or the premises? Is landlord responsible for ADA compliance? Who is responsible for cleaning and maintenance? What are cleaning and garbage disposal hours?

XX. Public Entity Issues

Unique local requirements or prohibitions

There are a number of issues that are unique to cities and other public entities. The letter of intent should spell out all approval and response times. Before entering into a letter of intent, the level of delegated authority to enter into lease contracts should be verified. Approvals by city council will have to be included into the timeline and authority section of the lease. Another key issue is the disclosure required by California Revenue and Taxation Code section 107.6: the disclosure of a possible possessory interest tax. Some cities have special policies that need to be included in the lease (no Styrofoam containers to be used in city limits, any anti-discrimination language, etc.).

Role Clarity

The lease should be clear on the roles in the lease between City as a police and permitting authority versus its role as a landlord. The City may not contract away its police and governing authority and if permitting of a tenant's improvements are included in a public entity landlord's lease, these roles should be clear and distinct so that landlord is not later accused of impermissibly waiving its proprietary rights as a consequence of its exercise of regulatory authority or, conversely, improperly contracting away its regulatory authority. Many private party tenants do not understand this distinction and will attempt to include these terms in leases. In drafting, try to use "Landlord" and "City" in articulating these roles, versus using "City" in reference to each role.

Nominal Rents/Friendly Parties

Many public entities use nominal rents for friendly tenants such as other public entities or non-profits. In any such lease, parties should ensure that responsibility for capital repairs is spelled out between the parties including roof repairs, HVAC replacement, parking replacement, and ADA improvements.

ADA Compliance

A tenant will always be responsible for compliance with ADA in its role as employer for making accommodations. Many landlords will require that any such special employee accommodation be tenant's expense, even if such accommodation requires improvements to the building or common area. However, tenants should carefully review whether a building or facility is compliant before move-in and require or negotiate that any common area or building improvements (other than employee accommodation) ADA improvements should be at landlord's expense, or at the most passed through on an amortized basis. Any inspection conducted by a Certified Access Specialist (CASp- the California parlance for an ADA inspector) must be disclosed to tenant, and tenant may conduct its own inspection, at its own expense, but any deficiencies may be at tenant's expense (Civil Code 1938). An acknowledgement of the existence or non existence of such a report is often included in the lease. There is no statutory requirement that a property be in compliance with ADA when a tenant takes occupancy, but a savvy tenant can negotiate for a contractual requirement to bring a property up to date, or at least not to pay for the updates caused by a violations.

Prevailing Wages

The parties should review public works and prevailing wage issues under state and federal law, including the Department of Industrial Relations definition of public works and applicability of the Davis Bacon law, and depending on the deal terms, address the issues in the lease.

Indemnity of Public Officials

The parties should review the indemnities to ensure that City's public officials and volunteers are included in addition to employees, contractors and agent. Avoid, however, public entity indemnity of private parties. In fact, there may already be a stance of not allowing indemnification language in lease agreements. Again, communicate about what kinds of

indemnities the city is comfortable agreeing to, and discuss with key staff the difference between gross negligence, ordinary negligence, and willful misconduct.

Public Records Act

Some private counterparties will have lease forms containing confidentiality language (although if you are following the advice above, you will not use the counterparty's lease form!) Make sure to include language regarding the Public Records Act in lease agreements and eliminate or modify the confidentiality language.

Early Termination for Loss of Funding

Beware of multi-year obligations and debt limitations under the California Constitution and insert a lease termination clause for loss of funding if the tenant is a public entity.

Issues to Consider from Tenant's Perspective

- Double check all numbers in the lease: Rent, lease term, calculation of start dates and occupancy
- What expenses are covered in the rent? Push them back to the landlord as much as possible and try to limit definition of operating and maintenance expenses for triple net leases
- Know who pays for compliance issues (ADA, environmental, etc.?) Preferably landlord with no pass through or, at most, amortized over long term (not lease term unless 10+ years).
- Require a warranty by landlord of good working order for building systems and roof at commencement.
- Negotiate that landlord's failure to repair after notice and failure to cure may be performed by tenant and deducted from rent or promptly reimbursed.

Issues to Consider from Landlord's Perspective

- Double check all numbers in the lease: Rent, lease term, calculation of penalties.
- Make sure tenant is responsible for expenses that go beyond normal wear and tear.
- Don't allow delay in possession to lead to rent abatement.
- Request as much notice as possible of intent to vacate.
- Understand the rights and obligations of the security deposit.
- Include a broad definition of operating expenses.
- Narrow definition of landlord's representations of safety or warranty.

- Require approval of all contractors and ensure there is language that limits tenant's use to a use not prohibited by law.

- Require access to premises for inspection and maintenance.[*]

XXI. Conclusion

There are many issues to consider in drafting a lease. Time and money will determine many of the decisions made, but careful consideration of the facts and needs of the parties, along with helpful tools such as master lease forms, checklists of issues, and communication with key staff and stakeholders, will ensure that the final lease addresses the parties' concerns and is a practical and enforceable document.

[*] ***Note of Attribution:***
Sophie Wenzlau and Michelle K. Enchill, Associates with Best Best & Krieger LLP, contributed to this paper.

LANDLORD'S LEASE CHECKLIST

1. DATE AND PARTIES.

_____ A. Is the lease dated for reference purposes (not necessarily commencement date)?

_____ B. Are the parties accurately identified and defined as Landlord and Tenant?

_____ C. If Landlord or Tenant is an agent, is evidence of authority indicated? If not, should evidence of authority be requested?

_____ D. Is Tenant's performance guaranteed? Should it be?

2. TERM.

Initial Term.

_____ (1) Is the initial term of lease identified with number of years, commencement and termination dates specified?

_____ (2) Is the date when rent obligation commences specified?

_____ (3) If there is a delay in possession, will there be rent abatement but no damages, cancellation or reimbursement of prepayments or security deposit? Does the lease provide that a delay in possession does not extend termination date? Is there any cap on delay of delivery of possession which would allow Tenant to terminate?

_____ (4) Are there any conditions to the effectiveness of the lease (e.g., termination of another lease, court approval or land use approval such as zoning change, use permit or subdivision map)?

B. Options to Extend Term.

_____ (1) Are the total number of all options to extend term specified?

_____ (2) Is Tenant required to give written notice of exercise of option to extend to Landlord at least one hundred twenty (120) days before expiration of term?

_____ (3) Is Tenant's exercise of option to extend ineffective if Tenant is in default on the date the notice of exercise is given or on the date that the renewal term is to commence?

_____ (4) If option is not exercised or if exercise of option is ineffective, does the lease expire at the end of the term then in effect?

_____ (5) Is the increase in or specific method for computation of rent during each renewal term addressed (preferably in the section on rent)?

Holding Over.

_____ (1) Does the lease contain a holdover provision? Are the terms and conditions of the lease to be the same during any holdover period? Is the amount of the rent to also be the same, or is the rent to increase by a specified amount or percentage? Is Tenant obligated to indemnify and hold Landlord harmless if others have prior rights to possession of the premises at the end of the term?

3. PREMISES.

_____ A. Are the premises fully and accurately described by street address, legal description, and square footage (Landlord's preference is usually for square footage to be measured from outside walls)? Is a plot plan attached? (Should one be?) What standard is used to describe the square footage (e.g., BOMA rentable versus usable)? Is the square footage described exactly or approximately? Does Tenant accept the calculation, or would Tenant have a right to challenge the figure and demand a reduction in rent?

_____ B. Does Tenant take the premises "as is" or are the improvement obligations of Landlord identified with specificity (see Construction section)? Does Landlord make any representations or warranties regarding the condition of the premises (are there any toxic substances or hazardous materials on the premises)? [Landlord should avoid making representations or warranties if possible—see sections 16.A(2) and 16.B(3).]

_____ C. Does the definition of the premises exclude common areas and other specifically described areas?

_____ D. May Landlord change the size, shape, location, number and extent of the building, common areas and excluded areas without Tenant's consent? Can Landlord relocate Tenant (and on what terms)?

_____ E. Is Tenant denied access to roof areas (except for maintenance purposes if Tenant is obligated to maintain)? Does Tenant have an option (or a right of first refusal) to expand or to purchase the premises? When can (or must) the option (or right) be exercised? If Tenant has an option, what lease terms will be applicable to the new space?

_____ F. To the extent that the discussion of Tenant's rights in the common area (see section 5) is inapplicable or incomplete, are Tenant's appurtenant rights (e.g., parking, loading, storage, railroad spur, easements, etc.) clearly specified?

_____ G. If there are underground storage tanks on the property, whose responsibility are they?

4. RENT.

Minimum Annual Rent.

_____ (1) Is a fixed dollar amount of minimum annual rent and when payable specified (e.g., monthly in advance without notice, demand or setoff)?

_____ (2) Does the lease provide for proration of rent for any period of less than one (1) month?

Periodic Rent Adjustment.

_____ (1) Does the lease provide fixed rent increases or is the minimum annual rent increased (never decreased) at the end of each twelve (12)-month period by the greater of a fixed percentage or the increase in an appropriate consumer price index over the same consumer price index for a specified base year?

_____ (2) Have you checked the above formula for workability by running sample numbers?

_____ (3) Is a method for replacing the consumer price index if discontinued specified?

_____ (4) Is there a specified increase (never decrease) on commencement of any renewal/extension term (fixed dollar amount, percentage, or CPI adjustment)?

Prepaid Rent/Security Deposit.

_____ (1) Is the amount of rent (if any) to be prepaid upon execution of lease specified?

_____ (2) Is the security deposit amount specified as well as disposition on default or on normal termination?

_____ (3) Is Tenant not entitled to any interest?

_____ (4) May Landlord commingle the prepaid rent and security deposit with other funds?

_____ (5) Have you checked with local counsel for any local restrictions on use of security deposit?

_____ (6) Is the deposit payable to the last assignee of Tenant's interest.

_____ (7) Are there provisions for further deposits (e.g., if the rent is increased or the premises are expanded or the deposit is applied to cure default)?

_____ (8) How are deposits handled in the event of a transfer of the Landlord's interest?

Additional Rent.

_____ (1) [Shopping Centers Only] Gross Receipts.

_____ (a) In addition to minimum annual rent, as periodically adjusted, is Tenant to pay Landlord a specified percent of gross receipts?

_____ (b) Is the broadest possible definition of gross receipts used (including credit and in-kind transactions and all orders placed in or through the premises)? Is the definition realistic with regard to the type of Tenant's business? Are exclusions from gross receipts clearly specified?

_____ (c) Does the lease give audit rights and penalties?

_____ (d) Is there a radius clause?

_____ (e) Must Tenant keep the premises well-stocked and use due diligence to achieve a certain percentage rent?

_____ (f) Does the lease terminate for failure to achieve a minimum percentage rent? If so, can Tenant prevent termination, even though Tenant's sales are insufficient, by paying the required minimum?

(2) Expense Reimbursements.

_____ (a) Is the lease a net lease with Tenant required to reimburse Landlord for all operating and tax costs? Is Tenant required to pay all taxes on its personal property? If the lease requires Tenant only to pay increases in operating expenses, are the base year(s) and base expenses or assessments adequately defined?

_____ (b) Are allocations based on:

_____ (i) Ratio of area of premises to total area of building/shopping center currently leased; or

_____ (ii) Ratio of area of premises to total leasable area of building/shopping center with multiplier for estimated vacancy rate?

_____ (c) Is there a mixed use of building by different tenants? [Special allocation problems arise.]

_____ (d) Is a procedure specified for reallocation periodically and on significant change (e.g., reassessment)?

_____ (e) Are the following expense items specifically included:

_____ (i) Taxes:

_____ • on building/shopping center (include common areas);

_____ • on Tenant improvements;
_____ • occupancy/use taxes;
_____ • lease transaction taxes;
_____ • gross receipts;
_____ • all other fees and assessments?
_____ (Is there any relief for Tenant from tax increases attributable to a change in ownership?)

(ii) Operating expenses:

_____ • Is there a broad definition of management, operating and maintenance costs, including, but not limited to: all costs of Landlord's compliance with obligations under the lease or similar leases with other tenants; wages, salaries and benefits; cost of services provided by third parties; rental value of manager's office, janitorial space, etc.; utilities and services not separately metered and paid directly by tenants (see paragraph 9 infra); materials and supplies; snow removal; trash removal; landscaping and gardening; security; maintenance and repair performed by Landlord (see paragraph 10 infra); Landlord's insurance (see paragraph 11 infra); depreciation on equipment and other personal property; depreciation on buildings, common areas, fixtures and capital improvements*; debt service and increases in variable rate*; tenant improvement costs paid by Landlord*; leasing and marketing costs including brokers' commissions, management fees and attorneys' fees*; remedial costs incurred by Landlord due to breathes of leases by other tenants or Landlord; Landlord's general overhead and administrative expenses; parking garage/lot expenses; and cost of commercial concessions in building? [*Items marked are normally excluded.]

_____ • Is there a method specified for projecting base year/comparison year to full occupancy?

_____ (f) Run sample figures to verify methods of calculation/allocation work.

_____ (g) Is the statement of expenses to be prepared by a CPA? May Tenant examine the books? Does Tenant have a right to object to the statement?

_____ (h) May Tenant challenge increased tax assessments in the name of Landlord if Landlord fails to do so? If so, is Tenant required to post a bond or otherwise indemnify Landlord?

Other Charges and Payments.

_____ (a) Are all other sums of money or charges required to be paid by lease defined as additional rent?

Delinquent Payments.

_____ (1) Is minimum annual rent or additional rent not paid within _____ (_____) days after due date (no notice required from Landlord) to bear interest until paid at the lesser of [specified interest rate] per annum or the highest rate allowed by law/or flat percentage late charge with liquidated damages recitals?

_____ (2) Check with local counsel regarding legality of late charges.

_____ (3) Is a penalty imposed for NSF/dishonored checks or rent late more than three times in any consecutive twelve (12) months (e.g., require rent and other charges to be paid quarterly in advance, cashier's checks only)?

Address for Payment.

5. COMMON AREAS.

Definition of "Common Areas."

_____ (1) Are common areas broadly defined including, but not limited to, the following: parking areas; access and perimeter roads; truck passageways (which may be in whole or in part subsurface); service corridors and stairways; landscaped areas; exterior walks, arcades, stairways, elevators, escalators and/or ramps, interior fountains, toilets and other public facilities; and bus stations and taxi stands?

_____ (2) Is any portion of the property not included within common areas to be included when designated and improved by Landlord for common use?

_____ B. Control of Common Areas. Are the common areas subject to the exclusive control and management of Landlord or Landlord's nominee?

C. Tenant's Use of Common Areas.

_____ (1) Is Tenant's use of common areas and parking spaces specifically defined?

_____ (2) Does Tenant acknowledge that Landlord makes no representation or warranty concerning the safety of the common areas or any security system? [Check with local counsel regarding Landlord's obligation to keep the common area safe.] Also, does Landlord have the right (but not the obligation) to limit access during nonbusiness hours?

_____ (3) Are specific restrictions placed on Tenant's right to sell or solicit in any manner on the common areas, or otherwise obstruct any part of the common areas?

6. USE OF PREMISES.

_____ A. Permitted Uses. Is the nature of Tenant's business specifically and narrowly defined?

B. Prohibited Uses.

_____ (1) Are specific types of businesses or activities not to be conducted on the premises specified?

_____ (2) Is Tenant prohibited from any use or purpose in violation of the laws, statutes, ordinances, rules or regulations imposed by any federal, state, local, municipal or other authority having jurisdiction? Does Tenant have an affirmative obligation to comply with laws and regulations?

_____ (3) Does the lease specify that Tenant shall not produce, handle, store, dispose, discharge or release any hazardous material, substance, waste, contaminant or pollutant on the property of which the premises and the common areas are a part, or into or upon ground or surface water in and around such property?

_____ C. [Shopping Centers Only.] Continuous Operation.

_____ (1) Does Tenant covenant to continuously operate Tenant's business in the premises during specified business hours?

_____ (2) Are limited exceptions granted for remodeling at the commencement of lease and taking inventory?

_____ D. Trash and Rubbish. Is Tenant required to deposit all trash and rubbish in designated receptacles?

_____ E. Rules and Regulations.

_____ (1) Is Tenant's use of the premises and the common areas subject to reasonable rules and regulations, subject to change by Landlord from time to time?

_____ (2) Do the provisions of the lease prevail in the event of a conflict between any rules and regulations and any provisions of the lease?

_____ F. [Shopping Centers Only.] No Covenants. Are no covenants given, express or implied, regarding majors, tenant mix, noncompetition, etc.?

7. CONSTRUCTION.

Construction by Tenant.

_____ (1) Are Tenant's obligations to construct improvements/remodel specified in a work letter attached as an exhibit to lease?

_____ (2) Is Tenant required to submit plans and specifications to Landlord for Landlord's prior written approval before any remodeling or construction is commenced and to give Landlord at least ten (10) days' prior notice of actual commencement to allow Landlord to post notice of nonresponsibility?

_____ (3) Is Tenant required to comply, at Tenant's sole cost, with all laws, statutes, ordinances, rules and regulations (including, but not limited to, obtaining permits, all applicable building codes, zoning ordinances, etc.)?

_____ (4) Is Landlord's approval of the contractor required before commencement of remodeling or construction?

_____ (5) Is Tenant obligated to indemnify, defend and hold Landlord harmless from and against any and all liens, costs, expenses, defects in construction, failure to complete construction (etc.) arising out of or in connection with Tenant's remodeling or construction? Does Tenant also affirmatively covenant to keep the property free of any liens arising out of Tenant's construction?

_____ (6) Must remodeling and construction be completed in accordance with approved plans and specifications unless deviation is approved in advance in writing by Landlord?

_____ (7) Is Tenant required to supply Landlord with "as built" plans and drawings?

_____ (8) Do improvements become the property of Landlord, either immediately or at the end of the term? Does Landlord have the option to require Tenant to remove improvements? If so, is the right specified in sufficient detail (e.g., when Landlord must elect, when Tenant must remove, the condition in which the premises are to be left)?

Construction by Landlord.

_____ (1) Are Landlord's obligations to construct improvements/remodel specified in a work letter attached as an exhibit to lease?

_____ (2) Is delay in completion of Landlord's construction treated as delay in possession under section 2.A(3), supra? If delay caused or contributed to by Tenant, is there no abatement of rent?

_____ (3) Is Landlord's work deemed completed when Landlord (or its architect) gives Tenant notice of substantial completion? Does Tenant have a right to

object to Landlord's construction? If so, when must Tenant object? Is there a "punchlist" procedure?

_____ (4) Does the lease deny Tenant access during Landlord's work, or does Tenant agree to perform its work in a manner which does not delay or hinder Landlord's work?

8. SIGNS, ANTENNAS AND OTHER EXTERIOR DECORATIONS.

_____ A. Is Tenant prohibited from erecting or installing any exterior signs or signs visible from the exterior; radio, television or microwave antennas; and loudspeakers, sound amplifiers or similar devices on the roof or exterior walls of the premises without Landlord's prior written consent?

_____ B. Are specifications for design and location of signs attached as an exhibit?

_____ C. Are there specifications for control of other exterior decorations, or decorations visible from the exterior (e.g., curtains)?

9. UTILITIES AND SERVICES.

_____ A. Does the lease require that all utilities and services used by Tenant are to be separately metered and billed directly to Tenant?

_____ B. If it is not practical to separately meter or directly bill any utilities or services, is Tenant required to reimburse Landlord for Tenant's pro rata share, together with any taxes thereon?

_____ C. Does the lease provide that Tenant's reimbursement shall be delinquent if not paid within ten (10) days of written demand by Landlord?

_____ D. Is the method for determining Tenant's pro rata share defined (e.g., based upon the ratio of the total number of square feet in the premises to the total number of leasable square feet in the property in which the premises are a part)?

_____ E. Does the lease provide that Landlord shall not be liable in damages or otherwise for any failure or interruption of any utilities or other services being furnished the premises, and no such failure or interruption shall entitle Tenant to terminate the lease or to abate payment of rent?

10. MAINTENANCE, REPAIRS AND ALTERATIONS.

Tenant's Obligations to Maintain and Repair Premises.

_____ (1) Except as provided in the section of the lease covering damage and destruction, is Tenant required to maintain the premises, including the interior surface of exterior walls; all windows, doors, door frames and door closures; all plate glass, storefronts and show cases; all carpeting and other floor covering; the HVAC system, all electrical equipment and all plumbing and sprinkler systems, if any? Is it feasible for

Tenant to maintain systems which serve other tenants. If not, should Landlord maintain as a common area expense?

_____ (2) Is Tenant required to make modifications or replacements to above as necessary or when required by governmental authority?

_____ (3) Is Tenant required to obtain a standard maintenance contract for the HVAC system for the premises, at Tenant's cost?

_____ (4) Is Tenant required to return the premises at the end of the term in as good condition as received, reasonable wear and tear excepted?

Landlord's Rights to Maintain and Repair Premises.

_____ (1) Does Landlord have the right, but not the obligation, to perform maintenance and repairs to the premises if Tenant refuses or neglects to?

_____ (2) Is the cost of any maintenance and repairs performed by Landlord to be paid for by Tenant as additional rent promptly upon demand, together with interest thereon from date of payment by Landlord?

Landlord's Obligations to Maintain and Repair Premises.

_____ (1) Except as provided in the section of the lease dealing with damage and destruction, is Landlord to maintain the foundations, exterior walls and roof (excluding interior ceiling), except for any repairs necessitated by any act, negligence or omission of Tenant or Tenant's agents, employees, invitees or customers?

_____ (2) Is the cost of all such maintenance and repairs to be passed through to Tenant?

_____ (3) Does Tenant waive any right to make repairs at Landlord's expense under the provisions of any laws permitting repairs by a tenant at the expense of the Landlord, to the extent allowed by law?

_____ (4) Does Tenant specifically waive any right to vacate the premises under the provisions of any laws permitting a tenant to vacate premises where the Landlord has failed to repair the premises, to the extent allowed by law?

Landlord's Maintenance and Repair of Common Areas.

_____ (1) Is Landlord to maintain and repair common areas? May Landlord specifically assess Tenant for damage Tenant has caused to the common areas?

_____ (2) Is Tenant's reimbursement of Landlord's common area maintenance costs covered by the lease? (See section 4.D(2), supra.)

_____ E. Emergency Repairs. Does Landlord have the right, but not the obligation, to make emergency repairs and to enter the premises at any time to do so?

11. INSURANCE.

_____ A. Risk of Loss. Does the lease require Tenant to bear all risk of loss to the premises, common areas and other buildings and structures located on or in the property which may occur, arise or be caused by the intentional or negligent act or omission of Tenant, Tenant's agents, employees, invitees or customers?

B. Worker's Compensation; Liability Insurance.

_____ (1) Is Tenant required to maintain worker's compensation insurance?

_____ (2) Is Tenant required to maintain in full force and effect bodily injury liability and property damage liability insurance adequate to protect Landlord against liability for injury to or death of any person in connection with the use, operation or condition of the premises, in a specified minimum amount of combined coverage?

Fire and Extended Coverage Insurance.

_____ (1) Is Tenant required to maintain insurance covering:

_____ (a) Tenant's leasehold improvements;

_____ (b) Trade fixtures, merchandise and other personal property on the premises in an amount of not less than one hundred percent (100%) of actual replacement cost providing protection against any peril included within the classification "fire and extended coverage," together with insurance against sprinkler damage and vandalism and malicious mischief, and, to the extent available, flood (require if in flood zone) and earthquake coverage (may be prohibitively expensive); and

_____ (c) All plate glass on the premises (if necessary)?

_____ (2) Are the proceeds of such insurance to be used to repair or replace the property insured?

Landlord's Insurance; Costs.

_____ (1) Is Landlord to maintain "fire and extended coverage" insurance covering the building of which the premises are a part?

_____ (2) May such insurance include coverage on buildings or stores other than the premises?

_____ (3) Is Tenant required to pay Landlord Tenant's pro rata share of the costs of such insurance [by monthly installments]?

_____ (4) Is all insurance coverage provided by Landlord for the sole benefit of Landlord, and all proceeds to be paid to Landlord, free and clear of any claims by Tenant?

Policy Form, Content, Insurer.

_____ (1) Does the lease require that all insurance carried by Tenant be issued by responsible insurance companies acceptable to Landlord (or specific ratings -- e.g., Best's AA) and licensed to do business in state where property located?

_____ (2) Is Landlord to be named as an additional insured?

_____ (3) Are copies of all policies or certificates of insurance to be provided to Landlord prior to Tenant's opening for business in the premises?

_____ (4) Is no policy to be cancelable except after thirty (30) days' prior written notice to Landlord?

_____ (5) Is Tenant required to provide Landlord with renewals or binders at least thirty (30) days prior to the expiration of any policy, or Landlord may order such insurance and charge the cost to Tenant?

Periodic Increase in Coverage.

_____ (1) If specified dollar amounts of coverage are required to be maintained by Tenant, does Landlord reserve the right to annually increase the minimum amount of such policy limits? [Note that increased coverage may not always be reasonably obtainable.]

Waiver of Subrogation.

_____ (1) Does Tenant waive rights of recovery against Landlord and officers, employees, agents and representatives of Landlord?

_____ (2) Is Tenant to obtain and furnish evidence of the waiver of the right of subrogation by Tenant's insurance carriers?

_____ (3) Consider waiver of subrogation as to Tenant as well.

12. INDEMNIFICATION OF LANDLORD.

_____ A. Is Tenant required to indemnify, defend and hold Landlord harmless? For causes other than Tenant's negligence? Are injuries caused by Landlord's negligence (gross negligence? ordinary negligence?) or willful misconduct excluded? Must Tenant indemnify Landlord for injury sustained by third parties in common areas? For breach of Tenant's obligations under the Lease?

13. DAMAGE AND DESTRUCTION.

Destruction Due to Peril Covered by Insurance.

_____ (1) If premises are totally or partially destroyed during the term from a peril covered by insurance carried pursuant to the lease, is Landlord to restore premises to extent permitted by insurance proceeds?

_____ (2) Does Landlord have the option not to restore premises if destruction exceeds specified percent of value of premises or specified dollar amount? Does Landlord also have the option not to restore if the damage is near the end of the lease term (e.g., during the last twelve (12) to fourteen (14) months)?

_____ (3) Is Landlord allowed to terminate lease in the event that existing laws do not permit reconstruction?

Destruction Due to Peril Not Covered by Insurance.

_____ (1) If the premises are totally or partially destroyed during the term from a peril not covered by insurance, does Landlord have the option to either restore premises or terminate lease?

_____ (2) Is Landlord allowed to terminate lease in the event that existing laws do not permit reconstruction?

Abatement of Rent.

_____ (1) Does the lease provide that unless the lease is terminated by Landlord, damage or destruction does not terminate lease, and Tenant required to continue the operation of its business to the extent reasonably practicable?

_____ (2) [Options:--Provided that the minimum annual rent and additional rent shall be reduced in the proportion to the extent that Tenant is deprived of the use of the premises (note: if rent to be abated, Landlord should carry rental interruption insurance, the cost of which to be passed through to Tenant) -- OR: the minimum annual rent and additional rent shall not be abated or reduced (Tenant should be required to carry business interruption insurance).]

Effect of Termination on Payments.

_____ (1) If lease terminates due to damage or destruction, do all monetary obligations terminate as of date Landlord gives notice to Tenant of termination, and are any prepayments to be repaid?

_____ (2) Does the lease provide that Tenant shall not be relieved of liability for any sums accrued but unpaid?

14. EMINENT DOMAIN; CONDEMNATION.

_____ A. Total Taking. If a total taking of premises occurs, does the lease terminate as of the date the condemning authority takes actual physical possession of the premises?

B. Partial Taking.

_____ (1) If a partial taking of the premises occurs, does the lease, as to the portion of the premises taken, terminate as of the date on which the condemning authority takes actual physical possession of such portion?

_____ (2) Does the lease continue in full force and effect as to the remainder of the premises?

_____ (3) Is the minimum annual rent payable by Tenant for the balance of the term to be proportionately abated, and is the method of computation specified?

Distribution of Compensation and Awards.

_____ (1) Is all compensation and damages awarded for the taking of all or any portion of the premises to belong to and be the sole property of Landlord?

_____ (2) Is Tenant entitled to recover from the condemning authority, but not from Landlord, any award for diminution in value of Tenant's leasehold interest or for Tenant's trade fixtures and equipment? Consider whether Tenant should be allowed any award for destruction of Tenant's leasehold interest.

15. ASSIGNMENT AND SUBLETTING.

Landlord's Consent Required.

_____ (1) Is Tenant prohibited from assigning, transferring, subletting, mortgaging or otherwise transferring or encumbering all or any part of the lease or premises without Landlord's prior written consent?

_____ (2) May Landlord refuse to give such consent for any reasonable reason?

_____ (3) Is Landlord to get [all rent/percentage of rent] in excess of lease rent?

_____ (4) Is Tenant not released by assignment or subletting?

_____ (5) Does Landlord reserve right to recapture the premises and terminate the lease?

_____ (6) Does the lease specifically prohibit assignment or subletting to affiliates of Tenant without Landlord's prior written consent?

_____ (7) Are mergers and reorganizations deemed assignments? Are transfer of more than a specified percentage (e.g., fifty percent (50%)) of Tenant's corporate stock deemed assignments? Are transfers of more than a specified percentage (e.g., fifty percent (50%)) of the partnership interests in Tenant, or any change of general partners, deemed assignments?

16. DEFAULTS; REMEDIES.

Default by Tenant. Does the lease define events of default by Tenant? Typical provisions:

_____ (1) Any failure by Tenant to pay the minimum annual rent, the additional rent or any other payment required to be made by Tenant, as and when due;

_____ (2) Tenant's abandonment or vacation of the premises for over _____ (_____) days;

_____ (3) A failure by Tenant to observe and perform any other provision of the lease to be observed or performed by Tenant [where such failure continues for thirty (30) days after written notice thereof by Landlord to Tenant]; or

_____ (4) The making by Tenant of any general assignment for the benefit of creditors, the filing by or against Tenant of a petition to have Tenant adjudged a bankrupt, or a petition for reorganization or arrangement under any law relating to bankruptcy or insolvency (unless, in the case of a petition filed involuntarily against Tenant, the same is dismissed within sixty (60) days), the appointment of a trustee or receiver to take possession of any of Tenant's assets located at the premises, or of Tenant's interest in the lease or the premises, where possession is not restored to Tenant within thirty (30) days, or the attachment, execution or other judicial seizure of any of Tenant's assets located at the premises or of Tenant's interest in the lease or the premises, where such seizure is not discharged within thirty (30) days.

_____ B. Landlord's Remedies. Does the lease specify Landlord's remedies (note: remedies available to Landlord upon Tenant's default will vary depending upon local law)? Does the lease specify that Landlord's listed remedies are in addition to any other remedies Landlord may have under law or in equity?

C. Default by Landlord and Tenant's Remedies.

_____ (1) Is Landlord not to be in default unless Landlord fails to perform obligations required of Landlord within sixty (60) days after written notice by Tenant to Landlord, specifying wherein Landlord has failed to perform such obligations; if the nature of Landlord's obligations is such that more than sixty (60) days are required for performance, then Landlord not in default if Landlord commences performance within sixty (60)-day period and thereafter diligently prosecutes the same to completion?

_____ (2) Is Tenant's sole remedy if Landlord is in default to terminate lease?

17. REPRESENTATIONS AND WARRANTIES.

Representations and Warranties of Tenant.

Does Tenant warrant that:

_____ (a) The nature of Tenant's business entity is as stated in lease;

_____ (b) Tenant has full right, power and authority to execute, deliver and carry out the terms of the lease and all documents and agreements necessary to give effect to the provisions contained in the lease; and

_____ (c) [Add other desirable warranties and representations depending on circumstances]?

_____ (2) Does Tenant agree and acknowledge that neither Landlord nor any agent or employee of Landlord has made any representation, promise or warranty except as expressly set forth in the lease?

Representations and Warranties of Landlord.

(1) Does Landlord warrant that:

_____ (a) The lease has been duly authorized, executed and delivered by Landlord?

_____ (b) The nature of Landlord's title to the premises is as stated in the lease (if desired)?

_____ (c) Repeat disclaimer -- no other representations or warranties given.

18. MISCELLANEOUS.

_____ A. Quiet Possession.

_____ B. Unavoidable Delays. Do unavoidable delays excuse performance but do not extend term of lease?

C. Estoppel Certificate.

_____ (1) Is Tenant required to submit to Landlord, within ten (10) days after demand, an estoppel statement substantially in the form of an exhibit attached to the lease, stating that (a) the lease is in full force and effect, without modification except as may be represented, (b) that there are no uncured defaults in the Landlord's performance under the lease, and (c) that no payments have been made in advance?

_____ (2) May the estoppel statement be conclusively relied upon by any prospective purchaser, assignee, sublessee or encumbrancer of the premises or the property of which the premises are a part?

_____ (3) Does Tenant's failure to deliver estoppel statement within ten (10) days of demand constitute agreement that the matters set forth in the demand are true?

Subordination, Attornment.

_____ (1) Upon request of Landlord or any mortgagee of Landlord, is Tenant required to subordinate to the lien of any mortgage or deed of trust against the land or the building of which the premises are a part?

_____ (2) Is Tenant required to attorn to the purchaser at any foreclosure or trustee's sale?

Sale of Premises by Landlord.

_____ (1) May Landlord sell, transfer or assign, in whole or in part, Landlord's interest in the lease and the property of which the premises are a part, without the consent of Tenant and without notice to Tenant?

_____ (2) Upon any such sale, transfer or assignment, is Landlord relieved of all liability and obligations under the lease?

Landlord's Access.

_____ (1) Does Landlord have the right to enter the premises at reasonable times for the purpose of inspecting the premises, showing the premises to prospective purchasers, lenders or lessees, and making alterations, repairs, improvements or additions to the premises or the building?

_____ (2) Does Landlord have the right during the last one hundred twenty (120) days of the lease term to place "For Lease" signs on or about the premises without rebate of rent or liability to Tenant?

_____ G. No Partnership, Association, Joint Venture or Other Relationship.

H. Notices.

_____ (1) Are notices required to be in writing and either served personally or sent by registered or certified United States mail, postage prepaid with return receipt requested, at addresses specified in the lease?

_____ (2) Is a method specified for designating a different address to which notices may be sent?

_____ (3) Are notices effective when delivered or _____ (_____) days after mailed?

Waivers.

_____ (1) Does the lease provide that no waiver by Landlord of any provision of the lease is to be deemed a waiver of any other provision of the lease or of any subsequent breach by Tenant?

_____ (2) Does the lease provide that Landlord's acceptance of rent shall not be a waiver of any preceding breach by Tenant other than the failure of Tenant to pay the particular rent accepted, regardless of Landlord's knowledge of breach?

Merger.

_____ (1) Does the lease provide that surrender, mutual cancellation or termination of the lease does not automatically work a merger, but at the option of Landlord terminates all subtenancies or may, at the option of Landlord, operate as an assignment to Landlord of all subtenancies?

_____ K. Severability Clause. Is there one?

_____ L. Headings. For convenience only?

_____ M. Integration Clause. Is there one?

_____ N. Governing Law and Venue. In the state in which the premises are located?

_____ O. Attorneys' Fees. Is Landlord entitled to recover attorneys' fees in any arbitration, action, trial, proceeding or appeal brought to enforce the terms of the lease or to declare rights under the lease? [Check with local counsel to determine if reciprocal.]

_____ P. Recording. Is recording of lease or memorandum of lease prohibited, except at request of Landlord?

_____ Q. Counterparts. Is there a provision for execution of lease in one (1) or more counterparts?

_____ R. Is the manner of amending specified?

_____ S. Is time of the essence?

_____ T. Is the lease binding on successors and assigns of the parties?

_____ U. Are the signatures properly executed and notarized where required?

PUBLIC AGENCY ISSUES

_____ Has Cal. Rev. and Tax Code Sec. 107.6 disclosure been given for possible tax on tenant's possessory interest when landlord is public entity and tenant is private?

_____ Will prevailing wage or Davis Bacon act be triggered by tenant improvements or lease concessions, or below FMV rent? Include disclosure of possible applicability.

_____ Is enough time given for Landlord/Tenant to respond if it needs to meet agenda deadlines and take approvals to public hearing? Generally need 30-45 days for decisions on options to purchase/rights of refusal or other decisions on property purchase or lease.

_____ Avoid deemed approval for tenant's proposed assignment or sublease and allow for enough review and approval time. Require a second notice and include cc to City/County attorney instead of deemed approval.

_____ Is there a confidentiality clause? If so, remove clause or insert warning that public entity cannot keep documents private because it is subject to PRA and FOIA.

_____ Indemnified landlord parties should include public officials and volunteers in addition to normal parties (employees, contractors and agents)

_____ Eliminate or limit any Landlord indemnity of Tenant; limit to claims arising form lease and limit any claims to property interest only- no general fund access.

_____ Look for multi-year obligations and debt limitations under California Constitution; insert lease termination clause for loss of funding if tenant is a public entity

_____ Insert condition precedent to lease effectiveness that lease be approved by appropriate public authority (City Council, Board of Supervisors, etc.).

_____ If lease rent is nominal ($1 or ?), be sure parties address responsibility and cost of any capital improvements during lease term (roof repair, HVAC replacement, parking replacement, ADA improvements).

_____ If landlord is public entity who is also utility provider, be sure responsibilities are separate and distinct. Interruptions should not be landlord's responsibility- but should be utility providers (different employees, etc.), unless causes by landlord in such function. Sometimes this is not possible.

_____ If landlord is public entity who is also permitting authority, be sure responsibilities are separate and distinct- i.e. landlord cannot contract away its land use approval rights, and any approval under lease is only as landlord, not as regulatory authority.

_____ Has form of lease been reviewed and approved by City Attorney/County Counsel?

BASIC LEASE INFORMATION (TRIPLE NET)

LEASE DATE:

TENANT:

TENANT'S NOTICE ADDRESS:

TENANT'S BILLING ADDRESS:

TENANT CONTACT: **PHONE NUMBER:**

FAX NUMBER:

EMAIL ADDRESS:

LANDLORD: City of Monterey, a municipal corporation

LANDLORD'S NOTICE ADDRESS: City Manager
City of Monterey
City Hall
580 Pacific Street
Monterey, CA 93940

LANDLORD'S PAYMENT ADDRESS: City of Monterey
Revenue Department
735 Pacific Street
Monterey, CA 93940

LANDLORD CONTACT: **PHONE NUMBER:** (831) 646-3995

Housing & Property Manager **FAX NUMBER:** (831) 646-5616

EMAIL ADDRESS: hpm@monterey.org

Project Description: 101,444 gross square feet of retail and closed water mooring space leased as part of the Fisherman's Wharf 1, City of Monterey

Building Description:

Premises: The Building located at ___Old Fisherman's Wharf consisting of _____ square feet, described in Exhibit A-1 and depicted on Exhibit A-2

Permitted Use: Retail use, including [full service restaurant, coffee house, gift shop and] other lawful retail uses, except as may be prohibited or restricted by the Lease (See Section 4.2) or the Prohibited and Restricted Uses in Exhibit E.

Tenant's Business/Trade Name:

Commencement Date:

Term (in years):

Expiration Date:

RENT:

Base Rent: $_____ per month
(subject to adjustment as provided in Section 6.1A hereof)

Percentage Rent: ____%

Estimated First Year Operating Expenses: $_____ per month

Tenant's Proportionate Share: ____%

Security Deposit: $_____

Radius Restriction: ____ miles

Guarantor:

The foregoing Basic Lease Information is incorporated into and made a part of this Lease. Each reference in this Lease to any of the Basic Lease Information shall mean the respective information above and shall be construed to incorporate all of the terms provided under the particular Lease paragraph pertaining to such information. In the event of any conflict between the Basic Lease Information and the Lease, the latter shall control.

LANDLORD

City of Monterey, a municipal corporation

By: _____

Its: _____

Date: _____

TENANT

By: _____

Its: _____

Date: _____

By: _____

Its: _____

Date: _____

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LEASE

THIS LEASE is made as of the ____day of _____, 20__, by and between **CITY OF MONTEREY, a municipal corporation** (hereinafter called "**Landlord**"), and _____, a _____ (hereinafter called "**Tenant**").

1. PREMISES.

1.1 Landlord leases to Tenant and Tenant leases from Landlord, upon the terms and conditions hereinafter set forth, those premises (the "**Premises**") depicted on **Exhibit A-1**. The Premises shall be all or part of a building (the "**Building**") and of the Wharf I project (the "**Project**" or "**Wharf I**") as described in the Basic Lease Information. The Building and Project are shown on **Exhibit A-2.** Landlord and Tenant acknowledge that physical changes may occur from time to time in the Premises, Building or Project, and that the number of buildings and additional facilities which constitute the Project may change from time to time, which may result in an adjustment in Tenant's Proportionate Share, as defined in the Basic Lease Information, as provided in Section 7.1.

1.2 The term "Wharf 1" shall mean that certain structure commonly known as the Monterey Wharf 1 or Fisherman's Wharf which includes the underlying sand up to the mean high tide line and the underlying tide lands seaward of the mean high tide line, as more particularly depicted in **Exhibit A-2**, and any replacements or betterments thereof. The term "Substructure" means the structure that lies just below the Wharf 1 decking and building floors and includes all pilings, columns, caps, stringers, shoring, braces and other supporting members as well as main feeder electrical, water, sewer, gas, drainage lines and other main feeder utility lines.

1.3 Grant from State of California. It is expressly understood and agreed to by Tenant that in the event any tenancy hereunder is or becomes inconsistent with the Grant from the State of California by which Landlord holds the Premises, or the Operating Agreement by and between the City and State, the rights and the obligations of the parties hereto will be governed solely and exclusively by the Grant and the applicable laws of the State of California, but in no event will Landlord have any responsibility or incur any liability to Tenant as a result of any such inconsistency.

2. POSSESSION AND LEASE COMMENCEMENT.

2.1 Existing Improvements. If this Lease pertains to Premises in which the interior improvements have already been constructed ("**Existing Improvements**"), the provisions of this Section 2.1 shall apply and the term commencement date ("**Commencement Date**") shall be the earlier of the date on which: (1) Tenant takes possession of some or all of the Premises under this Lease Agreement; or (2) Landlord notifies Tenant that Tenant may occupy the Premises. If for any reason Landlord cannot deliver possession of the Premises to Tenant on the scheduled Commencement Date, Landlord shall not be subject to any liability therefor, nor shall Landlord be in default hereunder nor shall such failure affect the validity of this Lease, and Tenant agrees to accept possession of the Premises at such time as Landlord is able to deliver the same, which date shall then be deemed the Commencement Date. Tenant shall not be liable for any Rent (defined below) for any period prior to the Commencement Date. Tenant's taking of possession of the Premises or any part thereof shall constitute Tenant's acceptance of the Building or Project. Tenant acknowledges that Tenant has inspected and accepts the Premises in their present condition, "as is," and as suitable for, the Permitted Use (as defined below), and for Tenant's intended operations in the Premises. Tenant agrees that the Premises and other improvements are in good and satisfactory condition as of when possession was taken. Tenant further acknowledges that no representations as to the condition or repair of the Premises nor promises to alter, remodel or improve the Premises have been made by Landlord or any agents of Landlord unless such are expressly set forth in this Lease. If for any reason Landlord cannot deliver possession of the Premises to Tenant within 30 days of the execution of this Lease, Landlord shall not be subject to any liability therefor, nor shall Landlord be in default hereunder nor shall such failure affect the validity of this Lease, and Tenant agrees to accept possession of the Premises at such time as possession is provided, which date shall then be deemed the Commencement Date. Tenant shall not be liable for any Rent for any period prior to the Rent Commencement Date, which shall be delayed day for day for each day Landlord does not deliver possession of the Premises. Upon Landlord's request, Tenant shall promptly execute and return to Landlord a "Start-Up Letter" in which Tenant shall agree, among other things, to acceptance of the Premises and to the determination of the Commencement Date, in accordance with the terms of this Lease, but Tenant's failure or refusal to do so shall not negate Tenant's acceptance of the Premises or affect determination of the Commencement Date.

2.2 Construction of Improvements. If this Lease pertains to a Building to be constructed or improvements to be constructed within a Building, the provisions of this Section 2.2 shall apply in lieu of the provisions of Section 2.1 above and the term commencement date ("**Commencement Date**") shall be the earlier of the date on which: (1) Tenant takes possession of some or all of the Premises; or (2) the improvements to be constructed or performed in the Premises by Landlord (if any) shall have been substantially completed in accordance with the plans and specifications, if any. Tenant's taking of possession of the Premises or any part thereof shall constitute Tenant's confirmation of substantial completion for all purposes hereof, whether or not substantial completion of the Building or Project shall have occurred. If for any reason Landlord cannot deliver possession of the Premises to Tenant on the scheduled Commencement Date, Landlord shall not be subject to any liability therefor, nor shall Landlord be in default hereunder nor shall such failure affect the validity of this Lease, and Tenant agrees to accept possession of the Premises at such time as such improvements have been substantially completed, which date shall then be deemed the Commencement Date. Tenant shall not be liable for any Rent for any period prior to the Commencement Date (but without affecting any obligations of Tenant under any improvement agreement appended to this Lease). In the event of any dispute as to substantial completion of work performed or required to be performed by Landlord, the certificate of Landlord's architect or general contractor shall be conclusive. Substantial completion shall have occurred notwithstanding Tenant's submission of a punchlist to Landlord, which Tenant shall submit, if at all, within three (3) business days after the Commencement Date or otherwise in accordance with any improvement agreement appended to this Lease. Upon Landlord's request, Tenant shall promptly execute and return to Landlord a "Start-Up Letter" in which Tenant shall agree, among other things, to acceptance of the Premises and to the determination of the Commencement Date, in accordance with the terms of this Lease, but Tenant's failure or refusal to do so shall not negate Tenant's acceptance of the Premises or affect determination of the Commencement Date.

2.3 Occupancy under a Prior Lease. If this Lease pertains to a Building in which Tenant has been in occupancy under a prior Lease, the provisions of this Section 2.3 shall apply in lieu of the provisions of Section 2.1 or 2.2 above. Tenant has been in occupancy in the Premises under the Lease dated _____, as amended, between City of Monterey and _____ (the "**Prior Lease**"). This Lease shall supersede and replace the prior Lease between Tenant and Landlord and their predecessors in interest, if any, except as such obligations expressly survive. The Premises shall be those that are in place as of the date this Lease is executed ("**Existing Improvements**"), subject to Tenant's Work as defined in Section 11.3 and the Tenant Improvements defined in Section 12.1. The term commencement date ("**Commencement Date**") shall be the date shown in the Basic Lease Information. Tenant acknowledges that due to Tenant's prior occupancy, Tenant is very familiar with and knowledgeable of the Premises, the Building and the Project, has had ample time to inspect and or investigate the condition of same, and accepts the Premises in their present condition, "as is," and as suitable for, the Permitted Use (as defined below), and for Tenant's intended operations in the Premises. Tenant agrees that the Premises and other improvements are in good and satisfactory condition as of the Commencement Date. Tenant further acknowledges that no representations as to the condition or repair of the Premises or Common Areas nor promises to alter, remodel or improve the Premises or Common Areas have been made by Landlord or any agents of Landlord unless such are expressly set forth in this Lease. Upon Landlord's request, Tenant shall promptly execute and return to Landlord a "Start-Up Letter" in which Tenant shall agree, among other things, to acceptance of the Premises and to the determination of the Commencement Date, in accordance with the terms of this Lease, but Tenant's failure or refusal to do so shall not negate Tenant's acceptance of the Premises or affect determination of the Commencement Date.

2.4 Pilings. The parties acknowledge that the Premises, Building, and Project are supported by pilings under the wharf, and that these pilings require maintenance over time. Landlord shall be responsible for the maintenance of all wharf pilings under the Building and Premises, and the expense for such maintenance shall be a common area maintenance charge. Maintenance, repairs and replacement of the pilings shall occur over a 3-year cycle based on work schedules, work crew capacity, and availability of reserve funds. The charge for piling repair may be collected as a reserve, in Landlord's reasonable discretion, resulting in carried reserve balances over such time period pursuant to the Operating Expense reconciliation procedures described in Section 7.3.

3. TERM.

3.1 Term. The term of this Lease (the "**Term**") shall commence on the Commencement Date and continue in full force and effect for the number of months or years specified as the Length of Term in the Basic Lease Information or until this Lease is terminated as otherwise provided herein. If the Commencement Date is a date other than the first day of the calendar month, the Term shall be the number of months or years of the Length of Term in addition to the remainder of the calendar month following the Commencement Date.

3.2 Option to Extend. Landlord hereby grants to Tenant the right and option (the "Option") to extend the term of this Lease, for the Premises in "as is" condition, for one (1) additional period of _____ years (the "Option

Term"). Provided Tenant is not at the time of exercise and has not been in default under the Lease more than twice during the 24 months prior to the Option exercise, even if such default is cured, Tenant may exercise the Option by sending written notice to Landlord ("**Exercise Notice**") no more than twelve months but no less than nine months prior to the expiration of the Lease Term. If Tenant fails to provide such notice, Tenant shall have no further or additional right to extend or renew the term of this Lease. If Tenant is in default on the date the Option Term is to commence beyond all applicable notice and cure periods, at Landlord's option, the Option Term shall not commence and this Lease shall expire at the end of the Lease Term as described in Section 3.1 above. This Option to Extend is personal to Tenant and may not be exercised by any assignee or subtenant. Any exercise by Tenant of any option to renew under this Section shall be irrevocable. If requested by Landlord, Tenant agrees to execute a lease amendment or, at Landlord's option, a new lease agreement on Landlord's then standard lease form for the Building, reflecting the forgoing terms and conditions, prior to the commencement of the renewal term. [Minimum Rent for the first year of the Option Term shall be the Minimum Rent for the last month of the Lease Term increased by 100% of the percentage of increase, if any, shown by the Consumer Price Index, as determined by the U.S. Bureau of Labor Statistics for all Urban Consumers for the San Francisco/Oakland/San Jose Metropolitan Areas ("**Index**"), for the month immediately preceding the date on which the Option Term begins ("**Option Term Commencement Date**") as compared with the Index for the same month in the immediately preceding calendar year. Beginning on the first anniversary of the Option Term Commencement Date and on each successive anniversary thereafter during the Option Term ("**Adjustment Date**"), Base Rent shall be increased by 100% of the percentage of increase, if any, shown by the most recent published Index immediately preceding the Adjustment Date as compared with the Index for the same month in the immediately preceding calendar year. In no event shall option rent be less than Minimum Rent in effect at end of previous term. Landlord shall calculate the amount of this increase in Base Rent after the United States Department of Labor publishes the statistics on which the amount of the increase will be based. Landlord shall give written notice of the amount of the increase at least 10 days prior to the Option Term Commencement Date or, for subsequent years in the Option Term, at least 10 days prior to the Adjustment Date. Tenant shall pay this amount, together with the monthly rent next becoming due under this Lease, and shall thereafter pay the monthly rent due under this Lease at this increased rate, which shall constitute Base Rent. Landlord's failure to make the required calculations promptly shall not be considered a waiver of Landlord's rights to adjust the monthly Base Rent due, nor shall it affect Tenant's obligations to pay the increased Base Rent. If the Index is changed so that the base year differs from that in effect on the Lease Commencement Date, the Index shall be converted in accordance with the conversion factor published by the United States Department of Labor, Bureau of Labor Statistics. If the Index is discontinued or revised during the Lease Term, the government index or computation with which it is replaced shall be used to obtain substantially the same result as if the Index had not been discontinued or revised.]

4. USE.

4.1 General. Tenant shall use the Premises for the permitted use specified in the Basic Lease Information ("**Permitted Use**") and for no other use or purpose. So long as Tenant is occupying the Premises, Tenant and Tenant's employees, agents, customers, visitors, invitees, licensees, contractors, assignees and subtenants (collectively, "**Tenant's Parties**") shall have the nonexclusive right to use, in common with other parties occupying the Building or Project, the driveways and other Common Area of the Building and Project, subject to the terms of this Lease and such rules and regulations as Landlord may from time to time prescribe. Landlord reserves the right, without notice or liability to Tenant, and without the same constituting an actual or constructive eviction, to alter or modify the Common Area from time to time, including the location and configuration thereof, and the amenities and facilities which Landlord may determine to provide from time to time.

4.2 Limitations. Tenant shall not permit any odors, smoke, dust, gas, substances, noise or vibrations to emanate from the Premises or from any portion of the Common Area as a result of Tenant's or any Tenant's Party's use thereof, nor take any action which would constitute a nuisance or would disturb, obstruct or endanger any other tenants or occupants of the Building or Project or elsewhere, or interfere with their use of their respective premises or Common Areas. Tenant shall not use or allow the Premises to be used for any immoral, improper or unlawful purpose, nor shall Tenant cause or maintain or permit any nuisance in, on or about the Premises. Tenant shall not commit or suffer the commission of any waste in, on or about the Premises. Tenant shall not place any loads upon the floors, walls or ceilings which could endanger the structure, or place any harmful substances in the drainage system of the Building or Project. No waste, materials or refuse shall be dumped upon or permitted to remain outside the Premises. Tenant shall not permit any uses as described in **Exhibit E**, Prohibited and Restricted Uses. Landlord shall not be responsible to Tenant for the non-compliance by any other tenant or occupant of the Building or Project with any of the above-referenced rules or any other terms or provisions of such tenant's or occupant's lease or other contract.

4.3 Compliance with Regulations. By entering the Premises, Tenant accepts the Premises and Building in the condition existing as of the date of such entry. Tenant agrees that if, as a consequence of Landlord's ownership (or ownership of an interest) in the Building or the use of Landlord's funds in connection with any construction

project on the Premises, Building and/or Project, any legal requirements applicable to construction projects (a) undertaken by California cities, or (b) supported by City funds (including, but not limited to, competitive bidding requirements, prevailing wage requirements, and public works bonding requirements) are triggered, Tenant shall cause all such requirements to be fully complied with at Tenant's sole cost and expense. Any failure by Tenant to cause all such applicable requirements to be fully complied with shall be a material breach of this Lease. Tenant shall at its sole cost and expense strictly comply with all existing or future applicable municipal, state and federal and other governmental statutes, rules, requirements, regulations, laws and ordinances, including zoning ordinances and regulations, and covenants, easements and restrictions of record governing and relating to the use, occupancy or possession of the Premises, to Tenant's use of the Common Area, or to the use, storage, generation or disposal of Hazardous Materials (hereinafter defined) (collectively "**Regulations**"). Tenant agrees to comply with all Regulations pertaining to prevailing wage, competitive bidding and public bonding requirements at its sole cost and expense which may be triggered due to this Lease. Tenant shall at its sole cost and expense obtain any and all licenses or permits necessary for Tenant's use of the Premises. Tenant shall at its sole cost and expense promptly comply with the requirements of any board of fire underwriters or other similar body now or hereafter constituted. Tenant shall not do or permit anything to be done in, on, under or about the Project or bring or keep anything which will in any way increase the rate of any insurance upon the Premises, Building or Project or upon any contents therein or cause a cancellation of said insurance or otherwise affect said insurance in any manner. Tenant shall indemnify, defend (by counsel reasonably acceptable to Landlord), protect and hold Landlord harmless from and against any loss, cost, expense, damage, attorneys' fees or liability arising out of the failure of Tenant to comply with any Regulation. Tenant's obligations pursuant to the foregoing indemnity shall survive the expiration or earlier termination of this Lease.

4.4 Hazardous Materials. As used in this Lease, "**Hazardous Materials**" shall include, but not be limited to, hazardous, toxic and radioactive materials and those substances defined as "hazardous substances," "hazardous materials," "hazardous wastes," "toxic substances," or other similar designations in any Regulation. Tenant shall not cause, or allow any of Tenant's Parties to cause, any Hazardous Materials to be handled, used, generated, stored, released or disposed of in, on, under or about the Premises, the Building or the Project or surrounding land or environment in violation of any Regulations. Tenant must obtain Landlord's written consent prior to the introduction of any Hazardous Materials onto the Project. Notwithstanding the foregoing, Tenant may handle, store, use and dispose of products containing small quantities of Hazardous Materials for "general office purposes" (such as toner for copiers) to the extent customary and necessary for the Permitted Use of the Premises; provided that Tenant shall always handle, store, use, and dispose of any such Hazardous Materials in a safe and lawful manner and never allow such Hazardous Materials to contaminate the Premises, Building, or Project or surrounding land or environment. Tenant shall immediately notify Landlord in writing of any Hazardous Materials' contamination of any portion of the Project of which Tenant becomes aware, whether or not caused by Tenant. Landlord shall have the right at all reasonable times and if Landlord determines in good faith that Tenant may not be in compliance with this Section 4.4 to inspect the Premises and to conduct tests and investigations to determine whether Tenant is in compliance with the foregoing provisions, the costs of all such inspections, tests and investigations to be borne by Tenant. Tenant shall indemnify, defend (by counsel reasonably acceptable to Landlord), protect and hold Landlord harmless from and against any and all claims, liabilities, losses, costs, loss of rents, liens, damages, injuries or expenses (including attorneys' and consultants' fees and court costs), demands, causes of action, or judgments directly or indirectly arising out of or related to the use, generation, storage, release, or disposal of Hazardous Materials by Tenant or any of Tenant's Parties in, on, under or about the Premises, the Building or the Project or surrounding land or environment, which indemnity shall include, without limitation, damages for personal or bodily injury, property damage, damage to the environment or natural resources occurring on or off the Premises, losses attributable to diminution in value or adverse effects on marketability, the cost of any investigation, monitoring, government oversight, repair, removal, remediation, restoration, abatement, and disposal, and the preparation of any closure or other required plans, whether such action is required or necessary prior to or following the expiration or earlier termination of this Lease. Neither the consent by Landlord to the use, generation, storage, release or disposal of Hazardous Materials nor the strict compliance by Tenant with all laws pertaining to Hazardous Materials shall excuse Tenant from Tenant's obligation of indemnification pursuant to this Section 4.4. Tenant's obligations pursuant to the foregoing indemnity shall survive the expiration or earlier termination of this Lease.

4.5 Restricted Uses. Tenant shall warehouse, store and/or stock in the Premises only such goods, wares and merchandise as Tenant intends to offer for retail sale or use in preparation of goods or food items or services for sale at, in, from or upon the Premises. This shall not preclude occasional emergency transfers of merchandise to the other stores of Tenant, if any, not located in the Project. Tenant shall use for office, clerical or other non-selling purposes only such limited space in the Premises as is, from time to time, reasonably required for Tenant's business in the Premises. No auction, "fire," bankruptcy or sidewalk sales may be conducted in or upon the Premises without Landlord's prior written consent. The Premises shall not be used for any purpose which shall interfere with commerce, navigation or fishing or in any manner be inconsistent with the Grant or any trusts upon which the Premises or the Pier are now or may hereinafter be held by Landlord.

4.6 Refuse and Sewage. Tenant agrees not to keep any trash, garbage, waste or other refuse on the Premises, including any designated refuse collection area in the Common Area, except in sanitary containers and agrees to regularly and frequently remove same from the Premises. Tenant shall keep all containers or other equipment used for storage of such materials in a clean and sanitary condition. Tenant shall properly dispose of all sanitary sewage and shall not use the sewage disposal system for the disposal of anything except sanitary sewage. Tenant shall keep the sewage disposal system free of all obstructions and in good operating condition. Tenant shall separately contract and pay directly for its trash disposal services.

4.7 Active Use. The parties acknowledge that Wharf 1 is a valuable historic resource of the City which is intended to be developed, used and preserved as a public resource for enjoyment by the general public. Since the Premises is located on Wharf 1, the parties acknowledge that the use of the Premises is to be in accordance with this stated intent, and that the ultimate objective of this Lease is for the active public use of the Premises as described under Permitted Use by and for the benefit of the general public and in a manner consistent with this Section 4.7.

4.8 Right to Close. In addition to any powers Landlord has or may have in the future, including but not limited to any powers due to its governmental capacities, Landlord shall have the right to require the temporary closure of Wharf I or Premises if, in Landlord's sole judgment and opinion, crowd control, weather conditions or other conditions so mandate. Nothing in this provision shall be deemed as limiting in any manner the City's regulatory authority to close Wharf I or Premises.

4.9 City Municipal Powers. The Landlord is entering into this Lease in its proprietary capacity, and not in its regulatory or governmental capacity. Nothing in this Lease shall be construed as restraining, impairing or restricting the City in its regulatory capacity, or granting any rights upon the Tenant with respect to the use, occupancy or operation of the Premises in a manner inconsistent with Law. This Lease does not grant any development rights upon the Tenant with respect to the Premises and any such development shall be subject to all applicable provisions of the Monterey Municipal Code.

5. RULES AND REGULATIONS. Tenant and Tenant's Parties shall faithfully observe and comply with the Project rules and regulations attached hereto as **Exhibit B** and any other rules and regulations and any modifications or additions thereto which Landlord may from time to time prescribe in writing for the purpose of maintaining the proper care, cleanliness, safety, traffic flow and general order of the Premises or the Building or Project. Tenant shall cause Tenant's Parties to comply with such rules and regulations. Landlord shall not be responsible to Tenant for the non-compliance by any other tenant or occupant of the Building or Project with any of such rules and regulations, any other tenant's or occupant's lease or any Regulations.

6. RENT.

6.1 Base Rent. Tenant shall pay to Landlord and Landlord shall receive, without notice or demand throughout the Term, monthly Base Rent as specified in the Basic Lease Information, payable in monthly installments in advance on or before the first day of each calendar month, in lawful money of the United States, without deduction or offset whatsoever, at the Payment Address specified in the Basic Lease Information or to such other place as Landlord may from time to time designate in writing. Base Rent for the first full month of the Term shall be paid by Tenant upon Tenant's execution of this Lease. If the obligation for payment of Base Rent commences on a day other than the first day of a month, then Base Rent shall be prorated and the prorated installment shall be paid on the first day of the calendar month next succeeding the Term Commencement Date. As used herein, the term "Base Rent" shall mean the Base Rent specified in the Basic Lease Information as it may be so adjusted from time to time. The Base Rent payable by Tenant hereunder is subject to adjustment as provided in Section 6.1A.

A. [Annual Adjustment. Beginning on the first anniversary of the Commencement Date, Base Rent shall increase annually at the end of each 12-month period by any increase in the Consumer Price Index as determined by the U. S. Bureau of Labor Statistics for all Urban Consumers for the San Francisco/Oakland/San Jose Metropolitan Area over the previous year. [**In no event will the increase be less than 3% or greater than 7%**.] Should the CPI be discontinued, the index used for comparison shall be a comparable index as designated by the Bureau. It is recognized by both parties that the Index for any month is not published for approximately two months. Tenant shall, therefore, continue to pay the current rental paid by Tenant until such time as the new rental is calculated and, at that time, Tenant shall pay within ten (10) days of notice of the new Base Rent the new amount plus arrearages. In no event shall Base Rent ever decrease below the prior year's Base Rent even if the CPI is negative. In such event, the Base Rent **shall increase at the minimum rate specified in this Section 6.1A, remain the same.] [*Choose one*]**

A. ALTERNATE RENT INCREASE CLAUSE [**Annual Adjustment**. Base Rent shall increase, beginning on the first anniversary of the Commencement Date, as follows:

[INSERT TABLE OF RENT INCREASES]

6.2 Percentage Rent. During the Term, Tenant will pay to Landlord, as provided below, the dollar amount by which the percent specified in Percentage Rent of Basic Lease Information above of Tenant's "Gross Sales" (as hereinafter defined) exceeds the Base Rent paid by Tenant to Landlord during each month of the Term ("**Percentage Rent**"). Calculations of Base Rent and Percentage Rent shall not include any consideration for Operating Expense contributions. Percentage rent will be calculated monthly, but for convenience, shall be paid quarterly. Tenant will furnish or cause to be furnished to Landlord a statement of the monthly Gross Sales of Tenant within ten (10) days after the close of each calendar quarter and a statement of the annual Gross Sales of Tenant within thirty (30) days after the close of each fiscal year. Such statements will be in a form substantially similar to **Exhibit D** attached to this Lease or in another form mutually acceptable to Landlord and Tenant. Such statements will be certified as an accurate accounting of Tenant's Gross Sales by an authorized representative of Tenant. Within ten (10) days after the end of each calendar quarter, Tenant will pay to Landlord the amount, if any, by which the product of the Percentage Rent Rate multiplied by the monthly Gross Sales during each of the immediately preceding 3 calendar months exceeds the respective monthly installment of Base Rent paid by Tenant. Annual reconciliation shall verify or correct the original reported monthly Gross Sales but shall not recalculate the Percentage Rent on an annual basis. Within ninety (90) days after the close of each fiscal year, an accounting of Tenant's Gross Sales during said fiscal year and the amounts paid to Landlord as Base Rent and as Percentage Rent during each month of such fiscal year will be made by Landlord and, on such accounting, an adjustment will be made with respect to Percentage Rent as follows: if Tenant has paid to Landlord an amount greater than Tenant is required to pay under the terms of this Section 6.2, Landlord shall issue a check in the amount of such excess Percentage Rent within thirty (30) days of such determination; or if Tenant has paid an amount less than the Percentage Rent required to be paid under this Section 6.2, Tenant will pay to Landlord such difference within thirty (30) days of such determination. On termination of this Lease, if Tenant is not in default under this Lease, Landlord will refund to Tenant the amount of any excess, promptly on Landlord's receipt of Tenant's request therefore.

A. Gross Sales. "Gross Sales," as used in this Lease, means the gross selling price of all merchandise or services sold or rented on a monthly basis in or from the Premises by Tenant, its subtenants, licensees, and concessionaires (including food and beverages; provided that this reference to food and beverages does not permit the sale of food or beverages from the Premises if not otherwise expressly permitted by this Lease), whether for cash or on credit, whether made by store personnel or by machines, or whether made by catalogue or Internet sale (from on or off the Premises), excluding therefrom the following: (i) sales taxes, excise taxes, or gross receipts taxes imposed by governmental entities on the sale of merchandise or services, but only if collected from customers separately from the selling price and paid directly to the respective governmental entities; and (ii) proceeds from the sale of fixtures, equipment, or property that are not stock in trade ("Exclusions from Gross Sales"). Tenant will use its reasonable good faith efforts to maximize Gross Sales from the Premises.

B. Recordation of Sales. At the time of a sale or other transaction, Tenant must record the sale or other transaction in a cash register with sealed continuous tape, or on a computer, or by using any other method of recording sequentially numbered purchases and keeping a cumulative total.

C. Books and Records. For a period of three (3) years following the submittal of its certified annual statement for each calendar or fiscal year, Tenant must keep and maintain full and accurate accounting books and records relative to transactions from the Premises in accordance with generally accepted accounting principles consistently applied. The accounting books and records kept and maintained by Tenant for audit purposes must include all records, receipts, journals, ledgers, and documents reasonably necessary to enable Landlord or its auditors to perform a complete and accurate audit of Gross Sales and Exclusions from Gross Sales in accordance with generally accepted accounting principles.

D. Audits. Landlord, at any time within three (3) years after receipt of any certified annual statement and on not less than ten (10) days' prior written notice to Tenant, may cause an audit to be made of Gross Sales and Exclusions from Gross Sales and all of Tenant's records and accounting books necessary (in Landlord's judgment) to audit such items. Tenant will make all such books and records available for the audit at the Premises or at Tenant's offices in the state in which the Premises is situated. If the audit discloses an underpayment of Percentage Rent, Tenant will immediately pay to Landlord the amount of the underpayment with interest, which will accrue from the date the payment should have been made through and including the date of payment. If the audit discloses an underreporting of Net Sales in excess of two percent (2%) of the reported Gross Sales, whether or not additional Percentage Rent is due, then Tenant will also immediately pay to Landlord all reasonable costs and expenses incurred in the audit and in collecting the underpayment,

including auditing costs and attorney fees. If the audit discloses an overpayment of Percentage Rent, Tenant will be entitled to a credit in the amount of the overpayment against the next payment(s) of Percentage Rent due, unless the audit was for the last year of the Term, in which event Landlord will refund to Tenant the overpayment within sixty (60) days following the date of the finalization of the audit.

E. Computing Percentage Rent. For the purpose of computing Percentage Rent, Tenant's Gross Sales for any period during which Tenant does not continuously and uninterruptedly conduct its business, as required by Section 40, will be deemed to be Tenant's Gross Sales for the corresponding period during the last calendar year in which Tenant operated continuously and uninterruptedly.

F. Confidentiality of Gross Sales Reporting. Landlord is a public entity subject to the Public Records Act. Information provided to Landlord pursuant to this Section III may be disclosed publicly as required by law. If Landlord receives a request for records related to information obtained from Tenant pursuant to this section, Landlord agrees to promptly provide Tenant with written notice of the request. Tenant will then have the time specified in the Landlord's notice to determine whether it considers any of the information confidential proprietary information and whether it will take legal action to preclude disclosure of the requested information. Tenant understands that the Landlord's notice of a request for records under the California Public Records Act (Gov. Code, section 6250, et seq.) will require a prompt response from Tenant given the Landlord's obligation to respond to such a request within 10 days of its receipt. Absent a timely response, Landlord may release the requested records. Landlord shall have no monetary liability to Tenant for release of information pursuant to a request under the California Public Records Act or any subpoena; nor shall Landlord be obligated to defend against any challenge related to a California Public Records Act request or a subpoena for records that Tenant asserts are confidential. Tenant further agrees to be liable for and pay all judgments against the Landlord, as well as attorney fees and costs, resulting from a challenge related to a records request or subpoena for records that Tenant asserts are confidential.

6.3 Additional Rent. All monies other than Base Rent required to be paid by Tenant hereunder, including, but not limited to, Tenant's Proportionate Share of Operating Expenses, as specified in Section 7 of this Lease, charges to be paid by Tenant under Section 16, the interest and late charge described in Sections 28.4 and 28.5, Percentage Rent, Landlord's Share of Profit (as defined in Section 23.3), and any monies spent by Landlord pursuant to Section 32, shall be considered additional rent ("**Additional Rent**"). "**Rent**" shall mean Base Rent and Additional Rent.

7. OPERATING EXPENSES.

7.1 Operating Expenses. In addition to the Base Rent required to be paid hereunder, Tenant shall pay as Additional Rent, Tenant's Proportionate Share of the Building and/or Project (as applicable), as defined in the Basic Lease Information, of Operating Expenses (defined below) in the manner set forth below. Tenant shall pay the applicable Tenant's Proportionate Share of each such Operating Expenses. Landlord and Tenant acknowledge that if the number of buildings which constitute the Project increases or decreases, or if physical changes are made to the Premises, Building or Project or the configuration of any thereof, Landlord may at its discretion reasonably adjust Tenant's Proportionate Share of the Building or Project to reflect the change. Landlord's determination of Tenant's Proportionate Share of the Building and of the Project shall be conclusive so long as it is reasonably and consistently applied. "**Operating Expenses**" shall mean all expenses and costs of every kind and nature which Landlord shall pay or become obligated to pay, because of or in connection with the ownership, management, maintenance, repair, preservation, replacement and operation of the Building or Project and its supporting facilities and such additional facilities now and in subsequent years as may be determined by Landlord to be necessary or desirable to the Building and/or Project (as determined in a reasonable manner) other than those expenses and costs which are specifically attributable to Tenant or which are expressly made the financial responsibility of Landlord or specific tenants of the Building or Project pursuant to this Lease. Operating Expenses shall include, but are not limited to, the following:

A. Taxes. All real property taxes and assessments, possessory interest taxes, sales taxes, personal property taxes, business or license taxes or fees, gross receipts taxes, service payments in lieu of such taxes or fees, annual or periodic license or use fees, excises, transit charges, and other impositions, general and special, ordinary and extraordinary, unforeseen as well as foreseen, of any kind (including fees "in-lieu" of any such tax or assessment) which are now or hereafter assessed, levied, charged, confirmed, or imposed by any public authority upon the Building or Project, its operations or the Rent (or any portion or component thereof), or any tax, assessment or fee imposed in substitution, partially or totally, of any of the above. Operating Expenses shall also include any taxes, assessments, reassessments, or other fees or impositions with respect to the development, leasing, management, maintenance, alteration, repair, use or occupancy of the Premises, Building or Project or any portion thereof, including, without limitation, by or for Tenant, and all increases therein or reassessments thereof whether the increases or reassessments result from increased rate and/or valuation (whether upon a

transfer of the Building or Project or any portion thereof or any interest therein or for any other reason). Operating Expenses shall not include inheritance or estate taxes imposed upon or assessed against the interest of any person in the Project, or taxes computed upon the basis of the net income of any owners of any interest in the Project. .

B. Revenue & Taxation Code Section 107.6. Possessory Interest Tax. Tenant recognizes and understands that this Lease may create a possessory interest subject to property taxes and that, if a possessory interest is created, Tenant shall, in accordance with this Section 7.1B hereof, be responsible for payment of property taxes levied against such possessory interest.

C. Insurance. All insurance premiums and costs, including, but not limited to, any deductible amounts, premiums and other costs of insurance incurred by Landlord, including for the insurance coverage set forth in Section 8.1 herein.

D. Common Area Maintenance.

(1) Repairs, replacements, supplies, utilities, and general maintenance of the Common Area for the Project which may include wharf structure and substructure (including pilings), balconies, public restrooms, mechanical rooms, building exteriors, compactor room, alarm systems, pest extermination, landscaped areas, surface decking, stringers, caps, docks, parking and service areas, driveways, sidewalks, loading areas, fire sprinkler systems, appurtenant buildings, sanitary and storm sewer lines, utility services, electrical, mechanical or other systems, telephone equipment and wiring servicing, plumbing, lighting, trash collection, security, extermination fees, signage, day porter and janitorial services, and any other items or areas which affect the operation or appearance of the Building or Project, which determination shall be at Landlord's discretion, except for: those items to the extent paid for by the proceeds of insurance; and those items attributable solely or jointly to specific tenants of the Building or Project. Landlord shall have the sole right and discretion to increase or decrease the Common Area. The public and common areas and facilities of and comprising the Building and Project, including, but not limited to, those areas of Wharf I open to the public or operating or supporting those areas open to the public and the Building and/or the Project shall be known as the "**Common Area**".

Common Area expenses shall be shared 40% by Landlord, 60% by the tenants of the Project. Tenant shall pay Tenant's Proportionate Share based on such 60% portion of the expenses for Common Area repairs, replacements, supplies, utilities, and general maintenance, as described in this Section 7.1D, for the Project. For avoidance of doubt, 40% of the Project's Common Area Maintenance expenses shall not be passed through to Tenant; Tenant shall pay Tenant's Proportionate Share based on the remaining 60% portion of the Project's Common Area maintenance expenses.

(2) Repairs, replacements, and general maintenance shall include the cost of any improvements made to or assets acquired for the Project or Building that in Landlord's discretion may reduce any other Operating Expenses, including present or future repair work, are reasonably necessary for the health and safety of the occupants of the Building or Project, or for the operation of the Building systems, services and equipment, or are required to comply with any Regulation, such costs or allocable portions thereof to be amortized over such reasonable period as Landlord shall determine, together with interest on the unamortized balance at the publicly announced "prime rate" charged by Wells Fargo Bank, N.A. (San Francisco) or its successor at the time such improvements or capital assets are constructed or acquired, plus two (2) percentage points, or in the absence of such prime rate, then at the U.S. Treasury six-month market note (or bond, if so designated) rate as published by any national financial publication selected by Landlord, plus four (4) percentage points, but in no event more than the maximum rate permitted by law, plus reasonable financing charges or reserves for the replacement of such improvements.

(3) Payment under or for any easement, license, permit, operating agreement, declaration, restrictive covenant or instrument relating to the Building or Project.

(4) All expenses and rental related to services and costs of supplies, materials and equipment used in operating, managing and maintaining the Premises, Building and Project, the equipment therein and the adjacent sidewalks, driveways, parking and service areas, including, without limitation, expenses related to service agreements regarding security, fire and other alarm systems, janitorial services, window cleaning, Building exterior maintenance, landscaping and expenses related to the administration, management and operation of the Project, including without limitation salaries, wages and benefits and management office rent.

(5) The cost of supplying any services and utilities which benefit all or a portion of the Premises, Building or Project, including without limitation services and utilities provided pursuant to Section 16 hereof.

(6) Legal expenses and the cost of audits by certified public accountants; provided, however, that legal expenses chargeable as Operating Expenses shall not include the cost of negotiating leases, collecting rents, evicting tenants nor shall it include costs incurred in legal proceedings with or against any tenant or to enforce the provisions of any lease.

(7) A management and accounting cost recovery fee not to exceed five percent (5%) of the sum of the Project's revenues whether managed by Landlord or third party management.

(8) All amounts necessary to inspect, maintain, repair and replace the bearing and fender pilings, structures and improvements of Wharf I. Such amounts may be collected after the expense has been incurred, or may be collected as reserve in advance for the estimated cost of such replacements pursuant to Section 2.4.

If the rentable area of the Building and/or Project is not fully occupied during any fiscal year of the Term as determined by Landlord, an adjustment shall be made in Landlord's reasonable discretion in computing the Operating Expenses for such year so that Tenant pays an equitable portion of all variable items (e.g., utilities, janitorial services and other component expenses that are affected by variations in occupancy levels) of Operating Expenses, as reasonably determined by Landlord; provided, however, that in no event shall Landlord be entitled to collect in excess of one hundred percent (100%) of the total Operating Expenses from all of the tenants in the Building or Project, as the case may be.

Operating Expenses shall not include the cost of providing tenant improvements or other specific costs incurred for the account of, separately billed to and paid by specific tenants of the Building or Project, the initial construction cost of the Building, lease commissions, or debt service on any mortgage or deed of trust recorded with respect to the Project other than pursuant to Section 7.1D(2) above. Notwithstanding anything herein to the contrary, in any instance wherein Landlord, in Landlord's sole discretion, deems Tenant to be responsible for any amounts greater than Tenant's Proportionate Share, Landlord shall have the right to allocate costs in any manner Landlord deems appropriate.

The above enumeration of services and facilities shall not be deemed to impose an obligation on Landlord to make available or provide such services or facilities except to the extent, if any, that Landlord has specifically agreed elsewhere in this Lease to make the same available or provide the same. Without limiting the generality of the foregoing, Tenant acknowledges and agrees that it shall be responsible for providing adequate security for its use of the Premises, the Building and the Project and that Landlord shall have no obligation or liability with respect thereto, except to the extent, if any, that Landlord has specifically agreed elsewhere in this Lease to provide the same.

7.2 Payment of Estimated Operating Expenses. "**Estimated Operating Expenses**" for any particular year shall mean Landlord's estimate of the Operating Expenses for such fiscal year made with respect to such fiscal year as hereinafter provided. Landlord shall have the right from time to time to revise its fiscal year and interim accounting periods so long as the periods as so revised are reconciled with prior periods in a reasonable manner. During the last month of each fiscal year during the Term, or as soon thereafter as practicable, Landlord shall give Tenant written notice of the Estimated Operating Expenses for the ensuing fiscal year. Tenant shall pay Tenant's Proportionate Share of the Estimated Operating Expenses with installments of Base Rent for the fiscal year to which the Estimated Operating Expenses applies in monthly installments on the first day of each calendar month during such year, in advance. Such payment shall be construed to be Additional Rent for all purposes hereunder. If at any time during the course of the fiscal year, Landlord determines that Operating Expenses are projected to vary from the then Estimated Operating Expenses by more than five percent (5%), Landlord may, by written notice to Tenant, revise the Estimated Operating Expenses for the balance of such fiscal year, and Tenant's monthly installments for the remainder of such year shall be adjusted so that by the end of such fiscal year Tenant has paid to Landlord Tenant's Proportionate Share of the revised Estimated Operating Expenses for such year, such revised installment amounts to be Additional Rent for all purposes hereunder.

7.3 Computation of Operating Expense Adjustment. "**Operating Expense Adjustment**" shall mean the difference between Estimated Operating Expenses and actual Operating Expenses for any fiscal year determined as hereinafter provided. Within one hundred twenty (120) days after the end of each fiscal year, or as soon thereafter as practicable, Landlord shall deliver to Tenant a statement of actual Operating Expenses for the fiscal year just ended, accompanied by a computation of Operating Expense Adjustment. If such statement shows that Tenant's payment based upon Estimated Operating Expenses is less than Tenant's Proportionate Share of Operating Expenses, then Tenant shall pay to Landlord the difference within twenty (20) days after receipt of such statement, such payment to constitute Additional Rent for all purposes hereunder. If such statement shows that Tenant's payments of Estimated Operating Expenses exceed Tenant's Proportionate Share of Operating Expenses, then (provided that Tenant is not in default under this Lease) Landlord shall pay to Tenant the difference within twenty (20) days after delivery of such statement to Tenant. Notwithstanding the foregoing, piling repair work and certain structural maintenance items that Landlord undertakes during the Lease term

pursuant to Section 2.4 ("**Piling Repair and Structural Maintenance**") shall be reconciled and statements provided on a three year basis. The Piling Repair and Structural Maintenance charge may be collected as a reserve, in Landlord's reasonable discretion, resulting in carried reserve balances over the 3-year cycle. The statement of actual Operating Expenses and computation of Operating Expense Adjustment for Piling Repair and Structural Maintenance shall be provided to Tenant within 120 days after the end of the third fiscal year following the Commencement Date or as soon thereafter as practicable, and at the same time every three years thereafter, at which times the Tenant shall pay the Operating Expense Adjustment (or adjusted reserve amount) for Piling Repair and Structural Maintenance within 20 days after the statement of actual Operating Expenses is delivered, or Landlord shall issue a refund for the remaining reserve balance within such 20 days. No refunds will occur from the Piling Repair and Structural Maintenance reserve account on an annual basis, although Landlord may adjust up or down the estimated reserve collection amounts from year to year based on adjusted repair schedules and required maintenance in order to fund the reserve and complete the repairs. The remaining balance at the end of the 3-year cycle shall be refunded, or the deficit shall be billed to Tenant. If this Lease has been terminated or the Term hereof has expired prior to the date of any statement of actual Operating Expenses, including a statement for Piling Repair and Structural Maintenance, then the annual Operating Expense Adjustment or the Operating Expense Adjustment for that portion of Piling Repair and Structural Maintenance completed before the Lease Termination shall be paid by the appropriate party within twenty (20) days after the date of delivery of the statement of actual Operating Expenses. Should this Lease commence or terminate at any time other than the first day of the fiscal year, Tenant's Proportionate Share of the Operating Expense Adjustment shall be prorated based on a month of 30 days and the number of calendar months during such fiscal year that this Lease is in effect. Notwithstanding anything to the contrary contained in Section 7.1 or 7.2, Landlord's failure to provide any notices or statements within the time periods specified in those sections shall in no way excuse Tenant from its obligation to pay Tenant's Proportionate Share of Operating Expenses.

7.4 Net Lease. This shall be a triple net Lease and Base Rent shall be paid to Landlord absolutely net of all costs and expenses, except as specifically provided to the contrary in this Lease. The provisions for payment of Operating Expenses and the Operating Expense Adjustment are intended to pass on to Tenant and reimburse Landlord for all costs and expenses of the nature described in Section 7.1 incurred in connection with the ownership, management, maintenance, repair, preservation, replacement and operation of the Building and/or Project and its supporting facilities and such additional facilities now and in subsequent years as may be determined by Landlord to be necessary or desirable to the Building and/or Project.

7.5 Tenant Audit. If Tenant shall dispute the amount set forth in any statement provided by Landlord under Section 7.2 or 7.3 above, Tenant shall have the right, to cause Landlord's books and records with respect to Operating Expenses for such fiscal year to be audited by certified public accountants selected by Tenant and subject to Landlord's reasonable right of approval. The Operating Expense Adjustment shall be appropriately adjusted on the basis of such audit. If such audit discloses a liability for a refund in excess of ten percent (10%) of Tenant's Proportionate Share of the Operating Expenses previously reported, the cost of such audit shall be borne by Landlord; otherwise the cost of such audit shall be paid by Tenant. If Tenant shall not request an audit in accordance with the provisions of this Section 7.5 within twenty (20) days after receipt of Landlord's statement provided pursuant to Section 7.2 or 7.3, such statement shall be final and binding for all purposes hereof. Tenant acknowledges and agrees that any information revealed in the above described audit may contain proprietary and sensitive information and that significant damage could result to Landlord if such information were disclosed to any party other than Tenant's auditors. Tenant shall not in any manner disclose, provide or make available any information revealed by the audit to any person or entity without Landlord's prior written consent, which consent may be withheld by Landlord in its sole and absolute discretion. The information disclosed by the audit will be used by Tenant solely for the purpose of evaluating Landlord's books and records in connection with this Section 7.5.

8. INSURANCE AND INDEMNIFICATION.

8.1 Landlord's Insurance. If, and to the extent Landlord elects to do so (in Landlord's sole discretion), Landlord may maintain insurance through individual or blanket policies insuring the Building against fire and extended coverage (including, if Landlord elects, "all risk" coverage, earthquake/volcanic action, flood and/or surface water insurance) for all or a portion of the full replacement cost of the Building, with deductibles and the form and endorsements of such coverage as selected by Landlord, together with rental interruption insurance against loss of Rent. Landlord may also carry such other insurance as Landlord may deem prudent or advisable, including, without limitation, liability insurance in such amounts and on such terms as Landlord shall determine. All such insurance maintained by Landlord shall be for the exclusive benefit of Landlord and Tenant shall have no right or interest therein.

8.2 Tenant Insurance. Tenant shall, at Tenant's expense, obtain and keep in force at all times the following:

A. Commercial General Liability Insurance (Occurrence Form). A policy of commercial general liability insurance (occurrence form) having a combined single limit of not less than Two Million Dollars ($2,000,000) per occurrence, Four Million Dollars ($4,000,000) in aggregate, providing coverage for, among other things, blanket contractual liability, Premises, products/completed operations with an "Additional Insured-Managers or Lessors of Premises Endorsement" and containing the "Amendment of the Pollution Exclusion Endorsement" for damage caused by heat, smoke or fumes from a hostile fire, and personal and advertising injury coverage, with deletion of (a) the exclusion for operations within fifty (50) feet of a railroad track (railroad protective liability), if applicable, and (b) the exclusion for explosion, collapse or underground hazard, if applicable. The policy shall not contain any intra-insured exclusions as between insured persons or organizations, and shall include coverage for liability assumed under this Lease as an "insured contract" for the performance of Tenant's indemnity obligations under this Lease;

B. Automobile Liability Insurance. Business automobile liability insurance having a combined single limit of not less than One Million Dollars ($1,000,000) per occurrence and insuring Tenant against liability for claims arising out of ownership, maintenance, or use of any owned, hired or non-owned automobiles;

C. Workers' Compensation and Employer's Liability Insurance. Workers' compensation insurance having limits not less than those required by state statute and federal statute, if applicable, and covering all persons employed by Tenant in the conduct of its operations on the Premises including coverage for all states and, if applicable, voluntary compensation, together with employer's liability insurance coverage in the amount of at least One Million Dollars ($1,000,000);

D. Property Insurance. "All risk" property insurance including boiler and machinery comprehensive form, if applicable, covering damage to or loss of any of Tenant's personal property, fixtures, equipment and alterations, including electronic data processing equipment (collectively, "**Tenant's Property**") (and coverage for the full replacement cost thereof including business interruption of Tenant), together with, if the property of Tenant's invitees is to be kept in the Premises, warehouser's legal liability or bailee customers insurance for the full replacement cost of the property belonging to invitees and located in the Premises; and

E. Business Interruption. Loss of income and extra expense insurance in amounts as will reimburse Tenant for direct or indirect loss of earnings attributable to all peril commonly insured against by prudent Tenants in the business of Tenant or to prevention of access to the Premises as a result of such perils.

8.3 General.

A. Insurance Companies. Insurance required to be maintained by Tenant shall be written by companies licensed to do business in the state in which the Premises are located and having a "General Policyholders Rating" of at least "A-VIII" (or such higher rating as may be required by lender having a lien on the Premises) as set forth in the most current issue of "Best's Insurance Guide."

B. Certificates of Insurance. Tenant shall deliver to Landlord certificates of insurance for all insurance required to be maintained by Tenant in a form acceptable to Landlord in its sole discretion, no later than seven (7) days prior to the date of possession of the Premises. Tenant shall, at least ten (10) days prior to expiration of the policy, furnish Landlord with certificates of renewal or "binders" thereof. Each certificate shall expressly provide that such policies shall not be cancelable or otherwise subject to modification except after thirty (30) days' prior written notice to the parties named as additional insureds in this Lease (except in the case of cancellation for nonpayment of premium in which case cancellation shall not take effect until at least ten (10) days' notice has been given to Landlord). If Tenant fails to maintain any insurance required in this Lease, Tenant shall be liable for all losses and costs suffered or incurred by Landlord (including litigation costs and attorneys' fees and expenses) resulting from said failure.

C. Additional Insured. Landlord, Landlord's lender, if any, and any property management company of Landlord for the Premises shall be named as additional insureds on a form approved by Landlord under all of the policies required by Section 8.2. The policies required under Section 8.2 shall provide for severability of interest.

D. Primary Coverage. All insurance to be maintained by Tenant shall, except for workers' compensation and employer's liability insurance, be primary, without right of contribution from insurance of Landlord. Any umbrella liability policy or excess liability policy (which shall be in "following form") shall provide that if the underlying aggregate is exhausted, the excess coverage will drop down as primary insurance. The limits of insurance maintained by Tenant shall not limit Tenant's liability under this Lease.

E. Waiver of Subrogation. Tenant waives any right to recover against Landlord for claims for damages to Tenant's Property whether or not covered by insurance. This provision is intended to waive fully, and for the benefit of Landlord, any rights and/or claims which might give rise to a right of subrogation in favor of any insurance carrier. The coverage obtained by Tenant pursuant to this Lease shall include, without limitation, a waiver of subrogation endorsement attached to the certificate of insurance.

F. Notification of Incidents. Tenant shall notify Landlord immediately and as soon as practicable, but no later than within twenty-four (24) hours after the occurrence of any accidents or incidents in the Premises, which could give rise to a claim under any of the insurance policies required under this Section 8.

8.4 Indemnity. Tenant shall indemnify, protect, defend (at Tenant's sole cost and with legal counsel acceptable to Landlord) and hold harmless, Landlord and Landlord's affiliated entities, and each of their respective members, managers, partners, officers, employees, council members, board members, lenders, agents, contractors, successors and assigns from and against any and all claims, judgments, causes of action, damages, penalties, costs, liabilities, and expenses, including all court costs and attorneys' fees, arising at any time during or after the Term, as a result (directly or indirectly) of or in connection with (i) default in the performance of any Obligation on Tenant's part to be performed under the terms of this Lease, or (ii) Tenant's use of the Premises, the conduct of Tenant's business or any activity, work or things done, permitted or suffered by Tenant or Tenant's employees, agents, customers, visitors, invitees, licensees, contractors, assignees or subtenants (individually, a "**Tenant Party**" and collectively, "**Tenant's Parties**") in or about the Premises, the Building, the Common Area or other portions of the Premises except as provided by law or for claims caused solely by Landlord's gross negligence or willful misconduct. Tenant's indemnity is not intended to nor shall it relieve any insurance carrier of its obligations under policies required to be carried by Licensee pursuant to the provisions of this Lease to the extent such policies cover the results of negligent acts or omissions of Landlord, its employees, agents, contractors, council members, board members and officers or the failure of Landlord to perform any of its obligations under this Lease. The obligations of Tenant under this Section 8.4 shall survive the termination or earlier expiration of this Lease.

8.5 Exemption of Landlord from Liability. Tenant, as a material part of the consideration to Landlord, hereby assumes all risk of damage to the Premises and its property including, but not limited to, Tenant's fixtures, equipment, furniture and alterations, or illness or injury to persons in, upon or about the Premises, arising from any cause, and Tenant hereby expressly releases Landlord and waives all claims in respect thereof against Landlord, except only such claims as are caused solely by Landlord's gross negligence or willful misconduct.

Tenant hereby agrees that Landlord shall not be liable for injury to Tenant's business or any loss of income therefrom or for damage to the property of Tenant, or injury to or illness or death of Tenant or any Tenant Party or any other person in or about the Premises, whether such damage, illness or injury is caused by fire, steam, electricity, gas, water or rain, or from the breakage, leakage or other defects of sprinklers, wires, appliances, ventilation, plumbing, air conditioning or lighting fixtures, or from any other cause, and whether said damage, illness or injury results from conditions arising upon the Premises, upon other portions of the Building or from other sources or places, and regardless of whether the cause of such damage, illness or injury or the means of repairing the same is inaccessible to Tenant, except only damage, illness or injury caused solely by Landlord's gross negligence or willful misconduct.

Landlord shall not be liable for any damages arising from any action, inaction or neglect by any contractor or other tenant, if any, of the Building or Landlord's failure to enforce the terms of any agreements with parties other than Tenant.

9. WAIVER OF SUBROGATION. Landlord and Tenant each waives any claim, loss or cost it might have against the other for any injury to or death of any person or persons, or damage to or theft, destruction, loss, or loss of use of any property (a "**Loss**"), to the extent the same is insured against (or is required to be insured against under the terms hereof) under any property damage insurance policy covering the Building, the Premises, Landlord's or Tenant's fixtures, personal property, leasehold improvements, or business, regardless of whether the negligence of the other party caused such Loss.

10. CONTROL OF AND CHANGES TO COMMON AREA. Landlord shall have the sole and exclusive control of the Common Area, and the right to make changes to the Common Area. The manner in which the Common Area shall be maintained shall be solely determined by Landlord. Furthermore, Landlord's rights shall include, but not be limited to, the right to (a) restrain the use of the Common Area by unauthorized persons; (b) utilize from time to time any portion of the Common Area for promotional, entertainment and related matters; (c) place permanent or temporary kiosks, displays, carts and stands in the Common Area and to lease same to tenants; (d) temporarily close any portion of the Common Area for repairs (including but not limited to paving or piling repairs (such closure shall be up to 1 week but no more often than once per 5 years, such week to be chosen by a majority vote of the tenants), improvements or Alterations, or to discourage non-

customer use, to prevent dedication or an easement by prescription or for any other reason deemed sufficient in Landlord's reasonable judgment; and (e) renovate, upgrade or change the shape and size of the Common Area or add, eliminate or change the location of improvements to the Common Area including, without limitation, buildings, parking areas, roadways and curb cuts, and to construct buildings on the Common Area. Landlord, at any time, may change the shape, size, location, number and extent of the improvements shown on **Exhibit A-2** and eliminate, add or relocate any improvements to any portion of the Project, and may add land to and/or withdraw land from the Project.

11. TENANT'S REPAIRS AND MAINTENANCE.

11.1 By taking possession of the Premises and Building, Tenant accepts them "as is," as being in good order, condition and repair and the condition in which Landlord is obligated to deliver them and suitable for the Permitted Use and Tenant's intended operations in the Premises, whether or not any notice of acceptance is given. Tenant shall at all times during the Term at Tenant's expense maintain the Building, including structural soundness of the roof, foundations, and exterior walls electrical, mechanical or other systems, telephone equipment and wiring servicing, plumbing, lighting in, or about the Building (but not the Common Area) and the Premises in a first-class, good, clean and secure condition and promptly make all necessary repairs and replacements, as determined by Landlord, with materials and workmanship of the same character, kind and quality as the original. Tenant shall, at its expense, promptly repair any damage to the Premises or the Building or Project resulting from or caused by any negligence or act of Tenant or Tenant's Parties.

11.2 If any portion of the Premises is used for the sale or storage of food, then Tenant, at Tenant's expense, will have a bonded, professional pest-and-sanitation control operator provide monthly pest control services. In addition, Tenant agrees to annually inspect the lateral sewer line to point of connection at main sewer line and have the lateral sewer line inspected with a plumbing camera every five years. Results of said inspections shall be provided to Landlord. Throughout Term Tenant will, at Tenant's sole expense, maintain the Premises in a clean, sanitary, and quiet manner and will take such steps as may be necessary, in the reasonable discretion of Landlord, to keep the Premises and/or contiguous other tenant-occupied premises and the Project free of nuisances, odors, and loud sounds, including music associated with Tenant's business or from the operation of any instrument, apparatus, equipment, radio, television, or amplification system. On Tenant's receipt of notice of any complaint of odor or noise that may be resulting from, directly or indirectly, the operation of Tenant's business, Tenant, at Tenant's sole expense, will take such steps as may be necessary to immediately remedy such odor or noise.

11.3 Operations by Tenant. Tenant will at its expense: (a) keep the inside and outside of all glass in the doors and windows located in the Premises intact and clean; (b) keep all exterior surfaces located on the Premises clean and free of graffiti; (c) replace promptly any cracked or broken glass located on the Premises with glass of like grade and quality; (d) maintain the Premises in a clean, orderly and sanitary condition and free of insects, rodents, vermin and other pests; (e) keep any garbage, trash, rubbish or other refuse in rat-proof containers within the interior of the Premises or in Landlord designated trash containers until removed; (f) have such garbage, trash, rubbish and refuse removed on a daily basis; (g) keep all mechanical apparatus reasonably free of vibration and noise which may be transmitted beyond the Premises; (h) comply with all applicable Law; (i) light the show windows of the Premises and exterior signs during Tenant's business hours and turn the same off to the extent reasonably required by Landlord; (j) comply with and observe all rules and regulations established by Landlord or its designee; (k) maintain sufficient and seasonal inventory and have sufficient number of personnel to maximize sales volume in the Premises; and (l) conduct its business in all respects in accordance with high standards of restaurant and retail operation as reasonably determined by Landlord.

12. ALTERATIONS.

12.1 [Except for the initial tenant improvements approved by Landlord and repairs for property condition under Section 12.3 and **Exhibit F**] Tenant shall not make, or allow to be made, any alterations, physical additions, improvements or partitions, including without limitation the attachment of any fixtures or equipment, in, about or to the Premises ("**Alterations**") without obtaining the prior written consent of Landlord, which consent shall not be unreasonably withheld with respect to proposed Alterations which: (a) comply with all applicable Regulations; (b) are, in Landlord's opinion, compatible with the Building or the Project and its mechanical, plumbing, electrical, heating/ventilation/air conditioning systems, and will not cause the Building or Project or such systems to be required to be modified to comply with any Regulations (including, without limitation, the Americans With Disabilities Act); and (c) will not interfere with the use and occupancy of any other portion of the Building or Project by any other tenant or its invitees. Specifically, but without limiting the generality of the foregoing, Landlord shall have the right of written consent for all plans and specifications for the proposed Alterations, construction means and methods, all appropriate permits and licenses, any contractor or subcontractor to be employed on the work of Alterations, and the time for performance of such work, and may impose rules and regulations for contractors and subcontractors performing such work. Tenant shall also supply to Landlord any

documents and information reasonably requested by Landlord in connection with Landlord's consideration of a request for approval hereunder. Tenant shall cause all Alterations to be accomplished in a first-class, good and workmanlike manner, and to comply with all applicable Regulations and Section 29 hereof. Tenant shall at Tenant's sole expense, perform any additional work required under applicable Regulations due to the Alterations hereunder. No review or consent by Landlord of or to any proposed Alteration or additional work shall constitute a waiver of Tenant's obligations under this Section 12, nor constitute any warranty or representation that the same complies with all applicable Regulations, for which Tenant shall at all times be solely responsible. Tenant shall reimburse Landlord for all costs which Landlord may incur in connection with granting approval to Tenant for any such Alterations, including any costs or expenses which Landlord may incur in electing to have outside architects and engineers review said plans and specifications. All such Alterations shall remain the property of Tenant until the expiration or earlier termination of this Lease, at which time they shall be and become the property of Landlord; provided, however, that Landlord may, at Landlord's option, require that Tenant, at Tenant's expense, remove any or all Alterations made by Tenant and restore the Premises by the expiration or earlier termination of this Lease, to their condition existing prior to the construction of any such Alterations. All such removals and restoration shall be accomplished in a first-class and good and workmanlike manner so as not to cause any damage to the Premises or Project whatsoever. If Tenant fails to remove such Alterations or Tenant's trade fixtures or furniture or other personal property, Landlord may keep and use them or remove any of them and cause them to be stored or sold in accordance with applicable law, at Tenant's sole expense. In addition to and wholly apart from Tenant's obligation to pay Tenant's Proportionate Share of Operating Expenses, Tenant shall be responsible for and shall pay prior to delinquency any taxes or governmental service fees, possessory interest taxes, fees or charges in lieu of any such taxes, capital levies, or other charges imposed upon, levied with respect to or assessed against its fixtures or personal property, on the value of Alterations within the Premises, and on Tenant's interest pursuant to this Lease, or any increase in any of the foregoing based on such Alterations. To the extent that any such taxes are not separately assessed or billed to Tenant, Tenant shall pay the amount thereof as invoiced to Tenant by Landlord.

In addition, at Landlord's election and notwithstanding the foregoing, however, Tenant shall pay to Landlord the cost of removing any such Alterations and restoring the Premises to their original condition, and such amount may be deducted from the Security Deposit or any other sums or amounts held by Landlord under this Lease.

12.2 Notices of Construction. In compliance with Section 29 hereof, at least ten (10) business days before beginning construction of any Alteration, Tenant shall give Landlord written notice of the expected commencement date of that construction to permit Landlord to post and record a notice of non-responsibility. Upon substantial completion of construction, if the law so provides, Tenant shall cause a timely notice of completion to be recorded in the office of the recorder of the county in which the Building is located.

12.3 Condition of Premises. Tenant shall correct any items within ninety (90) days of Lease Commencement shown on the Property Condition Report. If the Term is longer than sixty (60) months, then Landlord may, at any time after the expiration of month forty-eight (48) and prior to the commencement of the final twelve (12)-month period of the Term, require Tenant, at Tenant's cost, to make cosmetic changes to the Premises such as new floor finishes, painting, new wall covering, casework, and new tenant fixtures as necessary to maintain the Premises as a first-class operation as specified in a new property condition report to be obtained by Landlord. A new report may be obtained at Landlord's option and expense every five (5) years of the Lease Term. All such work by Tenant will be in accordance with Section 12 and will be completed within three (3) months after the date of Landlord's notice.

12.4 Prevailing Wages. Tenant acknowledges that Landlord has made no representation, express or implied, to Tenant or any person associated with Tenant regarding whether or not laborers employed relative to any construction on the Premises, Building, or Project must be paid the prevailing per diem wage rate for their labor classification, as determined by the State of California, pursuant to California Labor Code Sections 1720 et seq. Tenant agrees with Landlord that Tenant shall assume the responsibility and be solely responsible for determining whether or not laborers employed relative to any construction on the Premises, Building, or Project undertaken by Tenant must be paid the prevailing per diem wage rate for their labor classification, as determined by the State of California, pursuant to California Labor Code Sections 1720 et seq. Landlord shall not be under any duty to monitor or ensure the compliance of Tenant with any State of California labor laws, including, without limitation, prevailing wage laws. Tenant shall indemnify Landlord in accordance with the provisions of Section 8.4 against any claims pursuant to California Labor Code Section 1781 arising from Tenant's construction of any improvements, work or alterations on the Premises, Building, or Project.

13. SIGNS. Tenant shall not place, install, affix, paint or maintain any signs, notices, graphics or banners whatsoever or any window decor which is visible in or from public view or corridors, the Common Area or the exterior of the Premises or the Building, in or on any exterior window or window fronting upon any Common Area, the water, beach or ocean side, or service area without Landlord's prior written approval which Landlord shall have the right to withhold in its

absolute and sole discretion. Any installation of signs, notices, graphics or banners on or about the Premises or Project approved by Landlord shall be subject to any Regulations and to any other requirements imposed by Landlord. Tenant shall remove all such signs or graphics by the expiration or any earlier termination of this Lease. Such installations and removals shall be made in such manner as to avoid injury to or defacement of the Premises, Building or Project and any other improvements contained therein, and Tenant shall repair any injury or defacement including without limitation discoloration caused by such installation or removal.

14. TENANT'S SIGNS, AWNINGS AND CANOPIES. Tenant will not place, or allow any third party to place, or maintain on the roof or on any exterior door or wall of the Premises any permanent sign, banner, flag, awning or canopy or advertising matter without Landlord's prior written consent, which consent shall not be unreasonably withheld, delayed or conditioned. Tenant shall be permitted temporary window and exterior banner signage so long as such temporary signage is professionally produced and approved by Landlord in advance of installation. Tenant shall be allowed permanent building signage up to the maximum size permitted by local governmental authorities. Rear Building signage is prohibited. Tenant's sign shall comply with the City of Monterey Citywide Sign Guidelines adopted March 20, 2012, as the same may be amended or changed from time to time, and any other applicable governmental requirements and approvals. Tenant acknowledges that no pylon sign exists for the Project and no monument sign exists with respect to the Premises. Tenant's sign(s) shall be installed prior to Tenant's opening for business. Tenant further agrees to maintain such sign, awning, canopy, decoration, lettering, or advertising matter as may be approved in good condition and repair at all times at its own expense. If Tenant installs any sign, awning, canopy, decoration, lettering, or advertising matter without Landlord's prior written consent, Landlord may have it removed and stored at Tenant's expense. The removal and storage costs shall bear interest until paid at the maximum rate allowed by law. If Tenant elects to change its exterior signage after initial installation, any such new exterior signage shall be subject to approval by Landlord and the City. If any governmental requirement that Landlord is obligated to comply with necessitates replacement of Tenant's exterior signage, then Tenant shall remove Tenant's existing sign, patch the fascia, and install a new sign that complies with such governmental requirement, at Tenant's sole cost and expense.

No advertising medium shall be utilized by Tenant which can be heard or experienced outside the Premises, including without limitation, flashing lights, searchlights, loudspeakers, phonographs, radios or television, provided that this prohibition does not prevent Tenant from the placement of advertisements on television or radio to promote its business which are then broadcast over public and private mediums or to orally advertise in compliance with applicable laws. Except with Landlord's prior written consent, Tenant shall not display, paint or place, or cause to be displayed, painted or placed, any handbills, bumper stickers or other advertising devices on any vehicle parked in the adjacent parking area to the Project, including those belonging to Tenant, or to Tenant's agent or any other person; nor shall Tenant distribute or cause to be distributed in the Project any handbills or other advertising devices. Tenant shall have no right to spray paint the exterior or interior of the exterior doors without Landlord's prior written consent.

15. INSPECTION/POSTING NOTICES. After reasonable notice, except in emergencies where no such notice shall be required, Landlord and Landlord's agents and representatives, shall have the right to enter the Premises to inspect the same, to clean, to perform such work as may be permitted or required hereunder, to make repairs, improvements or alterations to the Premises, Building or Project or to other tenant spaces therein, to deal with emergencies, to post such notices as may be permitted or required by law to prevent the perfection of liens against Landlord's interest in the Project or to exhibit the Premises to prospective tenants, purchasers, encumbrancers or to others, or for any other purpose as Landlord may deem necessary or desirable; provided, however, that Landlord shall use reasonable efforts not to unreasonably interfere with Tenant's business operations. Tenant shall not be entitled to any abatement of Rent by reason of the exercise of any such right of entry. Tenant waives any claim for damages for any injury or inconvenience to or interference with Tenant's business, any loss of occupancy or quiet enjoyment of the Premises, and any other loss occasioned thereby. Landlord shall at all times have and retain a key with which to unlock all of the doors in, upon and about the Premises, excluding Tenant's vaults and safes or special security areas (designated in advance), and Landlord shall have the right to use any and all means which Landlord may deem necessary or proper to open said doors in an emergency, in order to obtain entry to any portion of the Premises, and any entry to the Premises or portions thereof obtained by Landlord by any of said means, or otherwise, shall not be construed to be a forcible or unlawful entry into, or a detainer of, the Premises, or an eviction, actual or constructive, of Tenant from the Premises or any portions thereof. At any time within six (6) months prior to the expiration of the Term or following any earlier termination of this Lease or agreement to terminate this Lease, Landlord shall have the right to erect on the Premises, Building and/or Project a suitable sign indicating that the Premises are available for lease.

16. SERVICES AND UTILITIES. Tenant shall contract directly for and obtain (and Landlord is to have no responsibility for) all utilities and services necessary for the use and occupancy of the Premises, with exception for domestic water and sewer services which shall be invoiced by Landlord to Tenant. Landlord shall not be liable for, and Tenant shall not be entitled to any abatement or reduction of Rent by reason of, the discontinuation of utilities to the Premises where such

failure is caused by accident, breakage, repairs, strikes, lockouts or other labor disturbances or labor disputes of any character or for any other causes. In the event of an interruption of utility services, Landlord shall cooperate with and assist Tenant as reasonably requested by Tenant (and at Tenant's expense) to reestablish such services as soon as is possible. Tenant hereby waives the provisions of California Civil Code Section 1932(1) or any other applicable existing or future Laws, permitting the termination of this Lease due to the interruption or failure of or inability to provide any services.

16.1 Tenant acknowledges that Tenant has inspected and accepts the water, electricity and other utilities and services being supplied or furnished to the Premises as of the date Tenant takes possession of the Premises, as being sufficient for use of the Premises for reasonable and normal use in their present condition, "as is," and suitable for the Permitted Use, and for Tenant's intended operations in the Premises. Tenant also agrees at all times to cooperate fully with Landlord and to abide by all of the regulations and requirements which Landlord may prescribe for the proper functioning and protection of electrical and plumbing.

16.2 Tenant shall not without written consent of Landlord use any apparatus, equipment or device in the Premises, which will in any way increase the amount of electricity, water, or any other resource being furnished or supplied for the use of the Premises for reasonable and normal retail use, in each case as of the date Tenant takes possession of the Premises and as determined by Landlord, or which will require additions or alterations to or interfere with the Building power distribution systems; nor connect with electric current, except through existing electrical outlets in the Premises or water pipes, any apparatus, equipment or device for the purpose of using electrical current, water, or any other resource. If Tenant shall require water or electric current or any other resource in excess of that being furnished or supplied for the use of the Premises as of the date Tenant takes possession of the Premises as determined by Landlord, Tenant shall first procure the written consent of Landlord which Landlord may refuse, to the use thereof, and Landlord may cause a special meter to be installed in the Premises so as to measure the amount of water, electric current or other resource consumed for any such other use. Tenant shall pay directly to Landlord upon demand as an addition to and separate from payment of Operating Expenses the cost of all such additional resources, energy, utility service and meters (and of installation, maintenance and repair thereof and of any additional circuits or other equipment necessary to furnish such additional resources, energy, utility or service). Landlord may add to the separate or metered charge a recovery of additional expense incurred in keeping account of the excess water, electric current or other resource so consumed. Following receipt of Tenant's request to do so, Landlord shall use good faith efforts to restore any service specifically to be provided under Section 15 that becomes unavailable and which is in Landlord's reasonable control to restore; provided, however, that Landlord shall in no case be liable for any damages directly or indirectly resulting from nor shall the Rent or any monies owed Landlord under this Lease herein reserved be abated by reason of: (a) the installation, use or interruption of use of any equipment used in connection with the furnishing of any such utilities or services, or any change in the character or means of supplying or providing any such utilities or services or any supplier thereof; (b) the failure to furnish or delay in furnishing any such utilities or services when such failure or delay is caused by acts of God or the elements, labor disturbances of any character, or otherwise or because of any interruption of service due to Tenant's use of water, electric current or other resource in excess of that being supplied or furnished for the use of the Premises as of the date Tenant takes possession of the Premises; (c) the inadequacy, limitation, curtailment, rationing or restriction on use of water, electricity, gas or any other form of energy or any other service or utility whatsoever serving the Premises or Project, whether by Regulation or otherwise; or (d) the partial or total unavailability of any such utilities or services to the Premises or the Building or the diminution in the quality or quantity thereof, whether by Regulation or otherwise; or (e) any interruption in Tenant's business operations as a result of any such occurrence; nor shall any such occurrence constitute an actual or constructive eviction of Tenant or a breach of an implied warranty by Landlord. Landlord shall further have no obligation to protect or preserve any apparatus, equipment or device installed by Tenant in the Premises, including without limitation by providing additional or after-hours heating or air conditioning. Landlord shall be entitled to cooperate voluntarily and in a reasonable manner with the efforts of national, state or local governmental agencies or utility suppliers in reducing energy or other resource consumption. The obligation to make services available hereunder shall be subject to the limitations of any such voluntary, reasonable program. In addition, Landlord reserves the right to change the supplier or provider of any such utility or service from time to time. Tenant shall have no right to contract with or otherwise obtain any electrical or other such service for or with respect to the Premises or Tenant's operations therein from any supplier or provider of any such service. Tenant shall cooperate with Landlord and any supplier or provider of such services designated by Landlord from time to time to facilitate the delivery of such services to Tenant at the Premises and to the Building and Project, including without limitation allowing Landlord and Landlord's suppliers or providers, and their respective agents and contractors, reasonable access to the Premises for the purpose of installing, maintaining, repairing, replacing or upgrading such service or any equipment or machinery associated therewith.

16.3 Utilities. Commencing on the Term Commencement Date, Tenant shall ensure that the Premises has sufficient electric, water, gas, telephone, sanitary and storm sewer lines to the Premises and equipment required to provide such services for Tenant's intended Use. If necessary, Landlord will, at Landlord's sole cost and expense, provide separate meters to measure Tenant's individual consumption of utilities. Tenant shall pay, upon demand, for all utilities

furnished to the Premises, or if not separately billed to or metered to Tenant, Tenant's Proportionate Share of all charges jointly serving the Project in accordance with Section 7. All sums payable under this Section 16 shall constitute Additional Rent hereunder.

16.4 Telecommunications Providers. Tenant may contract separately with providers of telecommunications or cellular products, systems or services for the Premises. Even though such products, systems or services may be installed or provided by such providers in the Building, in consideration for Landlord's permitting such providers to provide such services to Tenant, Tenant agrees that Landlord and the Landlord Indemnitees shall in no event be liable to Tenant or any Tenant Party for any damages of any nature whatsoever arising out of or relating to the products, systems or services provided by such providers (or any failure, interruption, defect in or loss of the same) or any acts or omissions of such providers in connection with the same or any interference in Tenant's business caused thereby. Tenant waives and releases all rights and remedies against Landlord and the Landlord Indemnitees that are inconsistent with the foregoing.

16.5 Energy Programs. Within thirty (30) days after the Delivery Date Tenant shall provide to Landlord authorizations from each utility to be used by Tenant in the operation of its Premises whose power consumption Landlord is required to report upon pursuant to California's Energy Use Program. Tenant agrees to cooperate with Landlord to satisfy any governmental requirements regarding energy efficiencies, or to qualify the Project for any energy efficiency programs.

17. SUBORDINATION. Without the necessity of any additional document being executed by Tenant for the purpose of effecting a subordination, this Lease shall be and is hereby declared to be subject and subordinate at all times to: (a) all ground leases or underlying leases which may now exist or hereafter be executed affecting the Premises and/or the land upon which the Premises and Project are situated, or both; and (b) any mortgage or deed of trust which may now exist or be placed upon the Building, the Project and/or the land upon which the Premises or the Project are situated, or said ground leases or underlying leases, or Landlord's interest or estate in any of said items which is specified as security. Notwithstanding the foregoing, Landlord shall have the right to subordinate or cause to be subordinated any such ground leases or underlying leases or any such liens to this Lease. If any ground lease or underlying lease terminates for any reason or any mortgage or deed of trust is foreclosed or a conveyance in lieu of foreclosure is made for any reason, Tenant shall, notwithstanding any subordination, attorn to and become the Tenant of the successor in interest to Landlord provided that Tenant shall not be disturbed in its possession under this Lease by such successor in interest so long as Tenant is not in default under this Lease. Within ten (10) days after request by Landlord, Tenant shall execute and deliver any additional documents evidencing Tenant's attornment or the subordination of this Lease with respect to any such ground leases or underlying leases or any such mortgage or deed of trust, in the form requested by Landlord or by any ground landlord, mortgagee, or beneficiary under a deed of trust, subject to such nondisturbance requirement. If requested in writing by Tenant, Landlord shall use commercially reasonable efforts to obtain a subordination, nondisturbance and attornment agreement for the benefit of Tenant reflecting the foregoing from any ground landlord, mortgagee or beneficiary, at Tenant's expense, subject to such other terms and conditions as the ground landlord, mortgagee or beneficiary may require.

18. FINANCIAL STATEMENTS. At the request of Landlord from time to time, no more often than once per year, Tenant shall provide to Landlord Tenant's and any guarantor's current financial statements or other information discussing financial worth of Tenant and any guarantor, which Landlord shall use solely for purposes of this Lease and in connection with the ownership, management, financing and disposition of the Project.

19. ESTOPPEL CERTIFICATE. Tenant agrees from time to time, within ten (10) days after request of Landlord, to deliver to Landlord, or Landlord's designee, an estoppel certificate stating that this Lease is in full force and effect, that this Lease has not been modified (or stating all modifications, written or oral, to this Lease), the date to which Rent has been paid, the unexpired portion of this Lease, that there are no current defaults by Landlord or Tenant under this Lease (or specifying any such defaults), that the leasehold estate granted by this Lease is the sole interest of Tenant in the Premises and/or the land at which the Premises are situated, and such other matters pertaining to this Lease as may be reasonably requested by Landlord or any mortgagee, beneficiary, purchaser or prospective purchaser of the Building or Project or any interest therein. Failure by Tenant to execute and deliver such certificate shall constitute an acceptance of the Premises and acknowledgment by Tenant that the statements included are true and correct without exception. Tenant agrees that if Tenant fails to execute and deliver such certificate within such ten (10)-day period, Landlord may execute and deliver such certificate on Tenant's behalf and that such certificate shall be binding on Tenant. Landlord and Tenant intend that any statement delivered pursuant to this section may be relied upon by any mortgagee, beneficiary, purchaser or prospective purchaser of the Building or Project or any interest therein. The parties agree that Tenant's obligation to furnish such estoppel certificates in a timely fashion is a material inducement for Landlord's execution of this Lease, and shall be an event

of default (without any cure period that might be provided under Section 28.1C of this Lease) if Tenant fails to fully comply or makes any material misstatement in any such certificate.

20. SECURITY DEPOSIT. Tenant agrees to deposit with Landlord upon execution of this Lease, a security deposit as stated in the Basic Lease Information (the "**Security Deposit**"), which sum shall be held and owned by Landlord, without obligation to pay interest, as security for the performance of Tenant's covenants and obligations under this Lease. The Security Deposit is not an advance rental deposit or a measure of damages incurred by Landlord in case of Tenant's default. Upon the occurrence of any event of default by Tenant, Landlord may from time to time, without prejudice to any other remedy provided herein or by law, use such fund as a credit to the extent necessary to credit against any arrears of Rent or other payments due to Landlord hereunder, and any other damage, injury, expense or liability caused by such event of default, and Tenant shall pay to Landlord, on demand, the amount so applied in order to restore the Security Deposit to its original amount. Although the Security Deposit shall be deemed the property of Landlord, any remaining balance of such deposit shall be returned by Landlord to Tenant at such time after termination of this Lease that all of Tenant's obligations under this Lease have been fulfilled, reduced by such amounts as may be required by Landlord to remedy defaults on the part of Tenant in the payment of Rent or other obligations of Tenant under this Lease, to repair damage to the Premises, Building or Project caused by Tenant or any Tenant's Parties and to clean the Premises. Landlord is hereby granted a security interest in the Security Deposit in accordance with applicable provisions of the California Commercial Code. Landlord may use and commingle the Security Deposit with other funds of Landlord. Tenant hereby waives the provisions of Section 1950.7 of the California Civil Code, and all other provisions of any Regulations, now or hereinafter in force, which restricts the amount or types of claim that a landlord may make upon a security deposit or imposes upon a landlord (or its successors) any obligation with respect to the handling or return of security deposits.

21. LIMITATION OF TENANT'S REMEDIES. The obligations and liability of Landlord to Tenant for any default by Landlord under the terms of this Lease are not personal obligations of Landlord or Landlord's affiliated entities, and each of their respective members, managers, partners, officers, employees, council members, board members, lenders, agents, contractors, successors and assigns, and Tenant agrees to look solely to Landlord's interest in the Project for the recovery of any amount from Landlord, and shall not look to other assets of Landlord nor seek recourse against the assets of Landlord's affiliated entities, and each of their respective members, managers, partners, officers, employees, council members, board members, lenders, agents, contractors, successors and assigns. Any lien obtained to enforce any such judgment and any levy of execution thereon shall be subject and subordinate to any lien, mortgage or deed of trust on the Project. Under no circumstances shall Tenant have the right to offset against or recoup Rent or other payments due and to become due to Landlord hereunder except as expressly provided in this Lease, which Rent and other payments shall be absolutely due and payable hereunder in accordance with the terms hereof. In no case shall Landlord be liable to Tenant for any lost profits, damage to business, or any form of special, indirect or consequential damage on account of any breach of this Lease or otherwise, notwithstanding anything to the contrary contained in this Lease.

22. CONSENT OF LANDLORD AND TENANT. Except as expressly provided to the contrary, wherever in this Lease consent or approval is required, such consent or approval shall be given in writing and shall not be unreasonably withheld, delayed, or conditioned. Landlord shall not be deemed to have withheld its consent unreasonably where Landlord's right to give its consent is conditioned on Landlord obtaining the consent of any person, agency or authority with the right to withhold its consent pursuant to applicable Laws.

If Landlord or Tenant fails to properly give any such consent, the other party hereto shall be entitled to specific performance and shall have such other remedies as are reserved to it under this Lease, but in no event shall Landlord or Tenant be entitled to terminate this Lease as a result of such failure to give consent (including any right of termination under Section 1995.310 of the California Civil Code) unless consent is withheld maliciously or in bad faith.

23. ASSIGNMENT AND SUBLETTING.

23.1 General. This Lease has been negotiated to be and is granted as an accommodation to Tenant. Accordingly, this Lease is personal to Tenant, and Tenant's rights granted hereunder do not include the right to assign this Lease or sublease the Premises, or to receive any excess, either in installments or lump sum, over the Rent which is expressly reserved by Landlord as hereinafter provided, except as otherwise expressly hereinafter provided. Tenant shall not assign or pledge this Lease or sublet the Premises or any part thereof, whether voluntarily or by operation of law, or permit the use or occupancy of the Premises or any part thereof by anyone other than Tenant, or suffer or permit any such assignment, pledge, subleasing or occupancy, without Landlord's prior written consent except as provided herein. If Tenant desires to assign this Lease or sublet any or all of the Premises, Tenant shall give Landlord written notice (the "**Transfer Notice**") at least ninety (90) days prior to the anticipated effective date of the proposed assignment or sublease, which shall contain all of the information reasonably requested by Landlord to address Landlord's decision criteria specified hereinafter. Landlord shall

then have a period of sixty (60) days following receipt of the Transfer Notice to notify Tenant in writing that Landlord elects either: (i) to terminate this Lease as to the space so affected as of the date so requested by Tenant; or (ii) to consent to the proposed assignment or sublease, subject, however, to Landlord's prior written consent of the proposed assignee or subtenant and of any related documents or agreements associated with the assignment or sublease. If Landlord should fail to notify Tenant in writing of such election within said period, Landlord shall be deemed to have waived option (i) above, but written consent by Landlord of the proposed assignee or subtenant shall still be required. If Landlord does not exercise option (i) above, Landlord's consent to a proposed assignment or sublease shall not be unreasonably withheld. Consent to any assignment or subletting shall not constitute consent to any subsequent transaction to which this Section 23 applies.

23.2 Conditions of Landlord's Consent. Without limiting the other instances in which it may be reasonable for Landlord to withhold Landlord's consent to an assignment or subletting, Landlord and Tenant acknowledge that it shall be reasonable for Landlord to withhold Landlord's consent in the following instances: if the proposed assignee does not agree to be bound by and assume the obligations of Tenant under this Lease in form and substance satisfactory to Landlord; the use of the Premises by such proposed assignee or subtenant would not be a Permitted Use or would violate any exclusivity or other arrangement which Landlord has with any other tenant or occupant or any Regulation or would increase the occupancy burden of the Building or Project, or would otherwise result in an undesirable tenant mix for the Project as determined by Landlord in its sole discretion; the proposed assignee or subtenant is not of sound financial condition as determined by Landlord in Landlord's sole discretion; the proposed assignee or subtenant does not have a good reputation as a tenant of property or a good business reputation; the proposed assignee or subtenant is a person with whom Landlord is negotiating to lease space in the Project or is a present tenant of the Project; the assignment or subletting would entail any Alterations which would lessen the value of the leasehold improvements in the Premises or use of any Hazardous Materials or other noxious use or use which may disturb other tenants of the Project; or Tenant is in default of any obligation of Tenant under this Lease, or Tenant has defaulted under this Lease on two (2) or more occasions during any twelve (12) months preceding the date that Tenant shall request consent. Failure by or refusal of Landlord to consent to a proposed assignee or subtenant shall not cause a termination of this Lease. Upon a termination under Section 23.1(i), Landlord may lease the Premises to any party, including parties with whom Tenant has negotiated an assignment or sublease, without incurring any liability to Tenant. At the option of Landlord, a surrender and termination of this Lease shall operate as an assignment to Landlord of some or all subleases or subtenancies. Landlord shall exercise this option by giving notice of that assignment to such subtenants on or before the effective date of the surrender and termination.

23.3 Bonus Rent. Tenant shall pay to Landlord as Additional Rent under the Lease 90% ("Landlord's Share") of the Profit (defined below) on such transaction as and when received by Tenant, unless Landlord gives written notice to Tenant and the assignee or subtenant that Landlord's Share shall be paid by the assignee or subtenant to Landlord directly. Landlord's Share of the Profit shall be in addition to any Percentage Rent which may be applicable to the assignee or sublessee. The "Profit" means (A) all amounts paid to Tenant for such assignment or sublease, including "key" money, monthly rent in excess of the monthly rent payable under the Lease, and all fees and other consideration paid for the assignment or sublease, including fees under any collateral agreements, less (B) real estate broker's commissions and costs of construction of tenant improvements required under such assignment or sublease directly incurred by Tenant for such assignment or sublease. For key money which includes the sale of assets as in a business purchase or assignment, (B) shall also include furniture fixtures and equipment, and merchandise, as applicable. Tenant is entitled to recover such costs and expenses before Tenant is obligated to pay Landlord's Share to Landlord. The Profit in the case of a sublease of less than all the Property is the rent allocable to the subleased space as a percentage on a square footage basis. Tenant shall provide Landlord a written statement certifying all amounts to be paid from any assignment or sublease of the Premises within thirty (30) days after the transaction documentation is signed, and Landlord may inspect Tenant's books and records to verify the accuracy of such statement. On written request, Tenant shall promptly furnish to Landlord copies of all the transaction documentation, all of which shall be certified by Tenant to be complete, true and correct. Landlord's receipt of Landlord's Share shall not be a consent to any further assignment or subletting. The breach of Tenant's obligation under this Section 23.3 shall be a material default of the Lease.

23.4 Corporation. If Tenant is a corporation, a transfer of corporate shares by sale, assignment, bequest, inheritance, operation of law or other disposition (including such a transfer to or by a receiver or trustee in federal or state bankruptcy, insolvency or other proceedings) resulting in a change in the present control of such corporation or any of its parent corporations by the person or persons owning a majority of said corporate shares, shall constitute an assignment for purposes of this Lease.

23.5 Unincorporated Entity. If Tenant is a partnership, joint venture, unincorporated limited liability company or other unincorporated business form, a transfer of the interest of persons, firms or entities responsible for managerial control of Tenant by sale, assignment, bequest, inheritance, operation of law or other disposition, so as to result in a change in the present control of said entity and/or of the underlying beneficial interests of said entity and/or a change in the

identity of the persons responsible for the general credit obligations of said entity shall constitute an assignment for all purposes of this Lease.

23.6 Liability. No assignment or subletting by Tenant, permitted or otherwise, shall relieve Tenant of any obligation under this Lease or any guarantor of this Lease of any liability under its guaranty or alter the primary liability of the Tenant named herein for the payment of Rent or for the performance of any other obligations to be performed by Tenant, including obligations contained in Section 27 with respect to any assignee or subtenant. Landlord may collect rent or other amounts or any portion thereof from any assignee, subtenant, or other occupant of the Premises, permitted or otherwise, and apply the net rent collected to the Rent payable hereunder, but no such collection shall be deemed to be a waiver of this Section 23, or the acceptance of the assignee, subtenant or occupant as tenant, or a release of Tenant from the further performance by Tenant of the obligations of Tenant under this Lease or of any guarantor. Any assignment or subletting which conflicts with the provisions hereof shall be void.

24. AUTHORITY. Landlord represents and warrants that it has full right and authority to enter into this Lease and to perform all of Landlord's obligations hereunder and that all persons signing this Lease on its behalf are authorized to do. Tenant and the person or persons, if any, signing on behalf of Tenant, jointly and severally represent and warrant that Tenant has full right and authority to enter into this Lease, and to perform all of Tenant's obligations hereunder, and that all persons signing this Lease on its behalf are authorized to do so.

25. CONDEMNATION.

25.1 Condemnation Resulting in Termination. If the whole or any substantial part of the Premises should be taken or condemned for any public use under any Regulation, or by right of eminent domain, or by private purchase in lieu thereof, and the taking would prevent or materially interfere with the Permitted Use of the Premises, either party shall have the right to terminate this Lease at its option. If any material portion of the Building or Project is taken or condemned for any public use under any Regulation, or by right of eminent domain, or by private purchase in lieu thereof, Landlord may terminate this Lease at its option. In either of such events, the Rent shall be abated during the unexpired portion of this Lease, effective when the physical taking of said Premises shall have occurred.

25.2 Condemnation Not Resulting in Termination. If a portion of the Project of which the Premises are a part should be taken or condemned for any public use under any Regulation, or by right of eminent domain, or by private purchase in lieu thereof, and the taking prevents or materially interferes with the Permitted Use of the Premises, and this Lease is not terminated as provided in Section 25.1 above, the Rent payable hereunder during the unexpired portion of this Lease shall be reduced, beginning on the date when the physical taking shall have occurred, to such amount as may be fair and reasonable under all of the circumstances, but only after giving Landlord credit for all sums received or to be received by Tenant by the condemning authority. Notwithstanding anything to the contrary contained in this section, if the temporary use or occupancy of any part of the Premises shall be taken or appropriated under power of eminent domain during the Term, this Lease shall be and remain unaffected by such taking or appropriation and Tenant shall continue to pay in full all Rent payable hereunder by Tenant during the Term; in the event of any such temporary appropriation or taking, Tenant shall be entitled to receive that portion of any award which represents compensation for the use of or occupancy of the Premises during the unexpired Term.

25.3 Award. Landlord shall be entitled to (and Tenant shall assign to Landlord) any and all payment, income, rent, award or any interest therein whatsoever which may be paid or made in connection with such taking or conveyance and Tenant shall have no claim against Landlord or otherwise for any sums paid by virtue of such proceedings, whether or not attributable to the value of any unexpired portion of this Lease, except as expressly provided in this Lease. Notwithstanding the foregoing, any compensation specifically and separately awarded Tenant for Tenant's personal property and moving costs, shall be and remain the property of Tenant.

25.4 Waiver of CCP § 1265.130. Each party waives the provisions of California Civil Code Procedure Section 1265.130 allowing either party to petition the superior court to terminate this Lease as a result of a partial taking.

26. CASUALTY DAMAGE.

26.1 General. If the Premises or Building should be damaged or destroyed by fire, flood, earthquake, tornado, or other casualty (collectively, "**Casualty**"), Tenant shall give immediate written notice thereof to Landlord. Within thirty (30) days after Landlord's receipt of such notice, Landlord shall notify Tenant whether in Landlord's estimation material restoration of the Premises can reasonably be made within one hundred eighty (180) days from the date of such notice and receipt of required permits for such restoration. Landlord's determination shall be binding on Tenant.

26.2 Within 180 Days. If the Premises or Building should be damaged by Casualty to such extent that material restoration can in Landlord's estimation be reasonably completed within one hundred eighty (180) days after the date of such notice and receipt of required permits for such restoration, this Lease shall not terminate. Provided that insurance proceeds are received by Landlord to fully repair the damage, Landlord shall proceed to rebuild and repair the Premises diligently and in the manner determined by Landlord, except that Landlord shall not be required to rebuild, repair or replace any part of any Alterations which may have been placed on or about the Premises or paid for by Tenant. [If the Premises are untenantable in whole or in part following such damage, the Rent payable hereunder during the period in which they are untenantable shall be abated proportionately, but only to the extent of rental abatement insurance proceeds received by Landlord during the time and to the extent the Premises are unfit for occupancy.]

26.3 Greater than 180 Days. If the Premises or Building should be damaged by Casualty to such extent that rebuilding or repairs cannot in Landlord's estimation be reasonably completed within one hundred eighty (180) days after the date of such notice and receipt of required permits for such rebuilding or repair, then Landlord shall have the option of either: (1) terminating this Lease effective upon the date of the occurrence of such damage, in which event the Rent shall be abated during the unexpired portion of this Lease; or (2) electing to rebuild or repair the Premises diligently and in the manner determined by Landlord. Landlord shall notify Tenant of its election within thirty (30) days after Landlord's receipt of notice of the damage or destruction. Notwithstanding the above, Landlord shall not be required to rebuild, repair or replace any part of any Alterations which may have been placed, on or about the Premises or paid for by Tenant. [If the Premises are untenantable in whole or in part following such damage, the Rent payable hereunder during the period in which they are untenantable shall be abated proportionately, but only to the extent of rental abatement insurance proceeds received by Landlord during the time and to the extent the Premises are unfit for occupancy.]

26.4 Tenant's Fault. Notwithstanding anything herein to the contrary, if the Premises or any other portion of the Building are damaged by Casualty resulting from the fault, negligence, or breach of this Lease by Tenant or any of Tenant's Parties, Base Rent and Additional Rent shall not be diminished during the repair of such damage and Tenant shall be liable to Landlord for the cost and expense of the repair and restoration of the Building caused thereby to the extent such cost and expense is not covered by insurance proceeds.

26.5 Insurance Proceeds. Notwithstanding anything herein to the contrary, if the Premises or Building are damaged or destroyed and are not fully covered by the insurance proceeds received by Landlord or if the holder of any indebtedness secured by a mortgage or deed of trust covering the Premises requires that the insurance proceeds be applied to such indebtedness, then in either case Landlord shall have the right to terminate this Lease by delivering written notice of termination to Tenant within thirty (30) days after the date of notice to Landlord that said damage or destruction is not fully covered by insurance or such requirement is made by any such holder, as the case may be, whereupon this Lease shall terminate.

26.6 Waiver. This Section 26 shall be Tenant's sole and exclusive remedy in the event of damage or destruction to the Premises or the Building. As a material inducement to Landlord entering into this Lease, Tenant hereby waives any rights it may have under Sections 1932, 1933(4), 1941 or 1942 of the Civil Code of California with respect to any destruction of the Premises, Landlord's obligation for tenantability of the Premises and Tenant's right to make repairs and deduct the expenses of such repairs, or under any similar law, statute or ordinance now or hereafter in effect.

26.7 Tenant's Personal Property. In the event of any damage or destruction of the Premises or the Building, under no circumstances shall Landlord be required to repair any injury or damage to, or make any repairs to or replacements of, Tenant's personal property.

26.8 Closure of Wharf. If the Wharf shall be damaged such that it is reasonably necessary, in Landlord's judgment, to close the Pier for safety, reconstruction or other purposes, Landlord may close the same for such time as it reasonably determines.

27. HOLDING OVER. Unless Landlord expressly consents in writing to Tenant's holding over, Tenant shall be unlawfully and illegally in possession of the Premises, whether or not Landlord accepts any rent from Tenant or any other person while Tenant remains in possession of the Premises without Landlord's written consent. If Tenant shall retain possession of the Premises or any portion thereof without Landlord's consent following the expiration of this Lease or sooner termination for any reason, then Tenant shall pay to Landlord for each day of such retention 150% of the amount of daily rental as of the last month prior to the date of expiration or earlier termination. Tenant shall also indemnify, defend, protect and hold Landlord harmless from any loss, liability or cost, including consequential and incidental damages and reasonable attorneys' fees, incurred by Landlord resulting from delay by Tenant in surrendering the Premises, including, without limitation, any claims made by the succeeding tenant founded on such delay. Acceptance of Rent by Landlord following

expiration or earlier termination of this Lease, or following demand by Landlord for possession of the Premises, shall not constitute a renewal of this Lease, and nothing contained in this Section 27 shall waive Landlord's right of reentry or any other right. Additionally, if upon expiration or earlier termination of this Lease, or following demand by Landlord for possession of the Premises, Tenant has not fulfilled its obligation with respect to repairs and cleanup of the Premises or any other Tenant obligations as set forth in this Lease, then Landlord shall have the right to perform any such obligations as it deems necessary at Tenant's sole cost and expense, and any time required by Landlord to complete such obligations shall be considered a period of holding over and the terms of this Section 27 shall apply. The provisions of this Section 27 shall survive any expiration or earlier termination of this Lease.

28. DEFAULT.

28.1 Events of Default. The occurrence of any of the following shall constitute an event of default on the part of Tenant:

A. Abandonment. Abandonment or vacation of the Premises for a continuous period in excess of five (5) days. Tenant waives any right to notice Tenant may have under Section 1951.3 of the Civil Code of the State of California, the terms of this Section 28.1 being deemed such notice to Tenant as required by said Section 1951.3.

B. Nonpayment of Rent. Failure to pay any installment of Rent or any other amount due and payable hereunder upon the date when said payment is due, as to which time is of the essence.

C. Other Obligations. Failure to perform any obligation, agreement or covenant under this Lease other than those matters specified in subsections A and B of this Section 28.1, and in Sections 8, 17, 19, and 27, such failure continuing for fifteen (15) days after written notice of such failure, as to which time is of the essence.

D. General Assignment. A general assignment by Tenant for the benefit of creditors.

E. Bankruptcy. The filing of any voluntary petition in bankruptcy by Tenant, or the filing of an involuntary petition by Tenant's creditors, which involuntary petition remains undischarged for a period of thirty (30) days. If under applicable law, the trustee in bankruptcy or Tenant has the right to affirm this Lease and continue to perform the obligations of Tenant hereunder, such trustee or Tenant shall, in such time period as may be permitted by the bankruptcy court having jurisdiction, cure all defaults of Tenant hereunder outstanding as of the date of the affirmance of this Lease and provide to Landlord such adequate assurances as may be necessary to ensure Landlord of the continued performance of Tenant's obligations under this Lease.

F. Receivership. The employment of a receiver to take possession of substantially all of Tenant's assets or Tenant's leasehold of the Premises, if such appointment remains undismissed or undischarged for a period of fifteen (15) days after the order therefor.

G. Attachment. The attachment, execution or other judicial seizure of all or substantially all of Tenant's assets or Tenant's leasehold of the Premises, if such attachment or other seizure remains undismissed or undischarged for a period of fifteen (15) days after the levy thereof.

H. Insolvency. The admission by Tenant in writing of its inability to pay its debts as they become due.

28.2 Remedies Upon Default.

A. Termination. In the event of the occurrence of any event of default, Landlord shall have the right to give a written termination notice to Tenant, and on the date specified in such notice, Tenant's right to possession shall terminate, and this Lease shall terminate unless on or before such date all Rent in arrears and all costs and expenses incurred by or on behalf of Landlord hereunder shall have been paid by Tenant and all other events of default of this Lease by Tenant at the time existing shall have been fully remedied to the satisfaction of Landlord. At any time after such termination, Landlord may recover possession of the Premises or any part thereof and expel and remove therefrom Tenant and any other person occupying the same, including any subtenant or subtenants notwithstanding Landlord's consent to any sublease, by any lawful means, and again repossess and enjoy the Premises without prejudice to any of the remedies that Landlord may have under this Lease, or at law or equity by any reason of Tenant's default or of such termination. Landlord hereby reserves the right, but shall not have the obligation, to recognize the continued possession of any subtenant. The delivery or surrender

to Landlord by or on behalf of Tenant of keys, entry codes, or other means to bypass security at the Premises shall not terminate this Lease.

B. Continuation After Default. Even though an event of default may have occurred, this Lease shall continue in effect for so long as Landlord does not terminate Tenant's right to possession under Section 28.2B hereof. Landlord shall have the remedy described in California Civil Code Section 1951.4 ("Landlord may continue this Lease in effect after Tenant's breach and abandonment and recover Rent as it becomes due, if Tenant has the right to sublet or assign, subject only to reasonable limitations"), or any successor code section. Accordingly, if Landlord does not elect to terminate this Lease on account of any event of default by Tenant, Landlord may enforce all of Landlord's rights and remedies under this Lease, including the right to recover Rent as it becomes due. Acts of maintenance, preservation or efforts to lease the Premises or the appointment of a receiver under application of Landlord to protect Landlord's interest under this Lease or other entry by Landlord upon the Premises shall not constitute an election to terminate Tenant's right to possession.

C. Increased Security Deposit. If Tenant is in default under Section 28.1B hereof and such default remains uncured for ten (10) days after such occurrence or such default occurs more than two (2) times in any twelve (12)-month period, Landlord may require that Tenant increase the Security Deposit to the amount of three times the current month's Rent at the time of the most recent default.

D. Mitigation of Damages. Both Landlord and Tenant shall each use commercially reasonable efforts to mitigate any damages resulting from a default of the other party under this Lease.

(1) Landlord's obligation to mitigate damages after a default by Tenant under this Lease that results in Landlord regaining possession of all or part of the Premises shall be satisfied in full if Landlord undertakes to lease the Premises to another tenant (a "**Substitute Tenant**") in accordance with the following criteria:

(a) Landlord shall have no obligation to solicit or entertain negotiations with any other prospective tenants for the Premises until Landlord obtains full and complete possession of the Premises including, without limitation, the final and unappealable legal right to re-let the Premises free of any claim of Tenant.

(b) Landlord shall not be obligated to offer the Premises to any prospective tenant when other premises in the Project suitable for that prospective tenant's use are currently available, or will be available within the next six (6) months.

(c) Landlord shall not be obligated to lease the Premises to a Substitute Tenant for a rental less than the current fair market rental then prevailing for similar retail space in the same market area as the Project.

(d) Landlord shall not be obligated to enter into a new lease under terms and conditions that are unacceptable to Landlord under Landlord's then current leasing policies for comparable space in the Project, provided such policies are commercially reasonable and have been regularly enforced by Landlord prior to the date of Tenant's default of this Lease.

(e) Landlord shall not be obligated to enter into a lease with any proposed Substitute Tenant that does not have, in Landlord's reasonable opinion, sufficient financial resources or operating experience to operate the Premises in a first-class manner, as evidenced by Landlord's willingness to accept other tenants at the Project and in other of Landlord's properties during the Term of this Lease.

(f) Landlord shall not be required to expend any amount of money to alter, remodel, or otherwise make the Premises suitable for a Substitute Tenant.

(g) Landlord shall not be obligated to enter into a lease with any Substitute Tenant whose use would:

(2) Materially interfere with the tenant mix or balance of the Project;

(3) Violate any restriction, covenant, or requirement contained in the lease of another tenant of the Project;

(4) Adversely affect the reputation of the Project; or

(5) Be incompatible with the operation of the Project as a first-class Project.

(6) Upon compliance with the criteria regarding the re-letting of the Premises after a default by Tenant, Landlord shall be deemed to have fully satisfied Landlord's obligation to mitigate damages under this Lease and under any law or judicial ruling in effect on the date of this Lease or at the time of Tenant's default; and Tenant waives and releases, to the fullest extent legally permissible, any right to assert in any action by Landlord to enforce the terms of this Lease, any defense, counterclaim, or rights of setoff or recoupment respecting the mitigation of damages by Landlord, unless and to the extent Landlord maliciously or in bad faith fails to act in accordance with the requirements of this clause.

(7) Tenant's right to seek damages from Landlord as a result of a default by Landlord under this Lease shall be conditioned on Tenant taking all actions reasonably required, under the circumstances, to minimize any loss or damage to Tenant's property or business, or to any of Tenant's officers, employees, agents, invitees, or other third parties that may be caused by any such default of Landlord.

28.3 Damages After Default. Should Landlord terminate this Lease pursuant to the provisions of Section 28.2A hereof, Landlord shall have the rights and remedies of a Landlord provided by Section 1951.2 of the Civil Code of the State of California, or any successor code sections. Upon such termination, in addition to any other rights and remedies to which Landlord may be entitled under applicable law or at equity, Landlord shall be entitled to recover from Tenant: (1) the worth at the time of award of the unpaid Rent and other amounts which had been earned at the time of termination, (2) the worth at the time of award of the amount by which the unpaid Rent and other amounts that would have been earned after the date of termination until the time of award exceeds the amount of such Rent loss that Tenant proves could have been reasonably avoided; (3) the worth at the time of award of the amount by which the unpaid Rent and other amounts for the balance of the Term after the time of award exceeds the amount of such Rent loss that the Tenant proves could be reasonably avoided; and (4) any other amount and court costs necessary to compensate Landlord for all detriment proximately caused by Tenant's failure to perform Tenant's obligations under this Lease or which, in the ordinary course of things, would be likely to result therefrom. The "worth at the time of award" as used in (1) and (2) above shall be computed at the Applicable Interest Rate (defined below). The "worth at the time of award" as used in (3) above shall be computed by discounting such amount at the Federal Discount Rate of the Federal Reserve Bank of San Francisco at the time of award plus one percent (1%). If this Lease provides for any periods during the Term during which Tenant is not required to pay Base Rent or if Tenant otherwise receives a Rent concession, then upon the occurrence of an event of default, Tenant shall owe to Landlord the full amount of such Base Rent or value of such Rent concession, plus interest at the Applicable Interest Rate, calculated from the date that such Base Rent or Rent concession would have been payable.

28.4 Late Charge. In addition to its other remedies, Landlord shall have the right without notice or demand to add to the amount of any payment required to be made by Tenant hereunder, and which is not paid and received by Landlord within five (5) days of the due date, an amount equal to an amount equal to five percent (5%) of the delinquent amount, or $100.00, whichever is greater, for each month or portion thereof that the delinquency remains outstanding to compensate Landlord for the loss of the use of the amount not paid and the administrative costs caused by the delinquency, the parties agreeing that Landlord's damage by virtue of such delinquencies would be extremely difficult and impracticable to compute and the amount stated herein represents a reasonable estimate thereof. Any waiver by Landlord of any late charges or failure to claim the same shall not constitute a waiver of other late charges or any other remedies available to Landlord.

28.5 Interest. Interest shall accrue on all sums not paid when due hereunder at the lesser of eighteen percent (18%) per annum or the maximum interest rate allowed by law ("**Applicable Interest Rate**") from the due date until paid.

28.6 Remedies Cumulative. All of Landlord's rights, privileges and elections or remedies are cumulative and not alternative, to the extent permitted by law and except as otherwise provided herein.

28.7 Replacement of Statutory Notice Requirements. When this Lease requires service of a notice, that notice shall replace rather than supplement any equivalent or similar statutory notice, including any notice required by California Code of Civil Procedure Section 1161 or any similar or successor statute. When a statute requires service of a notice in a particular manner, service of that notice (or a similar notice required by this Lease) in the manner required by this Section 28 shall replace and satisfy the statutory service-of-notice procedures, including those required by California Code of Civil Procedure Section 1162 or any similar or successor statute.

29. LIENS. Tenant shall at all times keep the Premises, the Building and the Project free from liens arising out of or related to work or services performed, materials or supplies furnished or obligations incurred by or on behalf of Tenant or in connection with work made, suffered or done by or on behalf of Tenant in or on the Premises, the Building or Project. If Tenant shall not, within ten (10) days following the imposition of any such lien, cause the same to be released of record by payment or posting of a proper bond, Landlord shall have, in addition to all other remedies provided herein and by law, the right, but not the obligation, to cause the same to be released by such means as Landlord shall deem proper, including payment of the claim giving rise to such lien. All sums paid by Landlord on behalf of Tenant and all expenses incurred by Landlord in connection therefor shall be payable to Landlord by Tenant on demand with interest at the Applicable Interest Rate as Additional Rent. Landlord shall have the right at all times to post and keep posted on the Premises any notices permitted or required by law, or which Landlord shall deem proper, for the protection of Landlord, the Premises, the Project and any other party having an interest therein, from mechanics' and materialmen's liens, and Tenant shall give Landlord not less than ten (10) business days' prior written notice of the commencement of any work in the Premises or Project which could lawfully give rise to a claim for mechanics' or materialmen's liens to permit Landlord to post and record a timely notice of non-responsibility, as Landlord may elect to proceed or as the law may from time to time provide, for which purpose, if Landlord shall so determine, Landlord may enter the Premises. Tenant shall not remove any such notice posted by Landlord without Landlord's consent, and in any event not before completion of the work which could lawfully give rise to a claim for mechanics' or materialmen's liens.

30. SUBSTITUTION. At any time after execution of this Lease, Landlord may substitute for the Premises other premises in the Project (the "**New Premises**") upon not less than sixty (60) days' prior written notice, in which event the New Premises shall be deemed to be the Premises for all purposes hereunder and this Lease shall be deemed modified accordingly to reflect the new location and shall remain in full force and effect as so modified, provided that:

30.1 The New Premises shall be similar in area and in function for Tenant's purposes; and

30.2 If Tenant is occupying the Premises at the time of such substitution, Landlord shall pay the expense of physically moving Tenant, Tenant's property and equipment to the New Premises and shall, at Landlord's sole cost, improve the New Premises with improvements substantially similar to those the Landlord has committed to provide or has provided in the Premises.

31. TRANSFERS BY LANDLORD. In the event of a sale or conveyance by Landlord of the Building or a foreclosure by any creditor of Landlord, the same shall operate to release Landlord from any liability upon any of the covenants or conditions, express or implied, herein contained in favor of Tenant, to the extent required to be performed after the passing of title to Landlord's successor-in-interest. In such event, Tenant agrees to look solely to the responsibility of the successor-in-interest of Landlord under this Lease with respect to the performance of the covenants and duties of "Landlord" to be performed after the passing of title to Landlord's successor-in-interest. This Lease shall not be affected by any such sale and Tenant agrees to attorn to the purchaser or assignee. Landlord's successor(s)-in-interest shall not have liability to Tenant with respect to the failure to perform any of the obligations of "Landlord," to the extent required to be performed prior to the date such successor(s)-in-interest became the owner of the Building.

32. RIGHT OF LANDLORD TO PERFORM TENANT'S COVENANTS. All covenants and agreements to be performed by Tenant under any of the terms of this Lease shall be performed by Tenant at Tenant's sole cost and expense and without any abatement of Rent. If Tenant shall fail to pay any sum of money, other than Base Rent, required to be paid by Tenant hereunder or shall fail to perform any other act on Tenant's part to be performed hereunder, including Tenant's obligations under Section 11 hereof, and such failure shall continue for fifteen (15) days after notice thereof by Landlord, in addition to the other rights and remedies of Landlord, Landlord may make any such payment and perform any such act on Tenant's part. In the case of an emergency, no prior notification by Landlord shall be required. Landlord may take such actions without any obligation and without releasing Tenant from any of Tenant's obligations. All sums so paid by Landlord and all incidental costs incurred by Landlord and interest thereon at the Applicable Interest Rate, from the date of payment by Landlord, shall be paid to Landlord on demand as Additional Rent.

33. WAIVER. If either Landlord or Tenant waives the performance of any term, covenant or condition contained in this Lease, such waiver shall not be deemed to be a waiver of any subsequent breach of the same or any other term, covenant or condition contained herein, or constitute a course of dealing contrary to the expressed terms of this Lease. The acceptance of Rent by Landlord (including, without limitation, through any "lockbox") shall not constitute a waiver of any preceding breach by Tenant of any term, covenant or condition of this Lease, regardless of Landlord's knowledge of such preceding breach at the time Landlord accepted such Rent. Failure by Landlord to enforce any of the terms, covenants or conditions of this Lease for any length of time shall not be deemed to waive or decrease the right of Landlord to insist

thereafter upon strict performance by Tenant. Waiver by Landlord of any term, covenant or condition contained in this Lease may only be made by a written document signed by Landlord, based upon full knowledge of the circumstances.

34. NOTICES. Each provision of this Lease or of any applicable governmental laws, ordinances, regulations and other requirements with reference to sending, mailing, or delivery of any notice or the making of any payment by Landlord or Tenant to the other shall be deemed to be complied with when and if the following steps are taken:

34.1 Rent. All Rent and other payments required to be made by Tenant to Landlord hereunder shall be payable to Landlord at Landlord's Payment Address set forth in the Basic Lease Information, or at such other address as Landlord may specify from time to time by written notice delivered in accordance herewith. Tenant's obligation to pay Rent and any other amounts to Landlord under the terms of this Lease shall not be deemed satisfied until such Rent and other amounts have been actually received by Landlord.

34.2 Other. All notices, demands, consents and approvals which may or are required to be given by either party to the other hereunder shall be in writing and either personally delivered, sent by commercial overnight courier, mailed, certified or registered, postage prepaid or sent by facsimile or electronic mail with confirmed receipt (and with an original sent by commercial overnight courier or U.S. mail), and in each case addressed to the party to be notified at the Notice Address for such party as specified in the Basic Lease Information or to such other place as the party to be notified may from time to time designate by at least fifteen (15) days' notice to the notifying party. Notices shall be deemed served upon receipt or refusal to accept delivery. Tenant appoints as its agent to receive the service of all default notices and notice of commencement of unlawful detainer proceedings the person in charge of or apparently in charge of occupying the Premises at the time, and, if there is no such person, then such service may be made by attaching the same on the main entrance of the Premises.

34.3 Required Notices. Tenant shall immediately notify Landlord in writing of any notice of a violation or a potential or alleged violation of any Regulation that relates to the Premises or the Project, or of any inquiry, investigation, enforcement or other action that is instituted or threatened by any governmental or regulatory agency against Tenant or any other occupant of the Premises, or any claim that is instituted or threatened by any third party that relates to the Premises or the Project.

34.4 Tenant's Lenders and Equipment. In the event that Tenant seeks to obtain a loan from a lender ("**Lender**") and to secure said loan by Tenant's leasehold interest, furniture, fixtures or equipment ("**FFE**"), copies of all notices given in connection with said loan shall require that the Lender provide the Landlord with all notices given in connection with said loan. Provided that the Landlord receives a written request from the Tenant pursuant to this Section 34.4, the City agrees to provide such Lender with copies of all notices given hereunder to Tenant when and in the same manner given to Tenant at such address as Lender furnishes to Landlord. Without waiving any of the obligations of the Tenant pursuant to this Lease, Landlord agrees to accept payment of Rent from Lender by and on behalf of Tenant.

35. ATTORNEYS' FEES. If Landlord places the enforcement of this Lease, or any part thereof, or the collection of any Rent due, or to become due hereunder, or recovery of possession of the Premises in the hands of an attorney, Tenant shall pay to Landlord, upon demand, Landlord's reasonable attorneys' fees and court costs, whether incurred without trial, at trial, appeal or review. In any action which Landlord or Tenant brings to enforce its respective rights hereunder, the unsuccessful party shall pay all costs incurred by the prevailing party including reasonable attorneys' fees, to be fixed by the court, and said costs and attorneys' fees shall be a part of the judgment in said action.

36. SUCCESSORS AND ASSIGNS. This Lease shall be binding upon and inure to the benefit of Landlord, its successors and assigns, and shall be binding upon and inure to the benefit of Tenant, its successors, and to the extent assignment is approved by Landlord as provided hereunder, Tenant's assigns.

37. FORCE MAJEURE. If performance by a party of any portion of this Lease is made impossible by any prevention, delay, or stoppage caused by strikes, lockouts, labor disputes, acts of God, inability to obtain services, labor, or materials or reasonable substitutes for those items, government actions, civil commotions, fire or other casualty, or other causes beyond the reasonable control of the party obligated to perform, performance by that party for a period equal to the period of that prevention, delay, or stoppage is excused. Tenant's obligation to pay Rent, however, is not excused by this Section 37. Either party shall have the right to terminate this Lease in the event of Force Majeure for a consecutive twelve (12)-month period.

38. SURRENDER OF PREMISES. Tenant shall, upon expiration or sooner termination of this Lease, surrender the Premises to Landlord in the same condition as existed on the date Tenant originally took possession thereof,

including, but not limited to, all interior walls cleaned, all interior painted surfaces repainted in the original color, all holes in walls repaired, all carpets shampooed and cleaned, and all floors cleaned, waxed, and free of any Tenant-introduced marking or painting, all to the reasonable satisfaction of Landlord. Tenant shall remove all of its debris from the Project. At or before the time of surrender, Tenant shall comply with the terms of Section 12.1 hereof with respect to Alterations to the Premises and all other matters addressed in such Section. If the Premises are not so surrendered at the expiration or sooner termination of this Lease, the provisions of Section 25 hereof shall apply. All keys to the Premises or any part thereof shall be surrendered to Landlord upon expiration or sooner termination of the Term. Tenant shall give written notice to Landlord at least thirty (30) days prior to vacating the Premises and shall meet with Landlord for a joint inspection of the Premises at the time of vacating, but nothing contained herein shall be construed as an extension of the Term or as a consent by Landlord to any holding over by Tenant. In the event of Tenant's failure to give such notice or participate in such joint inspection, Landlord's inspection at or after Tenant's vacating the Premises shall conclusively be deemed correct for purposes of determining Tenant's responsibility for repairs and restoration. Any delay caused by Tenant's failure to carry out its obligations under this Section 38 beyond the term hereof, shall constitute unlawful and illegal possession of Premises under Section 27 hereof.

39. PARKING. Landlord and Tenant acknowledge that City of Monterey operates a public parking lot adjacent to the Project. Tenant's and Tenant's Parties' Rights to use the parking area are the same rights as those of any member of the public, no more and no less.

City of Monterey and Landlord shall have no liability for any damage to property or other items located in the parking areas of the Project, nor for any personal injuries or death arising out of the use of parking areas adjacent to the Project by Tenant or any Tenant's Parties. Without limiting the foregoing, if City of Monterey arranges for the parking areas to be operated by an independent contractor not affiliated with City of Monterey, Tenant acknowledges that neither Landlord (nor City of Monterey, if different from Landlord) shall have any liability for claims arising through acts or omissions of such independent contractor. In all events, Tenant agrees to look first to its insurance carrier and to require that Tenant's Parties look first to their respective insurance carriers for payment of any losses sustained in connection with any use of the parking areas.

40. CONTINUOUS OPERATION.

40.1 Tenant Operations/Recapture. Tenant shall open for business to the public for at least one (1) day with the Premises fully fixturized and stocked with merchandise and inventory on or before the Commencement Date. Except with specific, prior approval of Landlord, Tenant shall not display or sell any merchandise or allow vending machines to be stored or remain on the sidewalk or elsewhere outside of the defined exterior of the Premises.

If subsequent to commencing the operation of Tenant's business from within the Premises, Tenant ceases the operation of its business from within the Premises for its Permitted Use for more than thirty (30) consecutive days except in the case of temporary closures due to an event of casualty, condemnation, remodels or in force majeure events such as strikes, lockouts, labor disputes, inability to procure materials, power failure, or events of a similar nature, Landlord shall have the right to recapture possession of the Premises and terminate this Lease by providing Tenant with written notice of Landlord's election to do so (hereinafter referred to as the "**Recapture Notice**"). This Lease shall terminate on the date set forth in the Recapture Notice, which date shall in any event be within 30 days of the date of the Recapture Notice (the "**Recapture Date**"), provided, however, nothing in this Section 40 shall release Tenant from its obligation to pay Landlord all payments of Rent due under the terms of this Lease prior to such Recapture Date. If the Recapture Date occurs within the first five (5) years of the Term, Tenant shall reimburse to Landlord the unamortized amount of leasing commissions incurred by Landlord under this Lease, amortized over the initial term of this Lease. Subject to the foregoing, upon the Recapture Date: (i) all obligations of both parties shall terminate, and (ii) the Lease shall have no further force or effect.

40.2 Hours of Business. From and after the Commencement Date, Tenant will keep the entire Premises continuously open for business during those days and hours as are customary and usual for the type of business operated by Tenant. In any event, minimum hours every year shall be as follows:

<u>From May 15 to and including October 15</u>:

Restaurants	11:00 a.m. to 9:00 p.m.
Retail Stores	11:00 a.m. to 8:00 p.m.
Retail Fish Markets	10:00 a.m. to 6:00 p.m.

Charter Boats	6:00 a.m. to 12:00 p.m.

From October 16 to and including May 14:

Restaurants	11:00 a.m. to 9:00 p.m.
Retail Stores	11:00 a.m. to 7:00 p.m.
Retail Fish Markets	10:00 a.m. to 6:00 p.m.
Charter Boats	6:00 a.m. to 12:00 p.m., except during inclement weather

Tenant will have its window displays, exterior signs, and exterior advertising displays adequately illuminated continuously during those hours and days that the Premises are required to be open for business to the public.

40.3 Radius Restriction. During the Term, neither Tenant nor any entity affiliated with Tenant will own, operate, or have any financial interest in any business similar to the business of Tenant, or operating under the same or a similar trade name as set forth in Basic Lease Information, if such other business is opened after the Effective Date and its front door or storefront opening is located within the Radius Restriction set forth in Basic Lease Information. Without limiting Landlord's remedies, if Tenant violates this covenant, then Landlord, for so long as Tenant is operating the other business, may (a) include the gross sales (as the term Gross Sales is defined in this Lease) of the other business in the Gross Sales made from the Premises for the purpose of computing Percentage Rent; (b) terminate this Lease on written notice to Tenant; or (c) increase the Base Rent in effect during the period of the violation of this covenant by twenty-five percent (25%). Landlord or its authorized representative, at all reasonable times during the Term and for a period of at least three (3) years after expiration or earlier termination of this Lease, has the right to inspect, audit, copy, and make extracts of the books, records, and accounts pertaining to such other business, in the manner set forth in Section 6.2C, for the purpose of determining and verifying the additional Percentage Rent due to Landlord under this Section 40.

41. MISCELLANEOUS.

41.1 General. The term "Tenant" or any pronoun used in place thereof shall indicate and include the masculine or feminine, the singular or plural number, individuals, firms or corporations, and their respective successors, executors, administrators and permitted assigns, according to the context hereof.

41.2 Time. Time is of the essence regarding this Lease and all of its provisions.

41.3 Choice of Law. This Lease shall in all respects be governed by the laws of the State of California.

41.4 Entire Agreement. This Lease, together with its Exhibits, addenda and attachments and the Basic Lease Information, contains all the agreements of the parties hereto and supersedes any previous negotiations. There have been no representations made by the Landlord or understandings made between the parties other than those set forth in this Lease and its Exhibits, addenda and attachments and the Basic Lease Information.

41.5 Modification. This Lease may not be modified except by a written instrument signed by the parties hereto. Tenant accepts the area of the Premises as specified in the Basic Lease Information as the approximate area of the Premises for all purposes under this Lease, and acknowledges and agrees that no other definition of the area (rentable, usable or otherwise) of the Premises shall apply. Tenant shall in no event be entitled to a recalculation of the square footage of the Premises, rentable, usable or otherwise, and no recalculation, if made, irrespective of its purpose, shall reduce Tenant's obligations under this Lease in any manner, including without limitation the amount of Base Rent payable by Tenant or Tenant's Proportionate Share of the Building and of the Project.

41.6 Severability. If, for any reason whatsoever, any of the provisions hereof shall be unenforceable or ineffective, all of the other provisions shall be and remain in full force and effect.

41.7 Recordation. Tenant shall not record this Lease or a short form memorandum hereof without Landlord's prior written approval.

41.8 Examination of Lease. Submission of this Lease to Tenant does not constitute an option or offer to lease and this Lease is not effective otherwise until execution and delivery by both Landlord and Tenant.

41.9 Accord and Satisfaction. No payment by Tenant of a lesser amount than the total Rent due nor any endorsement on any check or letter accompanying any check or payment of Rent shall be deemed an accord and satisfaction of full payment of Rent, and Landlord may accept such payment without prejudice to Landlord's right to recover the balance of such Rent or to pursue other remedies. All offers by or on behalf of Tenant of accord and satisfaction are hereby rejected in advance.

41.10 Easements. Landlord may grant easements on the Project and dedicate for public use portions of the Project without Tenant's consent; provided that no such grant or dedication shall materially interfere with Tenant's Permitted Use of the Premises. Upon Landlord's request, Tenant shall execute, acknowledge and deliver to Landlord documents, instruments, maps and plats necessary to effectuate Tenant's covenants hereunder.

41.11 Drafting and Determination Presumption. The parties acknowledge that this Lease has been agreed to by both the parties, that both Landlord and Tenant have consulted with attorneys with respect to the terms of this Lease and that no presumption shall be created against Landlord because Landlord drafted this Lease. Except as otherwise specifically set forth in this Lease, with respect to any consent, determination or estimation of Landlord required or allowed in this Lease or requested of Landlord, Landlord's consent, determination or estimation shall be given or made solely by Landlord in Landlord's good faith opinion, whether or not objectively reasonable. If Landlord fails to respond to any request for its consent within the time period, if any, specified in this Lease, Landlord shall be deemed to have disapproved such request.

41.12 Exhibits. The Basic Lease Information, and the Exhibits, addenda and attachments attached hereto are hereby incorporated herein by this reference and made a part of this Lease as though fully set forth herein.

41.13 No Light, Air or View Easement. Any diminution or shutting off of light, air or view by any structure which may be erected on lands adjacent to or in the vicinity of the Building shall in no way affect this Lease or impose any liability on Landlord.

41.14 No Third Party Benefit. This Lease is a contract between Landlord and Tenant and nothing herein is intended to create any third party benefit.

41.15 Quiet Enjoyment. Upon payment by Tenant of the Rent, and upon the observance and performance of all of the other covenants, terms and conditions on Tenant's part to be observed and performed, Tenant shall peaceably and quietly hold and enjoy the Premises for the term hereby demised without hindrance or interruption by Landlord or any other person or persons lawfully or equitably claiming by, through or under Landlord, subject, nevertheless, to all of the other terms and conditions of this Lease. Landlord shall not be liable for any hindrance, interruption, interference or disturbance by other tenants or third persons, nor shall Tenant be released from any obligations under this Lease because of such hindrance, interruption, interference or disturbance.

41.16 Counterparts. This Lease may be executed in any number of counterparts, each of which shall be deemed an original.

41.17 Multiple Parties. If more than one person or entity is named herein as Tenant, such multiple parties shall have joint and several responsibility to comply with the terms of this Lease.

41.18 Prorations. Any Rent or other amounts payable to Landlord by Tenant hereunder for any fractional month shall be prorated based on a month of 30 days. As used herein, the term "fiscal year" shall mean the calendar year or such other fiscal year as Landlord may deem appropriate.

42. ADDITIONAL PROVISIONS.

42.1 Inspection by Certified Access Specialist. Landlord discloses that the Premises have undergone inspection by a Certified Access Specialist and such report has been provided to Tenant prior to Lease execution for its inspection. The CASp report indicates non-compliance. The parties agree that Tenant shall be responsible and required to bring the Premises into compliance. California Civil Code Section 1938 subsection (e) provides: "A Certified Access Specialist (CASp) can inspect the subject premises and determine whether the subject premises comply with all of the

applicable construction-related accessibility standards under state law. Although state law does not require a CASp inspection of the subject premises, the commercial property owner or lessor may not prohibit the lessee or tenant from obtaining a CASp inspection of the subject premises for the occupancy or potential occupancy of the lessee or tenant, if requested by lessee or tenant. The parties shall mutually agree on the arrangements for the time and manner of the CASp inspection, the payment of the fee for the CASp inspection, and the cost of making and repairs necessary to correct violations of construction-related accessibility standards within the premises." Pursuant to Civil Code Section 1938(b), Tenant acknowledges and agrees that the CASp report provided by Landlord shall remain confidential and shall not be shared with other parties other than Tenant, its attorneys or contractors engaged to complete any CASp repairs. If Tenant wishes to have the Premises inspected by a CASp in addition to the initial report provided by Landlord: (i) Tenant must notify Landlord on or before the date when Tenant executes this Lease pursuant to the election below; (ii) the inspection will be at Tenant's sole cost and expense; (iii) the inspection must be scheduled through Landlord and in coordination with the Building's property manager; (iv) any repairs or modifications necessary to correct any violation of construction-related accessibility standards that is noted in the CASp report shall be Tenant's responsibility; and (v) Tenant must provide a copy of the CASp report to Landlord on completion. By initializing below, Tenant represents that:

Tenant acknowledges that it received the CASp inspection for the Premises at least 48 hours prior to Lease execution. Initials: _____

42.2 Guarantor. If there are any guarantors of this Lease, said guarantors shall have the same obligations as Tenant under this Lease, and shall execute a guaranty in the form attached hereto as **Exhibit G**.

42.3 Guard Service. Tenant hereby acknowledges that Landlord shall have no obligation whatsoever to provide guard service or other security measures for the benefit of the Premises, the Building or the Project. Tenant assumes all responsibility for the protection of Tenant, its agents, employees, contractors, customers and invitees and the property of Tenant and of Tenant's agents, employees, contractors, customers and invitees, from acts of third parties. Nothing herein contained shall prevent Landlord, in Landlord's reasonable judgment, from providing security protection for the Project or any part of it, in which event the cost thereof shall be a Common Area Cost subject to reimbursement as set forth in Article 7.

43. GOVERNING LAW; WAIVER OF TRIAL BY JURY. THIS LEASE SHALL BE CONSTRUED AND ENFORCED IN ACCORDANCE WITH THE LAWS OF THE STATE OF CALIFORNIA. IN ANY ACTION OR PROCEEDING ARISING HEREFROM, LANDLORD AND TENANT HEREBY CONSENT TO (I) THE JURISDICTION OF ANY COMPETENT COURT WITHIN THE STATE OF CALIFORNIA, (II) SERVICE OF PROCESS BY ANY MEANS AUTHORIZED BY CALIFORNIA LAW, AND (III) IN THE INTEREST OF SAVING TIME AND EXPENSE, TRIAL WITHOUT A JURY IN ANY ACTION, PROCEEDING OR COUNTERCLAIM BROUGHT BY EITHER OF THE PARTIES HERETO AGAINST THE OTHER OR THEIR SUCCESSORS IN RESPECT OF ANY MATTER ARISING OUT OF OR IN CONNECTION WITH THIS LEASE, THE RELATIONSHIP OF LANDLORD AND TENANT, TENANT'S USE OR OCCUPANCY OF THE PREMISES, AND/OR ANY CLAIM FOR INJURY OR DAMAGE, OR ANY EMERGENCY OR STATUTORY REMEDY.

44. ARBITRATION OF DISPUTES. IN THE EVENT THAT THE JURY WAIVER PROVISIONS OF SECTION 43 ABOVE ARE NOT ENFORCEABLE UNDER CALIFORNIA LAW, THEN THE FOLLOWING PROVISIONS OF THIS SECTION 44 SHALL APPLY. IT IS THE DESIRE AND INTENTION OF THE PARTIES TO AGREE UPON A MECHANISM AND PROCEDURE UNDER WHICH CONTROVERSIES AND DISPUTES ARISING OUT OF THIS LEASE OR RELATED TO THE PREMISES WILL BE RESOLVED IN A PROMPT AND EXPEDITIOUS MANNER. ACCORDINGLY, EXCEPT WITH RESPECT TO ACTIONS FOR UNLAWFUL OR FORCIBLE DETAINER OR WITH RESPECT TO THE PREJUDGMENT REMEDY OF ATTACHMENT, ANY ACTION, PROCEEDING OR COUNTERCLAIM BROUGHT BY EITHER PARTY HERETO AGAINST THE OTHER (AND/OR AGAINST ITS OFFICERS, DIRECTORS, EMPLOYEES, AGENTS OR SUBSIDIARY OR AFFILIATED ENTITIES) ON ANY MATTERS WHATSOEVER ARISING OUT OF OR IN ANY WAY CONNECTED WITH THIS LEASE, TENANT'S USE OR OCCUPANCY OF THE PREMISES AND/OR ANY CLAIM OF INJURY OR DAMAGE, SHALL BE HEARD AND RESOLVED BY A REFEREE UNDER THE PROVISIONS OF THE CALIFORNIA CODE OF CIVIL PROCEDURE, SECTIONS 638 - 645.1, INCLUSIVE (AS SAME MAY BE AMENDED, OR ANY SUCCESSOR STATUTE(S) THERETO) (THE "**REFEREE SECTIONS**"). ANY FEE TO INITIATE THE JUDICIAL REFERENCE PROCEEDINGS SHALL BE PAID BY THE PARTY INITIATING SUCH PROCEDURE; PROVIDED HOWEVER, THAT THE COSTS AND FEES, INCLUDING ANY INITIATION FEE, OF SUCH PROCEEDING SHALL ULTIMATELY BE BORNE IN ACCORDANCE WITH SECTION 35. THE VENUE OF THE PROCEEDINGS SHALL BE IN THE COUNTY IN WHICH THE PREMISES ARE LOCATED. WITHIN TEN (10) DAYS OF RECEIPT BY ANY PARTY OF A WRITTEN REQUEST TO RESOLVE ANY DISPUTE OR CONTROVERSY PURSUANT TO THIS SECTION 44, THE PARTIES

SHALL AGREE UPON A SINGLE REFEREE WHO SHALL TRY ALL ISSUES, WHETHER OF FACT OR LAW, AND REPORT A FINDING AND JUDGMENT ON SUCH ISSUES AS REQUIRED BY THE REFEREE SECTIONS. IF THE PARTIES ARE UNABLE TO AGREE UPON A REFEREE WITHIN SUCH TEN (10)-DAY PERIOD, THEN ANY PARTY MAY THEREAFTER FILE A LAWSUIT IN THE COUNTY IN WHICH THE PREMISES ARE LOCATED FOR THE PURPOSE OF APPOINTMENT OF A REFEREE UNDER CALIFORNIA CODE OF CIVIL PROCEDURE SECTIONS 638 AND 640, AS SAME MAY BE AMENDED OF ANY SUCCESSOR STATUTE(S) THERETO. IF THE REFEREE IS APPOINTED BY THE COURT, THE REFEREE SHALL BE A NEUTRAL AND IMPARTIAL RETIRED JUDGE WITH SUBSTANTIAL EXPERIENCE IN THE RELEVANT MATTERS TO BE DETERMINED, FROM JAMS/ENDISPUTE, INC., THE AMERICAN ARBITRATION ASSOCIATION OR SIMILAR MEDIATION/ARBITRATION ENTITY. THE PROPOSED REFEREE MAY BE CHALLENGED BY ANY PARTY FOR ANY OF THE GROUNDS LISTED IN SECTION 641 OF THE CALIFORNIA CODE OF CIVIL PROCEDURE, AS SAME MAY BE AMENDED OR ANY SUCCESSOR STATUTE(S) THERETO. THE REFEREE SHALL HAVE THE POWER TO DECIDE ALL ISSUES OF FACT AND LAW AND REPORT HIS OR HER DECISION ON SUCH ISSUES, AND TO ISSUE ALL RECOGNIZED REMEDIES AVAILABLE AT LAW OR IN EQUITY FOR ANY CAUSE OF ACTION THAT IS BEFORE THE REFEREE, INCLUDING AN AWARD OF ATTORNEYS' FEES AND COSTS IN ACCORDANCE WITH CALIFORNIA LAW. THE REFEREE SHALL NOT, HOWEVER, HAVE THE POWER TO AWARD PUNITIVE DAMAGES, NOR ANY OTHER DAMAGES WHICH ARE NOT PERMITTED BY THE EXPRESS PROVISIONS OF THIS LEASE, AND THE PARTIES HEREBY WAIVE ANY RIGHT TO RECOVER ANY SUCH DAMAGES. THE PARTIES SHALL BE ENTITLED TO CONDUCT ALL DISCOVERY AS PROVIDED IN THE CALIFORNIA CODE OF CIVIL PROCEDURE, AND THE REFEREE SHALL OVERSEE DISCOVERY AND MAY ENFORCE ALL DISCOVERY ORDERS IN THE SAME MANNER AS ANY TRIAL COURT JUDGE, WITH RIGHTS TO REGULATE DISCOVERY AND TO ISSUE AND ENFORCE SUBPOENAS, PROTECTIVE ORDERS AND OTHER LIMITATIONS ON DISCOVERY AVAILABLE UNDER CALIFORNIA LAW. THE REFERENCE PROCEEDING SHALL BE CONDUCTED IN ACCORDANCE WITH CALIFORNIA LAW (INCLUDING THE RULES OF EVIDENCE), AND IN ALL REGARDS, THE REFEREE SHALL FOLLOW CALIFORNIA LAW APPLICABLE AT THE TIME OF THE REFERENCE PROCEEDING. IN ACCORDANCE WITH SECTION 644 OF THE CALIFORNIA CODE OF CIVIL PROCEDURE, THE DECISION OF THE REFEREE UPON THE WHOLE ISSUE MUST STAND AS THE DECISION OF THE COURT, AND UPON THE FILING OF THE STATEMENT OF DECISION WITH THE CLERK OF THE COURT, OR WITH THE JUDGE IF THERE IS NO CLERK, JUDGMENT MAY BE ENTERED THEREON IN THE SAME MANNER AS IF THE ACTION HAD BEEN TRIED BY THE COURT. THE PARTIES SHALL PROMPTLY AND DILIGENTLY COOPERATE WITH ONE ANOTHER AND THE REFEREE, AND SHALL PERFORM SUCH ACTS AS MAY BE NECESSARY TO OBTAIN A PROMPT AND EXPEDITIOUS RESOLUTION OF THE DISPUTE OR CONTROVERSY IN ACCORDANCE WITH THE TERMS OF THIS SECTION 44. TO THE EXTENT THAT NO PENDING LAWSUIT HAS BEEN FILED TO OBTAIN THE APPOINTMENT OF A REFEREE, ANY PARTY, AFTER THE ISSUANCE OF THE DECISION OF THE REFEREE, MAY APPLY TO THE COURT OF THE COUNTY IN WHICH THE PREMISES ARE LOCATED FOR CONFIRMATION BY THE COURT OF THE DECISION OF THE REFEREE IN THE SAME MANNER AS A PETITION FOR CONFIRMATION OF AN ARBITRATION AWARD PURSUANT TO CODE OF CIVIL PROCEDURE SECTION 1285 ET SEQ. (AS SAME MAY BE AMENDED OR ANY SUCCESSOR STATUTE(S) THERETO).

IN WITNESS WHEREOF, the parties hereto have executed this Lease as of the day and the year first above written.

LANDLORD

City of Monterey, a municipal corporation

By: _____

Its: _____

Date: _____

APPROVED

TENANT

_____

By: _____

Its: _____

Date: _____

APPROVED AS TO FORM:

_____
Nancy A. Park, Attorney for City
Best Best & Krieger, LLP

Exhibit A-1

Premises Description/Floor Plan

Exhibit A-2

Project/Building Site Plan

Project

Exhibit B

Rules and Regulations

A. GENERAL RULES AND REGULATIONS

1. No sign, advertisement, name or notice shall be installed or displayed on any part of the outside of the Premises or in any part of the Common Area without the prior written consent of Landlord. Landlord shall have the right to remove, at Tenant's expense and without notice, any sign installed or displayed in violation of this rule. All approved signs or lettering on doors and walls shall be printed, painted, affixed or inscribed at the expense of Tenant by a person approved by Landlord, using materials and in a style and format approved by Landlord.

2. Tenant shall not place anything or allow anything to be placed near the glass of any window, door, partition or wall which may appear unsightly from outside the Premises, in Landlord's sole discretion. No awnings or other projection shall be attached to the outside walls of the Premises without the prior written consent of Landlord.

3. Tenant shall not obstruct any sidewalks, halls, passages, exits, entrances, or loading docks of the Premises. Neither Tenant nor any employee, invitee, agent, licensee or contractor of Tenant shall go upon or be entitled to use any portion of the roof of the Premises without the prior written consent of Landlord.

4. Unless expressly set forth to the contrary in Tenant's Lease, Tenant shall have no right or entitlement to the display of Tenant's name or logo on any Project sign, monument sign or pylon sign.

5. All cleaning and janitorial services for the Premises shall be provided, at Tenant's sole cost and expense, exclusively by or through Tenant or Tenant's janitorial contractors in accordance with the provisions of Tenant's Lease. Tenant shall not cause any unnecessary labor by carelessness or indifference to the good order and cleanliness of the Premises.

6. Tenant, upon termination of its tenancy, shall deliver to Landlord the keys of all doors and any other locks to the Premises which have been furnished to, or otherwise procured by Tenant.

7. Electric wires, telephones, alarm systems, cable systems, satellite network systems, Internet provider systems or other similar apparatus shall not be installed in the Premises except with the approval and under the direction of Landlord. The location of telephones, call boxes, alarm apparatus, communications equipment and any other equipment affixed to the Premises shall be subject to the approval of Landlord. Any installation of telephones, telegraphs, electric wires, alarm systems, cable systems, satellite network systems, Internet provider systems or other electric apparatus made without permission shall be removed by Tenant at Tenant's own expense.

8. Tenant shall not use or keep in the Premises any kerosene, gasoline or inflammable or combustible fluid or material other than those limited quantities necessary for the operation or maintenance of office equipment, subject to any express provisions of Tenant's Lease to the contrary. Tenant shall not use or permit to be used in the Premises any foul or noxious gas or substance, or permit or allow the Premises to be occupied or used in a manner offensive or objectionable to Landlord or other occupants of the Premises by reason of noise, odors or vibrations, nor shall Tenant bring into or keep in or about the Premises any birds or animals.

9. Tenant shall not use any method of heating or air conditioning other than that supplied by Landlord without the prior written consent of Landlord.

10. Landlord reserves the right from time to time, in Landlord's sole and absolute discretion, exercisable without prior notice and without liability to Tenant: (a) to name or change the name of the Premises or the Project; (b) to change the address of the Premises, and/or (c) to install, replace or change any signs in, on or about the Common Areas, the Premises or Project (except for Tenant's signs, if any, which are expressly permitted by Tenant's Lease).

11. Tenant shall close and lock all doors of its Premises and entirely shut off all water faucets or other water apparatus, unless otherwise needed for Tenant's business and, except with regard to Tenant's computers and other equipment, if any, which reasonably require electricity on a 24-hour basis, all electricity, gas or air outlets before Tenant and its employees leave the Premises. Tenant shall be responsible for any damage or injuries sustained by other tenants or occupants of the Premises or by Landlord for noncompliance with this rule.

12. The toilet rooms, toilets, urinals, wash bowls and other apparatus shall not be used for any purpose other than that for which they were constructed, and no foreign substances of any kind whatsoever shall be placed therein.

13. Tenant shall not make any room to room solicitation of business from other tenants in the Project.

14. Tenant shall not install any radio or television antenna, loudspeaker, cable or other Internet device, or other device on the roof or exterior walls of the Premises. Tenant shall not interfere with radio, television, cable or Internet broadcasting or reception from or in the Building or elsewhere.

15. Except as expressly permitted in Tenant's Lease, Tenant shall not mark, drive nails, screw or drill into the partitions, window mullions, woodwork or plaster, or in any way deface the Premises or any part thereof, except to install normal wall hangings. Tenant shall repair any damage resulting from noncompliance under this rule.

16. Canvassing, soliciting and distribution of handbills or any other written material, and peddling in the Common Area and other portions of the Project are expressly prohibited, and each tenant shall cooperate to prevent same.

17. Landlord reserves the right to exclude or expel from the Project any person who, in Landlord's judgment, is intoxicated or under the influence of liquor or drugs or who is in violation of any of the Rules and Regulations of the Project.

18. Tenant shall store all its trash and garbage within its Premises or in designated trash containers or enclosures within the Project. Tenant shall not place in any trash box or receptacle any material which cannot be disposed of in the ordinary and customary manner of trash and garbage disposal. All garbage and refuse disposal shall be made in accordance with directions reasonably issued from time to time by Landlord.

19. Tenant agrees that it shall comply with all fire and security regulations that may be issued from time to time by Landlord, and Tenant also shall provide Landlord with the name of a designated responsible principal or employee to represent Tenant in all matters pertaining to such fire or security regulations. Tenant shall cooperate fully with Landlord in all matters concerning fire and other emergency procedures.

20. Tenant assumes any and all responsibility for protecting its Premises from theft, robbery and pilferage. Such responsibility shall include keeping doors locked and other means of entry to the Premises closed.

21. The requirements of Tenant will be attended to only upon the appropriate application to Landlord or Landlord's designated representative by an authorized individual. Employees of Landlord shall not perform any work or do anything outside of their regular duties unless under special instructions from Landlord.

22. Landlord may waive any one or more of these Rules and Regulations for the benefit of Tenant or any other tenant, but no such waiver by Landlord shall be construed as a waiver of such Rules and Regulations in favor of Tenant or any other such tenant, nor prevent Landlord from thereafter enforcing any such Rules and Regulations against any and all of the tenants in the Building.

23. These Rules and Regulations are in addition to, and shall not be construed to in any way modify or amend, in whole or in part, the terms, covenants, agreements and conditions of any lease of premises in the Project.

24. Landlord reserves the right to make such other and reasonable Rules and Regulations as, in its judgment, may from time to time be needed for safety, security, care and cleanliness of the Project and for the preservation of good order therein. Tenant agrees to abide by all such Rules and Regulations hereinabove stated and any additional rules and regulations which are adopted.

25. Tenant shall be responsible for the observance of all of the foregoing rules by Tenant's employees, agents, clients, customers, invitees or guests.

Exhibit C

Tenant Work

Exhibit D

Gross Sales Reporting Statement

PLEASE REMIT TO:
City of Monterey
735 Pacific Street, Suite A
Monterey, CA 93940
(831) 646-3944

CITY OF MONTEREY

QUARTERLY REPORT OF ACTUAL GROSS RECEIPTS

QUARTER ENDED _____

Tenant:_____

Month	Gross Sales	Percentage	Percentage Rent	Less Minimum Rent	Amount Due
_____	$_____	@ 6 %	$_____	$_____	$_____
_____	$_____	@ 6%	$_____	$_____	$_____
_____	$_____	@ 6%	$_____	$_____	$_____

Balance due with this report $_____

I certify that the above information is a true and accurate report of the total gross receipts for the period indicated.

Signed:_____
Tenant or Tenant's Principal Agent

Date:_____

Exhibit E

Prohibited and Restricted Uses

The following uses are prohibited under this Lease. All terms under this Section 1 shall have the meanings normally given to such terms.

1. No portion of the Premises shall be used for any non-retail use or for any of the following purposes: a flea market or a business selling so-called "second hand" goods, an establishment engaged in the business of selling, exhibiting or delivering pornographic or obscene materials; a so-called "head shop"; off-track betting parlor; a laundromat or dry-cleaning facility; a warehouse; a discotheque, dance hall, or adult entertainment facility; bowling alley; skating rink; billiard or pool hall; massage parlor; game parlor or video arcade or provision of any games in, on or around Premises including but not limited to, self-operated arcade games, mid-way games, games of skill, or virtual reality games; fitness center, workout facility, gym, health spa or studio, or exercise facility; a beauty school, barber college, reading room, place of instruction or any other operation catering primarily to students or trainees and not to retail customers; industrial, residential or manufacturing uses (except approved fishing related uses); house of worship; a medical marijuana dispensary or other business or activity related to the cultivation, possession, manufacture, processing, storing, laboratory testing, labeling, transporting, distribution or sale of medical marijuana or a medical marijuana product or device; bar, tavern or cocktail lounge, unless it is operated in conjunction with a restaurant where the service of alcoholic beverages for on-premises consumption is ancillary to the restaurant business.

2. No portion of the Premises shall be used (i) for the maintenance of any nuisance or the conduct of any activity that violates public policy; (ii) for any activity that physically interferes with the business of any other owner or occupant of any other parcel or property on Wharf 1; (iii) in violation of any law or governmental regulation; (iv) for any "sidewalk sales," or any other sales, promotional activities or displays of merchandise outside the exterior wall of the Premises, except for Wharf promotional events or other events that may be approved by the Landlord from time to time, which approval may be withheld in the sole and absolute discretion of the Landlord; (v) for the storage of any items or vehicles, other than the storage of items within the confines of any building located within the Premises, which items are incidental to the business conducted thereon, and other than trash to be stored in appropriate containers within an enclosed trash area; (vi) to permit advertising media which can be heard or experienced from the exterior of the Premises, from which it emanates, such as flashing lights, searchlights, loudspeakers, phonographs, radios, televisions or any computer devices; (vii) for the distribution of any handbills, bumper stickers or other advertising devices on any vehicle parked in the parking area of Wharf 1; or (viii) for any other unreasonable use not compatible with the operation of Wharf 1 as a vibrant and well maintained commercial retail and restaurant area with a diversified grouping of retail stores, restaurants, and other mercantile establishments.

Exhibit F

Guaranty

LEASE GUARANTY

This Guarantee of Lease ("**Guarantee**") is given as of _____, 20__, by _____ (jointly and severally, "**Guarantor**"), _____ ("**Landlord**"), with reference to the following facts:

A. Landlord and _____ ("**Tenant**"), have executed or will execute that certain Standard Form Retail Lease (the "**Lease**") for _____, California ("**Premises**").

B. As an inducement to Landlord to make the Lease, Guarantor has agreed to guarantee Tenant's obligations under the Lease. Guarantor is desirous that Landlord enter into the Lease with Tenant.

NOW, THEREFORE, in consideration of the execution of the Lease by Landlord, Guarantor hereby unconditionally and irrevocably guarantees the full performance of each and all of the terms, covenants and conditions of the Lease to be kept and performed by Tenant as hereinafter provided.

1. Obligations Guaranteed. Guarantor hereby absolutely, irrevocably and unconditionally guarantees (a) the due and punctual payment to Landlord of all rentals, charges, sums or any other monies due Landlord by Tenant, and (b) the full and faithful performance of all of the terms, covenants, conditions and agreements contained in the Lease and any amendments or extensions thereto to be performed by Tenant. If Tenant fails to timely pay any amount due Landlord, Guarantor shall pay, within 10 days after Landlord's demand, the amount due Landlord by cashier's check or wire transfer.

2. Representations and Warranties. Guarantor hereby represents and warrants that (a) Guarantor has investigated fully whether any benefit will inure to Guarantor by reason of the execution of this Guarantee, and has determined that a direct or indirect benefit will inure to Guarantor by reason of the execution of this Guarantee; (b) Guarantor is not aware of any facts or circumstances that would contradict that this Guarantee is a legal, valid and binding agreement of Guarantor which is enforceable in accordance with its terms; (c) Guarantor has full right, power and authority to execute and deliver this Guarantee, and to perform the undertakings contained herein and the transactions contemplated hereby; and (d) in the case of a Guarantor which is not an individual, all corporate or other action necessary to authorize the execution and delivery of this Guarantee, and the performance of the undertakings contained herein, have been taken.

3. Authority of Landlord. Guarantor hereby agrees that, without notice to Guarantor, Landlord may alter, modify, extend or otherwise change any term of the Lease, and Guarantor's obligations hereunder shall automatically apply to the Lease as altered, modified, extended or changed. No exercise or nonexercise by Landlord of any right given Landlord by this Guarantee and no dealing by Landlord with Guarantor or any other guarantor or any other person shall in any way affect any of the obligations of Guarantor hereunder or give Guarantor any recourse against Landlord. Notwithstanding the foregoing, in the event that Tenant assigns its rights under the Lease to a third party which is not an affiliate of' Guarantor, then Guarantor shall not be obligated with respect to any increased obligation of such assignee tenant resulting from any alteration, modification, extension or other change of the Lease that is made without notice to Guarantor.

4. Waivers by Guarantor. Guarantor hereby expressly waives and relinquishes all rights and remedies accorded by applicable law to guarantors and agrees not to assert or take advantage of any such rights or remedies, including, but not limited to: (a) any right to require Landlord, as a condition precedent or concurrent to enforcement of this Guarantee, to proceed against Tenant or any other person or to proceed against or exhaust any security held by Landlord at any time or to pursue any other right or remedy in Landlord's power before proceeding against Guarantor; (b) any defense that may arise by reason of the incapacity, lack of authority, death or disability of any other person or persons or the failure of Landlord to file or enforce a claim against the estate (in administration, bankruptcy or any other proceeding) of any other person or persons; (c) notice of the acceptance of this Guarantee by any person; (d) demand, notice of default or nonpayment and all other notices of any kind to which Guarantor might otherwise be entitled in connection with this Guarantee or the Lease; (e) any defense based upon an election of remedies by Landlord; (f) any defense of whatsoever nature on the part of Tenant which otherwise may have been asserted by Guarantor as a defense hereunder; and (g) any defense arising because of Landlord's election, in any proceeding instituted under the federal Bankruptcy Code, of the application of Section 1111(b)(2) of the

federal Bankruptcy Code of 1978, as amended; it being agreed by the Guarantor that this Guarantee is an absolute guarantee of payment and performance and not of collection, that the failure of Landlord to exercise any rights or remedies Landlord has or may have against the Tenant shall in no way impair the obligation of the Guarantor and that the liability of the Guarantor hereunder is and shall be direct and unconditional. Without limiting the generality of the foregoing or any other provision hereof, Guarantor hereby expressly waives any and all benefits which might otherwise be available to Guarantor under California Civil Code Sections 2809, 2810, 2819, 2825, 2845, 2846, 2849, 2850, or any amendments thereto.

5. No Discharge of Guarantor. The Guarantor agrees that: (a) this Guarantee shall not be discharged or affected by the death or incompetency of the Guarantor; (b) Guarantor shall indemnify, defend, protect and hold Landlord harmless from any loss, cost or expense arising from or attributable to the failure of performance of any obligation, condition or event that is hereby guaranteed; and (c) the liability of Guarantor under this Guarantee shall be reinstated and revived, and the rights of Landlord shall continue, with respect to any amount at any time paid on account of the Lease, which shall thereafter be required to be restored or returned by Landlord upon the bankruptcy, insolvency or reorganization of Tenant, Guarantor or any other guarantor, or otherwise, all as though such amount had not been paid.

6. Independent Investigation by Guarantor. The Guarantor has made an independent investigation of the financial condition of Tenant and the ability of Tenant to perform the obligations hereby guaranteed prior to making this Guarantee. Guarantor hereby waives any defense that the Guarantor may have by reason of the failure of Landlord to provide the Guarantor with any information respecting the financial condition of Tenant, or Tenant's ability to perform any of the obligations hereby guaranteed, and any duty on the part of Landlord to disclose to Guarantor any facts that Landlord may now or hereafter know about Tenant, regardless of whether Landlord has reason to believe that any such facts materially increase the risk beyond that which Guarantor intends to assume or has reason to believe that such facts are unknown to Guarantor or has a reasonable opportunity to communicate such facts to Guarantor. Guarantor understands and agrees that Guarantor is fully responsible for being and keeping informed of the financial condition of Tenant and of all circumstances bearing on the risk of nonperformance of any obligations hereby guaranteed.

7. Counterparts. This Guarantee may be signed in multiple counterparts, with the same effect as if all signatories had executed the same counterpart.

8. Waiver of Subrogation. Until all obligations guaranteed hereby and all obligations of Guarantor hereunder have been fully performed, Guarantor shall have no right of subrogation or right of reimbursement from Tenant or any guarantor and waives any right to enforce any remedy which Landlord now has or may hereafter have against Tenant and any benefit of, and any right to participate in, any security now or hereafter held by Landlord.

9. Actions. The obligations of Guarantor hereunder are independent of the obligations of Tenant and, in the event of any default hereunder, a separate action or actions may be brought and prosecuted against Guarantor, whether not Tenant is joined therein or a separate action or actions are brought against Tenant. Landlord may maintain successive actions for other defaults. This Guarantee may be enforced by an action against Guarantor, without the necessity of joining in such action any other guarantor of the obligations of Tenant guaranteed hereby. Landlord's rights hereunder shall not be exhausted by exercise of any of the rights or remedies of Landlord or by any such action or by any number of successive actions until and unless all indebtedness and all obligations, the performance and payment of which are hereby guaranteed, have been paid and fully performed.

10. Payments; Attorneys' Fees. All payments, advances, charges, costs and expenses, including reasonable attorneys' fees, made or incurred by Landlord in the enforcement of this Guaranty or due from Guarantor in the collection or performance of the Lease obligations guaranteed hereby, or any portion thereof, shall be paid by Guarantor within 10 days after demand by Landlord, together with interest thereon accruing from and after the lapse of such 10 days at the rate of 10% per annum. Payment shall be made by cashier's check or wire transfer. Attorneys' fees shall include, but not be limited to, all costs, attorneys' fees and expenses incurred by Landlord in connection with any insolvency, bankruptcy, reorganization, arrangement or other similar proceedings involving Guarantor which affect the exercise by Landlord of the rights and remedies of Landlord hereunder. If Guarantor is the prevailing party in any litigation or action to enforce this Guarantee, Landlord shall reimburse Guarantor for all costs, attorneys' fees and expenses incurred by Guarantor in connection with such proceeding.

11. Severability. If any provision or portion thereof of this Guarantee is declared or found by a court of competent jurisdiction to be unenforceable or null and void, such provision or portion thereof shall be deemed stricken and severed from this Guarantee, and the remaining provisions and portions thereof shall continue in full force and effect.

12. Binding Effect; Assignment. This Guarantee shall inure to the benefit of Landlord, its successors and assigns, and shall bind the heirs, executors, administrators, personal representatives, successors and assigns of Guarantor. This Guarantee may be assigned by Landlord but only in connection with Landlord's assignment of Landlord's interest under the Lease and, when so assigned, Guarantor shall be liable to the assignees under this Guarantee without in any manner affecting the liability of Guarantor hereunder. Prior notice from Landlord of assignment or transfer is hereby waived by Guarantor.

13. Amendments. This Guarantee can only be amended in writing. Guarantor cannot be released from Guarantor's obligations hereunder, except by a writing duly executed by Landlord. Notwithstanding the return of this Guarantee to Guarantor by Landlord, or the execution of a release hereof by Landlord, this Guarantee and all obligations of Guarantor hereunder shall remain in effect for all periods of time thereafter during which any payments made by the Tenant with respect to the Lease may be claimed to be avoidable preference under applicable provisions of the federal Bankruptcy Code of 1978, as amended.

14. Miscellaneous. When the context and construction so require, all words used in the singular herein shall be deemed to have been used in the plural, and the masculine shall include the feminine and neuter, and vice versa. The word "person," as used herein, shall include any individual, company, firm, association, partnership, corporation, trust or other legal entity of any kind whatsoever. Each reference to "Guarantor" herein shall mean the undersigned, and each of them, and any combination of them.

15. Governing Law. This Guarantee shall be governed by and construed in accordance with the laws of the State of California.

16. Integration. Except as provided in any other written agreement now or at any time hereafter in force between Landlord and Guarantor, this Guarantee shall constitute the entire agreement of Guarantor with Landlord with respect to the subject matter hereof. All representations, understandings, promises and conditions concerning the subject matter hereof are expressed herein.

17. Authority. If Guarantor is a corporation, limited liability company or other entity, each person executing this Guarantee on behalf of such entity represents and warrants that he or she is duly authorized to execute and deliver this Guarantee on behalf of such entity, and that such person's execution of this Guarantee binds Guarantor to its terms and conditions.

18. Notices. All notices and demands required to be sent to the Landlord or Guarantor under the terms of this Guarantee shall be in writing and may be served (a) by personal delivery, (b) by certified mail, postage prepaid, (c) by overnight courier (i.e., Federal Express), or (d) by receipt-confirmed facsimile transmission, provided a copy is also delivered by personal delivery, mail or courier, to the address(es) and/or facsimile number(s) specified below, or to such other addresses or facsimile number as a party may from time to time designate by notice pursuant to this paragraph. Notices shall be deemed received upon the earlier of (i) if personally delivered, the date of delivery to the address of the person to receive such notice, (ii) if mailed, two days following the date of posting by the U.S. Postal Service, (iii) if by overnight courier, on the business day following the deposit of such notice with such courier, (iv) if by facsimile, upon printed confirmation of facsimile transmission.

Landlord Notice Address:
City of Monterey
Attn: City Manager
580 Pacific Street
Monterey, CA 93940

Guarantor Notice Address

_____
_____
_____
_____

19. Joint and Several Obligations. The obligations of each of the persons signing this Guarantee shall be joint and several. If this Guarantee is unenforceable against of any of the Guarantors, such unenforceability shall not affect the obligations of the remaining persons comprising Guarantor or the enforceability of this Guarantee against such remaining Guarantors.

IN WITNESS WHEREOF, the undersigned guarantor, intending to be bound, has executed this Guarantee as of the date first above written.

GUARANTOR:

EXHIBIT ONLY – DO NOT SIGN _____

New CPUC Regulation of Community Choice Aggregators

Wednesday, September 12, 2018 General Session; 3:30 – 5:00 p.m.

Megan Somogyi, Partner, Goodin, MacBride, Squeri & Day, LLP

Notes:_____

New CPUC Regulation of Community Choice Aggregators

Megan Somogyi
Partner
Goodin, MacBride, Squeri & Day, LLP

New CPUC Regulation of Community Choice Aggregators

I. INTRODUCTION

The structure of the California electricity market is changing rapidly due, in large part, to the sudden proliferation of Community Choice Aggregators (CCAs). Though CCAs were authorized by the state Legislature in 2002, immediately following the California electricity crisis, the first active CCA did not launch until 2010,[1] the second active CCA did not launch until 2014,[2] and CCAs did not begin launching in significant numbers until 2017.[3] Eleven CCAs are slated to begin operations by the end of 2018. Not only is the rate at which CCAs are launching increasing exponentially, but the newly operational CCAs serve significant geographical areas—and significant numbers of customers that used to get their electricity from Pacific Gas and Electric Company, Southern California Edison Company, and San Diego Gas & Electric Company, the large investor owned utilities (IOUs). The IOUs themselves predict that by 2025, close to 85 percent of customers in California could receive their electricity from a CCA or direct access provider.[4]

This shift does not just represent a shrinking customer base for the IOUs or an increase in customer choice. It means that the responsibility for ensuring that enough electricity is available to meet California's needs is rapidly being fragmented and spread among an increasing number of disaggregated entities. This decentralization is the driving force behind the unprecedented CCA regulations issued by the California Public Utilities Commission (CPUC) in 2017 and 2018. The CPUC has increased the number of requirements CCAs must meet and upped the level of participation in CPUC proceedings required of CCAs, but the most significant of these recent edicts is the mandatory one-year minimum freeze between CCA implementation and the date on which it can begin serving customers.[5] Not only did this rule change completely—and abruptly—the manner in which CCAs had been forming and launching, but it was a marked departure from the CPUC's longstanding refusal to exercise control over the

[1] Marin Clean Energy.
[2] Sonoma Clean Power.
[3] Silicon Valley Clean Energy, Apple Valley Choice Energy, Redwood Coast Energy Authority, and Pico Rivera Innovative Municipal Energy.
[4] Joint Prepared Testimony of PG&E, SCE, and SDG&E, R.17-06-026, ch. 1, pp. 1-5 (line 26)–1-6 (line 2).
[5] Resolution E-4907.

actual operations of CCAs.[6]

Shortly after the CPUC imposed the one-year waiting period on new and expanding CCAs, it issued the Draft Green Book, titled *California Customer Choice: An Evaluation of Regulatory Framework Options for an Evolving Electricity Market*.[7] The introduction to the Green Book by CPUC President Michael Picker states the reason for the CPUC's sudden increase in CCA regulation and its efforts to get a handle on the emerging electricity market: "In the last deregulation, we had a plan, however flawed. Now, we are deregulating electric markets through dozens of different decisions and legislative actions, *but we do not have a plan. If we are not careful, we can drift into another crisis*."[8] The CPUC, driven by its fear of repeating the energy crisis of the early 2000s, is now trying to formulate a plan. That plan will necessarily include increased regulatory oversight of all market participants and increased responsibilities—operational and financial—for CCAs.

Cities and counties that are contemplating forming a CCA, joining an existing CCA, or expanding a CCA's service territory need a thorough understanding of CPUC jurisdiction, emerging regulations, and the history that informs those regulations. CCAs' statutory right to self-direct their procurement of electricity[9] and to operate free from CPUC micromanaging has been their lodestar when interacting with the agency. That autonomy is the very thing with which the CPUC is now reckoning. While the CCAs will not become fully regulated utilities under CPUC jurisdiction, they will not retain the operational flexibility they enjoyed until recently.

II. DIRECT AND INDIRECT CPUC REGULATION OF CCAS

Community Choice Aggregators exist in a regulatory twilight, neither fully regulated nor entirely free to do as they please. The CPUC has jurisdiction over the rates, operations, infrastructure, and policy decisions of privately owned electric utilities (the IOUs). CCAs are public entities and therefore not subject to full rate and operational

[6] See D.05-12-041, p. 9 ("Nothing in [Public Utilities Code section 366.2] directs the Commission to regulate the CCA's program except to the extent that its program elements may affect utility operations and the rates and services to other customers. For example, the statute does not require the Commission to set CCA rates or regulate the quality of its services.").
[7] Draft Green Book (May 17, 2018).
[8] *Id.* at p. iii (emphasis added).
[9] Pub. Util. Code § 366.2(a)(5)

regulation. But the CPUC does have control over certain aspects of CCA operations, directly and indirectly. CCAs must register with, and submit their implementation plans to, the CPUC before they begin serving customers; the CPUC recently issued a decision that formalized the requirement that new CCAs post a bond when they register.[10] The CPUC directly oversees CCA compliance with California's requirements to meet renewable energy targets (the Renewables Portfolio Standard or RPS). The CPUC also has authority to ensure that CCAs purchase enough energy to serve their customers under high-electricity-use conditions (Resource Adequacy or RA).

The CPUC exercises indirect control over CCAs through the investor owned utilities. While CCAs provide electricity to their customers, the IOUs provide the transmission, distribution, metering, and billing services to the CCA's customers. The CPUC's oversight of IOU tariffs and operations, which dictate the rates and terms under which the "wires" and administrative services are provided, affects CCAs and their customers. The IOUs are also entitled to recover the costs of energy purchased or infrastructure built on behalf of customers that subsequently left the IOU for CCA service. When CCAs were first authorized, these recoverable costs included the Department of Water Resources energy contracts that arose during the California energy crisis.[11] Now, the bulk of the costs are for renewable energy contracts that were executed in the early years of the renewable energy market. The requirement that CCA customers reimburse the IOUs for certain expenditures raises monthly electricity bills for CCA customers and affects the CCA's ability to charge lower rates than the IOU.

Community Choice Aggregators were authorized by the Legislature in 2002 in Assembly Bill 117. AB 117 enacted Public Utilities Code sections 218.3, 331.1, 366.2, 381.1, and 394.25 pertaining to CCA formation and operation; of these, section 366.2 is the most significant because it contains the framework for CCA formation and CPUC oversight. Section 366.2 contains three fundamental directives that are central to the issue of CPUC regulation of CCAs: (1) CCAs are solely responsible for procuring all

[10] D.18-05-022, *Decision Establishing Reentry Fees and Financial Security Requirements for Community choice Aggregators* (June 7, 2018).
[11] See D.04-12-046, *Order Resolving Phase 1 Issues on Pricing and Costs Attributable to Community Choice Aggregators and Related Matters* (December 21, 2004), pp. 5–6.

the electricity necessary to serve their customers[12]; (2) the CPUC must determine the costs CCA customers have to pay to reimburse the incumbent utility for electricity it purchased or services it provided on behalf of the CCA customers it no longer serves,[13] in order to ensure the utility's remaining customers don't experience bill increases (or, that they remain "indifferent" to the CCA customers' departure); and (3) the CCA must submit to the CPUC its implementation plan, which must provide for universal access, reliability, equitable treatment of all customer classes, and any requirements established by state law or by the CPUC.[14]

The third directive is historically the most straightforward, but is also the mechanism through which the CPUC imposed the new requirement that CCAs wait at least a year between filing their implementation plans and beginning operations. The registration and implementation requirements were originally set by the CPUC in 2005.[15] Rejecting the IOUs' arguments that the CPUC had broad jurisdiction over all aspects of CCA operations, the CPUC determined that AB 117 did not give it authority to approve or disapprove a CCA implementation plan or any subsequent modifications.[16] Nor did the CPUC believe it had authority to dictate the contents of CCA implementation plans.[17] The CPUC concluded that CCA implementation plans were merely the mechanism by which the CCA provided the information necessary to receive the transmission, distribution, and billing services from the IOU.[18] The CCA submits its implementation plan and registration package to the CPUC; the CPUC certifies receipt within 90 days and provides the CCA with its cost responsibility for IOU expenses.[19] This hands-off approach was the rule for 12 years, until the CPUC proposed to impose a minimum one-year freeze before a CCA begins serving customers.[20] The purpose of this moratorium is to align CCA operations with the cycle on which load-serving entities (LSEs) are required to demonstrate that they have purchased enough electric capacity to serve all of

[12] Pub. Util. Code § 366.2(a)(5).
[13] *Id.* at §§ 366.2(a)(4), (c)(5)–(8), (c)(20), (d)–(k).
[14] *Id.* at §§ 366.2(c)(4)–(5).
[15] D.05-12-041, pp. 4, 6–9, 12–18.
[16] *Id.* at pp. 6–9, 14.
[17] *Id.* at p. 16.
[18] *Id.* at p. 9.
[19] *Id.* at p. 12; see also Pub. Util. Code §§ 366.2(c)–(f).
[20] Draft Resolution E-4907 (issued December 8, 2017).

their customers on a high-use day.[21] Resolution E-4907 and CCA Resource Adequacy requirements are discussed in detail in Section IV, below.

The first and second directives—that CCA have total autonomy in buying electricity and that the CPUC must allocate IOU costs to CCA customers to ensure that remaining IOU customers don't pay more than they should—have dovetailed in the current issues the CPUC is attempting to sort out. CCAs' procurement autonomy has traditionally been a fact without significant policy or practical implications. The CPUC has jurisdiction to enforce CCAs' compliance with California's renewable energy procurement targets, with annual Resource Adequacy requirements, and with other specialized procurement requirements (like energy storage[22]), but the CPUC cannot bless the CCAs' Power Purchase Agreements or otherwise dictate where the CCAs' power comes from. The IOUs are subject to the same policy-driven procurement requirements, though the CPUC does review their energy contracts for reasonableness. But as CCAs are rapidly forming to serve customers that are already served by the IOUs, and for whom the IOUs have already bought power, the potential for significant double-procurement and significant IOU costs that must be paid by CCA customers has spurred the CPUC to reexamine the electric market structure[23] and existing cost allocation mechanisms.[24]

To understand the existing market structure into which CCAs are entering in record numbers, and to understand why this change has prompted the CPUC to increase its oversight over CCAs, it is necessary to understand the energy crisis of the early 2000s.

III. EVERYTHING OLD IS NEW AGAIN: THE CALIFORNIA ENERGY CRISIS

The process of forming California's current electricity market began in 1976, when the state Legislature opened the wholesale electric market to competition by passing legislation that allowed IOUs to purchase electricity from any private entity

[21] Res. E-4907, p. 10.
[22] D.13-10-040 (requiring CCAs to procure storage for 1% of their peak load).
[23] The Commission's current thinking on the electricity market in California is addressed in the Green Book section below.
[24] The question of how CCA customer responsibility for stranded IOU power costs is addressed in the section on the Power Charge Indifference Adjustment (PCIA).

producing renewable energy or using cogeneration.[25] Until that time, the IOUs were vertically integrated, meaning they owned the plants that produced electricity, the transmission and distribution systems that sent power out to customers, and were responsible for all metering, billing, and customer service. The IOUs were the only option for obtaining electricity, and they were the electricity "market" in California. Two years after the Legislature authorized the IOUs to purchase some of their power elsewhere, Congress passed the Public Utility Regulatory Policies Act of 1978 (PURPA)[26] in response to the Middle Eastern oil embargo, in order to diversify the country's fuel supply. PURPA *required* utilities to buy electricity at wholesale prices from non-utility generators that used cogeneration or renewable technologies that met certain qualifying criteria. In addition to mandating electricity procurement for the first time, PURPA changed the electric sector by requiring that the IOUs' wholesale purchases be at the utility's "avoided cost"—the price the utilities would pay for power "but for" the qualifying generator—in order to keep the IOUs' customers financially indifferent to where the power was coming from. PURPA also ensured that the third-party generators would be guaranteed access to the IOU-owned transmission grid so that the power they sold could actually be delivered.[27]

The CPUC contributed to the nascent wholesale electricity market by conceiving and adopting long-term power purchase agreements (PPAs or standard offers) that served as the contracts between the IOUs and the third-party generators. The most important aspect of the PPAs was their guaranteed long-term capacity payments, with 10-year fixed energy prices; this revenue stream allowed private capital investment in new generation projects to be essentially backed by the creditworthiness of the IOUs' balance sheets. The third-party generators built 10,000 MWs of electric generation to compete with the IOUs' in-house generation plants.[28]

In the early 1990s, pressure was mounting on Congress, the state Legislature, and the regulators to fully open the electric sector to allow competition in both supply *and* purchase, which was already the model in the natural gas, transportation,

[25] Green Book, p. 63. Cogeneration uses a single fuel source to produce electric energy and a second form of energy, such as heat or steam, simultaneously or sequentially.
[26] 16 USC chapter 46, § 2601 et seq.; 18 CFR Part 292 *et seq*.
[27] Green Book, p. 63.
[28] *Id.* at pp. 63–64.

and telecommunications markets. The prevailing argument was that the electric power industry was no longer a natural monopoly and should be deregulated. Congress responded in 1992, passing the Energy Policy Act, which opened access to the IOU-owned transmission networks to independent energy producers and allowed them to enter into contracts for electricity with third parties. The Energy Policy Act also created a new category of electric generators that were not subject to regulation as a public utility.[29] By 1995, parallel courses of study and policy decisions in the Legislature and at the CPUC culminated in action by both entities that set in motion the deregulation of California's electricity market.

A. CPUC Deregulation Decisions

In 1993, the CPUC began studying California's existing electric market and regulatory structure, and began formal proceedings to restructure and reform its regulation of the electric industry for retail and wholesale customers. The CPUC ultimately decided on two courses of action: (1) customer choice would be implemented through Direct Access, which would allow customers to buy electricity directly from non-IOU retail sellers; and (2) the way utility rates were set would change. The CPUC's fundamental goal in restructuring the electric industry was to lower electricity bills without harming the IOUs' financial integrity. The IOUs would remain the providers of last resort and would continue to deliver electricity to all customers through the IOUs' distribution systems.[30] The CPUC's market and ratemaking study culminated in its Preferred Policy Decision, issued in 1995.[31] The Preferred Policy Decision articulated the CPUC's vision for customer choice and a competitive electricity market, which was set to launch on January 1, 1998.

While the IOUs would retain their "wires" and their obligation to serve the public as a last resort, in order to foster a true competitive market the CPUC provided incentives to the IOUs if they would voluntarily divest themselves of at least 50% of their generating plants (particularly fossil fuel plants). This paved the way for non-utilities to own or build their own electric plants. It also required the CPUC to address the fact that the IOUs were entitled to reimbursement for the costs of building and operating the plants

[29] Green Book, p. 64.
[30] *Id.* at pp. 64–65.
[31] D.95-12-063.

they no longer owned.[32] Under basic utility ratemaking in California, an IOU recovers the costs to build and operate a generating asset over the course of the asset's depreciable life—generally in the neighborhood of 30 or 40 years. If the plant must be shut down or is sold to a non-utility before its depreciable life expires, the utility is still entitled to recover its costs for the plant. Costs a utility is entitled to collect for assets or contracts that are no longer serving its customers are "stranded costs." In order to ensure the IOUs recovered the stranded costs of their now-divested power plants, the CPUC created the Competition Transition Charge (CTC) to collect those costs from all customers, regardless of whether they stayed with the utility or switched to a Direct Access provider for electricity service.[33] To balance the IOUs' right to recover their costs and need to protect retail customers from sharp rate increases or fluctuations, the CPUC imposed a retail rate cap that was designed to last until 2005, the target date for the IOUs to finish divesting their generating assets.[34]

In addition to allowing customers to choose where their electricity came from, the CPUC directed that two new entities would be created to oversee the "free" market: the Independent System Operator[35] and the Power Exchange.[36] The new market structure, combined with the rate cap the CPUC imposed on IOU retail rates, contributed to the eventual collapse of the competitive electricity market.

B. Legislative Restructuring—AB 1890

Assembly Bill (AB) 1890 was introduced during the 1995 legislative session, before the CPUC adopted its Preferred Policy Decision, and was ultimately signed into law in September 1996.[37] AB 1890 incorporated the CPUC's creation of the Competition Transition Charge and its proposed market structure, but also accelerated the completion target for the deregulation process from 2005 to 2002.[38] AB 1890 mandated an immediate 10% rate reduction for residential and small commercial customers of the

[32] Green Book, p. 67.
[33] Green Book, p. 67; see also D.95-12-063. The CTC applies to pre-1998 electricity contracts.
[34] D.95-12-056, 64 CPUC 2d 1, 236–237.
[35] This entity still exists and is now known as the California Independent System Operator (CAISO).
[36] Green Book, p. 66.
[37] AB 1890 (Brulte) (ch. 854).
[38] See AB 1890 (implementing Pub. Util. Code §§ 330(u), 335, 364(b)(1)); see also Green Book, p. 68.

IOUs, with an increase to 20% savings by Spring 2002.[39]

C. The Collapse of the Market

Under the CPUC's and Legislature's edicts, the Independent System Operator (ISO) would operate the state's transmission assets as a unified grid and would coordinate daily scheduling and dispatch of the electricity provided by market participants, while the Power Exchange (PX) would oversee the actual electricity market. These functions were separated to move away from the traditional vertically integrated utility structure and to prevent market manipulation.[40] In practice, separating the market clearinghouse from the load-serving function prevented the right hand from knowing what the left was doing. Under the new market structure, the IOUs were also prevented from entering into long-term contracts for electricity, which meant they had to buy their power on the spot market. This ultimately prevented the IOUs from hedging their electricity costs against market price fluctuations.

The dual-entity market structure functioned for a couple years, until the summer of 2000. Because the IOUs had divested approximately 40% of their power plants, and because no new large power plants were built in California in the late 1990s, California began to depend on imported electricity to meet its needs. A significant portion of imported power was from large hydroelectric facilities in the Pacific Northwest, which, at the end of 2000 was in the midst of a 100-year drought; California did not receive about 8,000 MW of power it was counting on. This shortfall meant that California's old fossil-fueled plants were being strained to make up the difference. And since late 1999, the ISO had issued "no touch" orders for the aging fossil plants, which meant their operators could not perform any maintenance. Record heatwaves in May and June 2000 caused the ISO to declare the first power shortage and led to a series of rolling blackouts in the San Francisco Bay Area. The ISO ordered these power cuts because electricity supplies were low and several generating plants were offline for maintenance.

These shortages were due partly to the aging generating fleet, which had not been maintained properly due to the ISO's orders and due to the fact that the IOUs had little incentive to fix up plants they would shortly have to sell. The shortages were

[39] Green Book, p. 68.
[40] D.95-12-056, 64 CPUC 2d at p. 69–79.

also due to some plants being offline, which was the result legitimate equipment failure and also the result of market manipulation by some privately owned generators who wanted to drive up the price of electricity. Some independent power marketers also manipulated the amount of energy made available to the grid to create false grid congestion on major transmission corridors, which also drove up the price of electricity. And the IOUs themselves were able to manipulate the PX by submitting low demand forecasts for the following day, which left the PX scrambling when the un-forecasted demand hit the system the next day. It is worth noting that some of these schemes did not violate the market rules. Between the faulty market structure, legitimate power shortages, and market manipulation, electricity prices increased from $40/MWh in spring 1998 to $250/MWh[41] by December 2000.

The IOUs bought electricity at these exorbitant prices, but could not recover their costs from customers due to the retail rate cap. The Federal Energy Regulatory Commission (FERC) also denied the CPUC's request for a wholesale price rate cap, and instead imposed a "flexible" cap of $150/MWh; this was still more than a 300% increase over electricity prices the previous year. Because the IOUs were paying vastly more for electricity than they were getting from their customers' monthly bills, all three California IOUs hurtled toward bankruptcy—with PG&E actually declaring bankruptcy—and their credit ratings were downgraded to junk status. They couldn't buy power for their customers. Governor Gray Davis declared a State of Emergency by January 2001.

D. The Legislative Response to the Energy Crisis

After the Governor declared a State of Emergency, the Legislature, CPUC, and Governor's Office worked together to identify another entity in California that had the credit rating to buy the large amounts of electricity that the IOUs could not. They selected the California Department of Water Resources, which subsequently entered into long-term contracts backed by the State's credit. While this arrangement put an end to stratospheric energy prices, the contracts were executed when prices were high and California's electricity customers had to pay those costs.

The Legislature also passed a number of bills aimed at reestablishing order

[41] Some sources cite the record high prices at closer to $1400/MWh in late 2000.

in the electric market, which largely put the IOUs back in charge. The Legislature prohibited the sale of any IOU-owned power plants until 2006,[42] suspended Direct Access and put a 10% cap on the nonresidential DA market,[43] mandated long-term power purchase contracts in order to stabilize reliability and pricing,[44] expedited permitting of thermal power plants and adopted energy conservation initiatives,[45] returned the electric supply and demand forecasting function to the California Energy Commission,[46] and increased CPUC authority over power plants.[47] The Legislature also created the Resource Adequacy requirement by mandating that all LSEs maintain physical generation capacity sufficient to meet its load requirements[48] and authorized CCA formation.[49] CCAs, and the regulatory requirements that are now constraining them, arose as a direct result of the energy crisis.

IV. POWER AND MONEY: CCA RESOURCE ADEQUACY AND COST RESPONSIBILITY REQUIREMENTS

Increased CPUC influence over CCA operations is most significant in terms of Resource Adequacy and the Power Charge Indifference Adjustment (PCIA). The former is the requirement that all LSEs secure enough power to supply all of their customers on a high-electricity-use day. The latter is the amount CCA customers must pay to reimburse the IOU for the electricity it bought for those customers before they left IOU service for the CCA. Resource Adequacy is the lynchpin of the CPUC's one-year minimum freeze on new CCA operations, and will impose increased procurement requirements (which means more money out of pocket) in the future. The PCIA, which the CPUC is currently redesigning, has the potential to shift hundreds of millions of dollars onto CCA customers, which may well force existing CCAs out of business or prevent new CCAs from forming.

[42] AB 6x (Dutra, Pescetti, Bowen).
[43] AB 1x (Keely, Migden).
[44] AB 57 (Wright).
[45] AB 970 (Ducheny).
[46] SB 1389 (Bowern). In the deregulated market, supply and demand were to have been provided by the competitive market instead of a statewide forecast. (See Green Book, p. 71.)
[47] SB 39xx (Burton, Speier).
[48] AB 380 (Nunes) (2005).
[49] AB 117 (Migden).

A. Resource Adequacy

The CPUC is charged with establishing Resource Adequacy (RA) requirements for all load-serving entities, which includes CCAs.[50] Resource Adequacy means that there is enough power available to serve the entire California grid in the coming year under high-electricity-demand scenarios, including demand spikes due to generator outages and transmission constraints; every LSE must demonstrate through monthly and annual filings that they have purchased capacity commitments of at least 115% of their peak load.[51] Capacity refers to the maximum output of electricity that a generator can produce under ideal conditions. Because all generators do not operate at maximum capacity 100% of the time, capacity is distinct from actual generation. Resource Adequacy focuses on capacity, instead of actual electric output, because the idea is that a certain amount of electricity has to be capable of being produced if necessary, not that the maximum level of energy be on the grid at all times.[52] This requirement—that there be more than enough power available to the grid at all times—arose as a direct result of the energy crisis.[53]

For purposes of resource adequacy requirements, CCAs are CPUC-jurisdictional LSEs.[54] Historically, the effect of CCA formation on the resource adequacy process has been minimal due to the small number of active CCAs. Since CCA formation began increasing rapidly in 2017, however, the effect on load allocation between IOUs and CCAs—and therefore the effect on resource adequacy commitments—has changed the procurement calculus faster than the CPUC has been

[50] Pub. Util. Code §§ 380(a), (k).
[51] D.04-01-050, *Interim Opinion, Order Instituting Rulemaking to Establish Policies and Cost Recovery Mechanisms for Generation Procurement and Renewable Resource Development* (January 26, 2004), p. 22.
[52] There are three types of Resource Adequacy: system, flexible, and local. System RA refers to the amount of electricity needed to serve the entire CAISO grid under peak load conditions, plus a 15% planning reserve margin. Because not every region, county, or city in California has the same population density and electricity usage, LSEs must also meet specific local RA requirements. Local RA requirements are calculated by the CAISO and are allocated to each CPUC-jurisdictional LSE by the CPUC. Flexible RA capacity was developed in 2013, seven years after system and local RA were adopted in 2006. Flexible RA, or "flexible capacity need," is the amount of economically dispatched electricity needed by the CAISO to manage grid reliability during the greatest three-hour continuous ramp in each month.[52] In plain language, this means that flexible RA is necessary when electricity use on the statewide grid increases sharply and steadily over a three-hour period. As with local RA, the CAISO calculates its expected maximum flexible capacity needs for each month and the CPUC allocates that need by MW to each CPUC-jurisdictional LSE.
[53] D.04-10-035, *Interim Opinion Regarding Resource Adequacy* (November 4, 2004), p. 3.
[54] Pub. Util. Code § 380(a).

able to track. The most recent CPUC RA decision addresses the fact that CCAs have tended to launch or expand service at times of the year that do not correspond with the RA procurement cycle.[55] Because CCA formation causes a significant and automatic shift in load from the incumbent IOU to the CCA, the misalignment between CCA operational timelines and the RA planning process has left the IOUs with significant excess RA capacity for customers they no longer serve.[56] It also means the CCA must generally procure RA for its new customers on short notice, and that procurement is not factored into the CPUC's statewide annual RA plan. To stop the disconnect from getting worse, CPUC's Energy Division proposed that CCA participation in the year-ahead RA process be mandatory. The CPUC agreed.[57] CCAs must now submit load forecasts and year-ahead RA filings if they wish to serve load or expand their service territory in the following calendar year. This new requirement is what created the one-year implementation freeze imposed on new or expanding CCAs by Resolution E-4907.

In addition to the implementation holding period, the CPUC is currently considering how best to enact a multi-year local RA requirement for all LSEs.[58] The RA procurement cycle has always been one year, but recent resource shortages in specific locations and the rapid dispersal of RA responsibility among an increasing number of CCAs, prompted the CPUC to start looking at a three-to-five year RA cycle for local resources and the possibility of designating a central buyer.[59] The multi-year requirement will impose increased costs on LSEs because they will be required to buy capacity at the start of the cycle for each year of the cycle. The CPUC's Energy Division originally recommended LSEs be required to purchase 100% of their local RA requirement for Years 1 and 2 and 80% for Year 3; the CCAs, by contrast, proposed 90% for Year 1 and 25% for Years 2 and 3.[60] The CPUC directed 100% procurement in Year 1 and 95% in Year 2, and asked parties to make proposals for Year 3.[61] The CPUC also indicated that a central buyer for local RA is "the solution most likely to provide cost efficiency, market

[55] D.18-06-030, *Decision Adopting Local Capacity Obligations for 2019 and Refining the Resource Adequacy Program* (June 25, 2018), p. 17.
[56] *Ibid.*
[57] *Id.* at p. 16.
[58] See D.18-06-030, p. 28.
[59] *Id.* at pp. 24–25, 28–33.
[60] *Id.* at p. 29.
[61] *Id.* at pp. 29–30.

certainty, reliability, administrative efficiency, and customer protection."[62] While the CPUC asked for parties' proposals regarding the structure of the multi-year local RA program, and whether and how a central buyer should be established, it appears the CPUC heavily favors a central buyer of some kind.[63] If the CPUC continues down that path, the CCAs will lose a portion of the procurement autonomy they have defended so fiercely at the CPUC.

B. Resolution E-4907: One-year Freeze on New CCA Operations

Control over future purchasing decisions for local Resource Adequacy capacity is not the only limitation the CPUC has imposed on CCAs recently. With Resolution E-4907, the CPUC imposed an unprecedented restriction on CCA implementation: new or expanding CCAs must file their implementation plans by January 1 in order to serve load *starting in the following year*.[64] The purpose of this minimum one-year holding period is to align CCA operations with the CPUC's Resource Adequacy planning process.[65]

Before Resolution E-4907, CCAs were able to form and launch service on their own timeline. The only CPUC-related timing requirement was the 90-day period in which the CPUC had to certify receipt of the CCA's implementation plan, and the subsequent time (if any) necessary for the CPUC to provide the CCA with its determination of the costs CCA customers must pay to reimburse the IOU that used to serve them for any now-unnecessary power purchased on their behalf.[66] While the CCA would have to comply with CPUC-administered procurement requirements for resource adequacy and renewable energy, the CPUC's own view of its authority over CCA operations was always extremely limited.

The CPUC characterized the new CCA implementation timeline as "an informal process of review,"[67] but the substance of the Resolution shows an iron hand in a velvet glove. The CPUC did not change its longstanding conclusion that it lacks authority over actual CCA operations or procurement decisions, but instead justified its

[62] *Id.* at p. 32.
[63] *Id.* at pp. 32–33.
[64] Res. E-4907, p. 11.
[65] *Ibid.*
[66] Pub. Util. Code § 366.2(c)(7).
[67] Res. E-4907, p. 1.

abrupt directive as part of the statutory requirement that CCAs submit implementation plans to the CPUC, and as an extension of the 2005 decision that established the original filing practices.[68] The CPUC also cited to Section 366.2(c)(4), which requires CCA implementation plans to provide for universal access, reliability, equitable customer treatment, "and any requirements established by state law or by the commission concerning aggregated service."[69]

While the one-year minimum freeze may only be a function of the CPUC's limited purview over the submission of CCA implementation plans, the effect of that holding period is substantive. CCA comments on the proposed Resolution expressed concern with the apparent lack of process—the Draft Resolution issued without notice to or input from stakeholders—and the significant burden the waiting period would place on nascent CCAs.[70] The CPUC dismissed the due process concerns by stating that "[t]he changes in the CCA timeline made by this resolution are an exercise of authority the Commission has had since 2002. Section 366.2(c)(8) establishes the authority of the Commission to designate a CCA's start date with consideration of the impact on the [IOU's] annual procurement."[71] The CPUC created a limited exception to the new filing deadline in response to the outcry from CCAs: the filing deadline to serve load in 2019 was moved back two months to March 1, 2018, and a waiver process was created for CCAs that were able to reach an agreement with the IOU to resolve cost-shifting issues.[72] The CPUC's recent RA decision declined to extend this exception beyond 2018.[73]

C. <u>The Power Charge Indifference Adjustment</u>

The CPUC's resolution of the cost-allocation issue between IOU and CCA customers is the second thing that will have a significant impact on CCA operations in the future. The PCIA is part of the CPUC's Cost Responsibility Surcharge, which was implemented immediately after the energy crisis to ensure that customers that were on Direct Access service pre-crisis—the only customers allowed to get electricity from non-IOU providers post-crisis—paid their fair share of IOU costs incurred on their behalf

[68] See *id.* at pp. 8–11.
[69] Res. E-4907, p. 10.
[70] *Id.* at pp. 15–17.
[71] *Id.* at p. 16.
[72] *Id.* at p. 17.
[73] D.18-06-030, p. 21.

before they became DA customers.[74] The PCIA specifically addresses the IOUs' above-market costs for the energy they procure, or power plants they built, on behalf of customers that subsequently leave for CCA or DA service. The bulk of the IOUs' PCIA-eligible portfolios are long-term contracts for renewable energy that were entered into when the renewables market in California was getting started; as a result, most of the contracts are significantly more expensive than the current market value for renewable energy.[75] This fact, combined with the rapidly increasing numbers of customers leaving utility service for CCAs, means that the IOUs are holding a significant amount of expensive power for which they have no customers—but the power still has to be paid for by the customers for whom the IOUs bought it.[76]

The current PCIA methodology does not accurately assign power costs between IOU and departed customers because it uses forecasts, administratively created benchmarks (placeholder prices), and other administrative cost adders,[77] instead of relying on actual contract costs, actual generation, and actual market prices for energy. The exact size and direction of the improper cost allocation is hotly disputed: the CCAs calculate an annual cost shift of $173 million from IOU customers to CCA customers[78]; the IOUs calculate an annual cost shift of $178 million in the other direction, from CCA customers to IOU customers.[79] The best way to change the methodology to eliminate the improper cost shifting is even more bitterly contested, and parties have proposed a range of revised benchmarks, annual true-ups, proposals to break up and reallocate the IOUs' energy contracts, and market-based solutions involving actual costs and revenues. The CPUC issued a Proposed Decision on August 1, 2018, which adopted a two-part solution. First, the market price benchmarks will be adjusted to more accurately reflect the market price of the IOUs' power contracts; a 2.2 cent/kWh cap and a 0.5 cent/kWh maximum

[74] D.02-11-022, *Opinion, Order Instituting Rulemaking Regarding the Implementation of the Suspension of Direct Access Pursuant to Assembly Bill 1X and Decision 01-09-060*, pp. 2–3. The current methodology used to calculate departing customer responsibility for IOU energy procurement costs was adopted in D.06-07-030 and revised in D.11-12-018.
[75] For example, in 2011 the price of solar energy was approximately $100/MW; in 2018, solar energy is between $30 and $50/MW. (See Joint IOU Testimony, R.17-06-026, pp. 1-10 (line 9)–1-11 (line 4).
[76] See Pub. Util. Code § 366.2
[77] Joint IOU Testimony, R.17-06-026, ch. 2, pp. 2-8 to 2-9. While the parties to the PCIA reform proceeding have different views on the specific flaws in the PCIA methodology and how best to address them, all parties agree the current methodology is not working.
[78] CalCCA Opening Brief, R.17-06-026, p. 25.
[79] Joint IOU Reply Testimony, R.17-06-026, ch. 1, pp. 1-6 (line24)–1-7 (line 3).

annual adjustment, coupled with an annual true-up process, will also be implemented.[80] In the second phase, the parties will continue to discuss longer-term market-based solutions to decreasing the IOUs' excess power portfolios and to fairly allocating the costs to customers.[81] On August 14, 2018, the Assigned Commissioner issued an Alternate Proposed Decision that, among other things, increased the rate collar to a 25% up/down range on either side of the previous year's PCIA rate.[82] The Alternate Proposed Decision also determined that CCAs are responsible to pay the costs of utility-owned generating plants that were built before 2002[83]; the Proposed Decision concluded that CCAs should *not* pay those costs.[84] The rate cap and limit on annual adjustments in the CPUC's tentative decision has granted a reprieve to departed load customers from bearing the full brunt of the IOUs' stranded power costs. The final decision, which may contain changes to the determinations in the Proposed Decision or Alternate Proposed Decision, and the outcome of Phase II of the proceeding will ultimately determine whether the PCIA will allocate hundreds of millions of additional dollars per year to CCA customers, which could eliminate CCA cost-competitiveness and drive customers back to the IOUs.[85]

V. THE GREEN BOOK: CPUC VIEWS ON EMERGING CUSTOMER CHOICE

The CPUC launched its California Customer Choice Project following a joint hearing with the California Energy Commission in May 2017. In May 2018, the CPUC issued the draft Green Book, which sets out the framework for the conversation between California's energy policy decision-makers and stakeholders about how to address the changing electricity market.[86] The Green Book addresses market changes other than CCA proliferation, such as the increase in rooftop solar and other behind-the-meter resources, but CCAs are a major focus. The fundamental questions posed in the Green Book concern ensuring grid reliability and resiliency, adequate consumer

[80] Proposed Decision Modifying the Power Charge Indifference Adjustment Methodology (August 1, 2018), Ordering Paragraphs, pp. 128–131.
[81] Proposed Decision, R.17-06-026, Ordering Paragraph 10.
[82] Alternate Proposed Decision, R.17-06-026, Conclusion of Law Nos. 20 and 21.
[83] *Id.* at pp. 47–48.
[84] Proposed Decision, R.17-06-026, pp. 56–58.
[85] CalCCA estimates that CCA rates are on average 3% lower than the IOU rates.
[86] Green Book, p. iv.

protections given the new options, IOU ability to recover the costs of their power contracts and the costs of maintaining the transmission and distribution system that will continue to be used by CCAs and DA providers, and identifying who will be responsible (and financially able) for buying long-term power contracts, all while ensuring California's renewable energy goals are met.[87] The Green Book draws parallels between the market changes that led to the energy crisis and the changes resulting from CCA formation; the CCAs objected to this comparison.[88] Despite the CCAs' arguments to the contrary, the CPUC has yet to exorcise the spectre of the energy crisis and remains preoccupied with the implications of CCA proliferation for California's grid reliability.

On June 22, 2018, the CPUC and California Energy Commission held a joint *en banc* to discuss customer choice and the Green Book.[89] During the first panel on the level of choice Californians should have and how best to provide it, CPUC President Picker questioned CCA representatives on whether CCAs perform risk management at a level that the CPUC is looking for. President Picker focused on whether CCAs have a view on who should assume the responsibility of being the providers of last resort if the IOUs are relieved of that duty, and whether CCAs have a view on and a plan for the reopening of Direct Access for commercial and industrial customers—which form a significant rate base for any LSE—if the pending Senate Bill 237 passes.[90] President Picker said the answers made him "a little nervous" because it seemed to him that CCAs hadn't thought about it, and weren't accounting for the rapid legislative changes that can happen in the energy market, which indicated to him that CCAs aren't doing the kind of risk management that he wants to see. While President Picker was speaking in his personal capacity during the *en banc*, his concerns are mirrored in the CPUC's recent exercise of increased control over CCAs to ensure reliability and to prevent a second breakdown in the structure of the California energy market.

[87] *Id.* at pp. 6–7.
[88] Comments of CalCCA on Draft Green Book, p. 2, available at: http://www.cpuc.ca.gov/uploadedFiles/CPUC_Public_Website/Content/Utilities_and_Industries/Energy_-_Electricity_and_Natural_Gas/California%20Community%20Choice%20Association%20(CalCCA)_DraftGreenBookComments.pdf.
[89] Video available at: http://www.adminmonitor.com/ca/cpuc/en_banc/20180622/.
[90] SB 237 (Hertzberg) (2017–2018 Reg. Sess.). The bill was placed on the suspense file during its August 8, 2018, Assembly Appropriations Committee hearing.

VI. OTHER EXPANDED CPUC REGULATION OF CCAS

The CPUC has recently increased its oversight of CCAs in other areas, though these expanded requirements will not have as significant an impact on CCA operations as Resource Adequacy and cost responsibility.

A. Renewables Portfolio Standard Requirements

CCAs are required to file proposed RPS procurement plans to demonstrate their compliance with the renewable energy targets set forth in Senate Bill 350,[91] and the CPUC must issue a decision determining whether the plans comply with the statutory procurement requirements and CPUC rules. In 2016, CPUC determined that it was not necessary to require CCAs to file RPS solicitation documentation and cost quantification tables in their RPS plans, both of which the large IOUs must provide.[92] In the Ruling identifying issues and setting the schedule for the 2017 RPS procurement plan cycle, the Commission reversed this decision.[93] Because the rapid proliferation of CCAs is affecting the manner in which California's renewable energy targets are met and the manner in which the CPUC administers that process, the CPUC directed CCAs to include RPS solicitation and cost information in their procurement plans.[94]

In 2018, the CPUC increased CCA compliance requirements again. Now, in addition to project development status updates, potential compliance delays, and risk assessment information,[95] CCAs must also provide an assessment of their RPS portfolio supplies and demand, and explain how they intend to increase portfolio diversity to address issues of renewable integration, under-utilization of RPS-eligible generation, forecasted transportation electrification, and maximizing customer value; this discussion must be squared with the information previously submitted in CCAs' implementation

[91] New CCAs must file their RPS plans upon registering with the CPUC or 90 days prior to delivering load, whichever occurs first. (D.17-12-007). Because CCAs are now subject to a minimum one-year freeze between registering and commencing service, RPS plans must be submitted along with the CCA's registration materials.
[92] D.16-12-044, *Decision Accepting Draft 2016 Renewables Portfolio Standard Procurement Plans* (December 15, 2016).
[93] Docket R.15-02-020, *Assigned Commissioner and Assigned Administrative Law Judge's Ruling Identifying Issues and Schedule of Review for 2017 Renewables Portfolio Standard Procurement Plans, etc.* (May 26, 2017), pp. 6–7 ("2017 RPS Ruling").
[94] *Ibid*; see also Pub. Util. Code § 399.13(a)(5).
[95] 2017 RPS Ruling, p. 9, Table 1.

plans.[96] CCAs expanding their service territory must now provide quantitative data on how increased customer demand and load served will affect the CCA's RPS procurement and load forecasts, and an explanation of how the CCA plans to serve that load with existing or future procurement.[97] The 2018 RPS ruling also directs CCAs, for the first time, to identify their assumed minimum margin of procurement above the minimum level necessary to comply with the RPS program that will mitigate the risks of delayed or terminated renewable projects that are under contract to the CCA.[98]

This new information requirement will promote transparency and the ability of the CPUC to understand and forecast the amount and types of renewable energy resources that will serve California in the next 10 to 20 years.[99]

B. Integrated Resources Planning Requirements

The most recent iteration of the Integrated Resources Planning (IRP) process at the CPUC was instituted to address the new RPS requirements of SB 350.[100] SB 350 required *all* LSEs, not just the IOUs, to submit integrated resource plans to the CPUC[101]; integrated resource plans are intended to ensure LSEs have an optimized portfolio of energy resources that meets the policy goals of reliability, cost, and reducing GHG emissions.[102] As the CPUC considered how best to structure the new IRP framework to include CCA integrated resource plans, the CCAs urged the CPUC to take the same hands-off approach as with CCA implementation plans: certification that the IRP was submitted, but no substantive control over the procurement or planning contained therein.[103] The CPUC disagreed.[104] The CPUC concluded that its role "is to certify substantive compliance of the CCA's plan" to ensure consistency with the

[96] Docket R.15-02-020, *Assigned Commissioner and Assigned Administrative Law Judge's Ruling Identifying Issues and Schedule of Review for 2018 Renewables Portfolio Standard Procurement Plans* (June 21, 2018), p. 9 ("2018 RPS Ruling").
[97] *Ibid.*
[98] 2018 Ruling, p. 12
[99] 2018 RPS Ruling, pp. 6, 8.
[100] *Joint Scoping Memo and Ruling of Assigned Commissioner and Administrative Law Judge*, R.16-02-007, p. 2.
[101] Rulemaking 16-02-007, p. 14.
[102] *Id.* at p. 13.
[103] D.18-02-018, pp. 23–24.
[104] *Id.* at p. 25 ("We maintain that our authority and responsibility over CCA planning is considerably broader than the CCAs and their representatives argue.").

requirements of SB 350.[105] If the CPUC finds that a CCA's integrated resource plan does not conform to the statutory requirements, the CPUC has the authority to order long-term procurement commitments by the CCA.[106]

C. Rulemaking on "Affordable" Utility Service

On July 12, 2018, the CPUC opened a Rulemaking to examine what constitutes "affordable" utility service, how the CPUC should measure it, and what changes must be made to ensure affordability.[107] The CPUC did not require CCA participation in this Rulemaking, but it encouraged them to become parties because CCAs may be affected by the outcome of the proceeding.[108]

VII. CONCLUSION

Despite the fact that CCAs are not answerable to the CPUC for the majority of their operations and decisionmaking, the CPUC has made it clear that it will exercise what authority it does have to the fullest extent in order to ensure reliability and to avoid a second energy crisis. The CPUC's recent edicts regarding implementation timelines, procurement requirements, and the costs that will ultimately be assigned to CCAs in the second phase of the PCIA proceeding will all have a marked effect on CCAs' daily operations and may impact their long-term viability.

[105] *Id.* at pp. 26–27.
[106] *Id.* at p. 28.
[107] Rulemaking 18-07-006, pp. 10–12.
[108] *Id.* at pp. 15–16.

FPPC Update

Thursday, September 13, 2018 General Session; 8:00 – 9:30 a.m.

Daniel G. Sodergren, City Attorney, Pleasanton

Notes:

FAIR POLITICAL PRACTICES COMMISSION ("FPPC") UPDATE

League of California Cities 2018 Annual Conference

September 13, 2018

DANIEL G. SODERGREN
CITY ATTORNEY
CITY OF PLEASANTON

Table of Contents

A. ENFORCEMENT

Enforcement Action against Los Angeles County (Use of Public Funds in an Election)

The Fair Political Practices Commission ("Commission") is considering whether Los Angeles County failed to properly disclose payments made for communications that were allegedly covered by Regulation 18420.1, which addresses payments by state or local agencies for a campaign related communication. The communications at issue included television spots the County made to inform its residents about a March 2017 ballot measure (Measure H), a sales tax measure to fund homeless services and prevention. The Howard Jarvis Taxpayers Association complained that the communications expressly advocated for passage of the measure.

Measure H passed with approximately 69% of the voters approving. This matter is also now the subject of litigation (*Howard Jarvis Taxpayers Association v. County of Los Angeles* (Los Angeles County Superior Court Case No. BC714579) filed on July 17, 2018).

1. Background

This enforcement action raises important questions related to the distinction between the legal standards that apply to campaign finance reporting under the Political Reform Act[1] (the "Act") and the constitutional limitations that apply to the expenditure of public funds to support or defeat a ballot measure.

a. Constitutional Limitations

In *Vargas v. City of Salinas* (2009) 46 Cal.4th 1, the California Supreme Court reaffirmed its holding in *Stanson v. Mott* (1976) 17 Cal.3d 206, which established that, absent clear and unambiguous statutory authority, cities may not spend public funds to assist in the passage or defeat of an initiative or other ballot measure. Nevertheless, cities may spend public money for informational purposes, to provide the public with a "fair presentation" of relevant information relating to an initiative or other ballot measure.

These cases point out that some activities "unquestionably constitute improper campaign activity" such as ". . . the use of public funds to purchase such items as bumper stickers, posters, advertising "floats," or television and radio 'spots.'" (*Stanson v. Mott, supra,* 17 Cal.3d at p. 221; *Vargas v. City of Salinas, supra*, 46 Cal.4th at p. 32.) In other cases, ". . . 'the style, tenor and timing' of a communication must be considered in determining whether the communication is properly treated as campaign activity." (*Vargas*, at p 33 (citing to *Stanson*, at p. 222.).)

[1] The 1974 voter-adopted Political Reform Act is contained in Government Code Sections 81000 through 91014. All statutory references are to the Government Code, unless otherwise indicated. The regulations of the Fair Political Practices Commission are contained in Sections 18110 through 18997 of Title 2 of the California Code of Regulations. All regulatory references are to Title 2, Division 6 of the California Code of Regulations, unless otherwise indicated.

b. Campaign Finance Reporting

The Act requires political candidates and campaign committees to file written reports of election expenditures made and contributions received once certain thresholds are reached. (§§ 84204.5, 82013.)

In *Governor Gray Davis Com. v. American Taxpayers Alliance* (2002) 102 Cal.App.4th 449, the court made clear that the definition of an "expenditure" under the Act must be ". . . limited in accordance with the First Amendment mandate 'that a state may regulate a political advertisement only if the advertisement advocates *in express terms the election or defeat of a candidate.*' [Citation omitted.]" (*Id.*at p. 470.)

Taking into account this limitation, the definition of "independent expenditure" contained in section 82031 was amended in 2009 to now provide that:

> "Independent expenditure" means an expenditure made by any person, including a payment of public moneys by a state or local governmental agency, in connection with a communication which expressly advocates the election or defeat of a clearly identified candidate or the qualification, passage or defeat of a clearly identified measure, or taken as a whole and in context, unambiguously urges a particular result in an election but which is not made to or at the behest of the affected candidate or committee.

In 2009, the Commission amended Regulation 18420.1 to clarify when a payment of public moneys by a state or local governmental agency constitutes an "independent expenditure" for the purposes of section 82031. In doing so, the Commission incorporated both the "express advocacy" standard set forth in 82031 and the standards set forth in the *Vargas* and *Stanson* cases. Regulation 18420.1 now reads in relevant part that:

> (a) A payment of public moneys by a state or local governmental agency, or by an agent of the agency, made in connection with a communication to the public that expressly advocates the election or defeat of a clearly identified candidate or the qualification, passage, or defeat of a clearly identified measure, as defined in Section 82025(c)(1), or that taken as a whole and in context, unambiguously urges a particular result in an election is one of the following:
>
> > (1) A contribution under Section 82015 if made at the behest of the affected candidate or committee.
> >
> > (2) An independent expenditure under Section 82031.
>
> (b) For the purposes of subdivision (a), a communication paid for with public moneys by a state or local governmental agency unambiguously urges a particular result in an election if the communication meets either one of the following criteria:

(1) It is clearly campaign material or campaign activity such as bumper stickers, billboards, door-to-door canvassing, or other mass media advertising including, but not limited to, television, electronic media or radio spots.

(2) When considering the style, tenor, and timing of the communication, it can be reasonably characterized as campaign material and is not a fair presentation of facts serving only an informational purpose.

In adopting these amendments to Regulation 18420.1, the Commission did add this cautionary note:

> COMMENT: Nothing in this regulation should be read as condoning or authorizing use of public moneys for campaign related activities by a state or local governmental agency. Under many circumstances these activities may be illegal. (See Penal Code Section 424; Government Code Sections 8314, 54964, and 89001; Education Code Section 7054; and *Vargas v. City of Salinas* (2009) 46 Cal.4th 1.).

2. Comment Letter

The California State Association of Counties ("CSAC") and the League submitted written comments in support of Los Angeles County in the pending administrative enforcement action (a copy of which is attached). These comments include arguments that Regulation 18420.1 is beyond the scope of the Commission's jurisdiction and is inconsistent with the definition of "independent expenditure" contained in section 82031.

As mentioned above, in adopting Regulation 18420.1, the Commission relied in part on the California Supreme Court decision in *Vargas v. City of Salinas*, *supra*, 46 Cal.4th 1, to define a contribution or independent expenditure. However, the *Vargas* case addressed the constitutionally permissible use of public funds to communicate with a public agency's constituents and specifically rejected the use of the Act's standards in that context.[2] Therefore, the comment letter argues that Regulation 18420.1 goes beyond the Act and into the realm of constitutional speech, and therefore, exceeds the jurisdiction of the Commission.

The comment letter questions whether Regulation 18420.1 would apply to such things as: community television channels that broadcast city council meetings, where ballot measures may be discussed and city councils may take positions by adopting resolutions; and placing informative documents concerning the impact of a ballot measure on a city website. The comment letter states that creating this type of ambiguity ". . . illustrates why the FPPC should not be in the business of enforcing constitutional speech standards."

[2] See *Vargas v. City of Salinas*, *supra*, 46 Cal.4th at 31-32 ["Whatever virtue the 'express advocacy' standard might have in the context of the regulation of campaign contributions to and expenditures by candidates for public office, this standard does not meaningfully address the potential constitutional problems arising from the use of public funds for campaign activities that we identified in *Stanson*." (footnote omitted.)].

B. ADVICE LETTERS

The following are select advice letters issued by the Commission between May 4, 2018 and August 16, 2018:

1. Interests in Real Property

a. 500-foot Property Rule

Under the Act's 500-foot rule, set forth in Regulation 18702.2(a)(11), a decision's effect on an official's real property interest, other than an interest in commercial property containing a business, is material if the decision affects real property within 500 feet of the official's real property, unless there are sufficient facts to indicate that the decision will not have a reasonably foreseeable measurable impact on the official's real property. During this reporting period, the Commission issued seven advice letters involving the 500-foot rule. Five of the seven advice letters concluded, on the specific facts, that there would be a reasonably foreseeable and material impact on the official's financial interest. In the following two advice letters, the Commission determined that the official could participate in the decision:

- **Mooney Advice Letter No. A-18-067**

City councilmember who owns residential rental property within 500 feet of an area zoned as Intensive Use can participate in amendments to the city's zoning ordinance which would allow recreational marijuana cultivation, manufacturing and distribution, in Intensive Use zoned areas. This is based on the fact that Intensive Use areas are already zoned to allow medical marijuana and the extension of permissible use to include recreational marijuana does not present a reasonably foreseeable measurable impact on the councilmember's property.

- **Eckmeyer Advice Letter No. A-18-087**

Heritage commissioners may take part in decisions relating to an application for a property tax reduction under the Mills Act even though the residential property that is the subject of the application is located within 500 feet of each of the commissioners' respective residences. Because the Mills Act contract would not include exterior work to the property - only window repairs, foundational improvements, and landscaping - it would have very little effect on neighboring properties or the overall character of the neighborhood.

b. Other Real Property Interests

- **Hill Advice Letter No. A-18-092**

Regulation 18702.2(a)(6) provides that the reasonably foreseeable financial effect of a governmental decision on a parcel of real property in which an official has a financial interest, other than a leasehold interest, is material whenever the governmental decision:

> Involves construction of, or improvements to, streets, water, sewer, storm drainage or similar facilities, and the parcel in which the official has an interest will receive new or improved services that are distinguishable from improvements and services that are provided to or received by other similarly situated properties in the official's jurisdiction or where the official will otherwise receive a disproportionate benefit or detriment by the decision.

In this advice letter, the Commission determined that, because highway on and off-ramps are similar to "facilities" and "streets", a mayor could not participate in decisions relating to the selection of U.S. Highway 101 on and off-ramps given that sites under consideration were within approximately 2,600 feet of his residence.

- **Mooney Advice Letter No. A-18-076**

This advice letter relates to zoning ordinance amendments that established standards for accessory dwelling units ("ADUs") in residentially zoned areas in the city. A city councilmember owned five properties in the city - four residential and one commercial - that may have been eligible for the construction of an ADU under the proposed zoning ordinance amendments.

Under the Act, a decision's financial effect on an official's interest is presumed reasonably foreseeable if the interest is a named party in, or the subject of, the decision (Regulation 18701(a)). An interest is the "subject' of a proceeding, and deemed materially affected, when the decision determines the parcel's zoning or rezoning (other than a zoning decision applicable to all properties designated in that category). (Regulation 18702.2(a)(2).)

In this case, the Commission determined that the councilmember could not participate in the decision because his real property ". . . is the subject of this decision regarding staff's proposed zoning amendments. His five parcels are currently in the areas zoned for ADU's and the decision on the amendments will determine if he may have ADUs on these parcels."

2. Interests in Business Entities

- **Borger Advice Letter No. A-18-059**

Mayor who owns and operates a gas station located approximately 2,165 feet from a Costco facility may not participate in a decision to include a gas station at the Costco facility. Regulation 18702.1 provides that a decision's effect on an official's business interest is material if a prudent person with sufficient information would find it reasonably foreseeable that the decision's financial effect would contribute to a change in the value of the privately-held business entity. In this case, the Commission determined that "[i]f the Costco Project is approved, it will increase the competition borne by gas stations within the City, including the Mayor's gas station." The Commission based this on the fact that there were only four gas stations in the City and the Costco gas station would much larger than the average gas station. Therefore, the Commission found that it was reasonably foreseeable that the decisions relating to the Costco gas station would contribute to a change in value of the mayor's gas station.

3. Government Code Section 1090

a. Consultants

The California Supreme Court recently affirmed that "[i]ndependent contractors come within the scope of section 1090 when they have duties to engage in or advise on public contracting that they are expected to carry out on the government's behalf." (*People v. Superior Court* (*Sahlolbei*) (2017) 3 Cal.5th 230, 245.)

- **Sanchez Advice Letter No. A-18-157**

Consulting engineering firm was hired by city to prepare final project drawings, plans and written specifications (Contract Documents) that would serve as a basis for the award of a contract to a construction contractor who would actually build a regional recycled water project ("project"). The Commission determined that the consulting engineering firm could also enter into a contract with the city to perform both engineering design services during construction and construction management services related to the project. In doing so, the Commission found that the firm had no financial interest in the contract because it did not seek to build the project. The Commission also pointed out that:

> It is plain that [the engineering firm's] pre-construction design services did not determine the scope of the engineering design services during construction, which is dependent upon inquires and request form the contractor who builds the project. If fact, these engineering services during construction would simply be a continuation of the same pre-construction design services [the engineering firm] has already provided.

b. Nonprofit Corporations and Entities

i. Officer or Employee of a Nonprofit Corporation or Entity

Under section 1091(b)(1), an officer or employee of a nonprofit corporation, or an Internal Revenue Code Section 501(c)(3) or 501(c)(5) entity, has a remote interest in contracts of that nonprofit corporation or entity. Therefore, such interest must be disclosed to the body or board of which the official is a member and noted in its official records, and the official must recuse him or herself from any participation in the contract.

- **Goldstein Advice Letter No. A-18-056**

County supervisor's husband was offered a paid position with a nonprofit corporation. Therefore, the board of supervisors may make grants to the nonprofit corporation as long as the interested supervisor discloses her interest and recuses herself from any participation in the contract.

ii. Nonsalaried Member of a Nonprofit Corporation

Under section 1091.5(a)(7), an officer or employee is deemed not to be interested in a contract if his or her interest is that of a ". . . nonsalaried member of a nonprofit corporation, provided that the interest is disclosed to the body or board at the time of the first consideration of the contract and provided further that this interest is noted in its official records."

- **Torres Advice Letter No. A-17-270**

Member of city's finance committee, who is an equity member of private member-owned country club incorporated as a nonprofit mutual benefit corporation, is considered to be a "non-salaried member of a non-profit corporation" for the purposes of section 1091.5(a)(7).[3] Therefore, under section 1090, he has no financial interest in in the country club's renegotiation of an agreement or license with the city.[4]

iii. Noncompensated Officer of a Nonprofit Corporation

Under section 1091.5(a)(8) an officer or employee is deemed not to be interested in a contract if his or her financial interest is that of a ". . . noncompensated officer of a nonprofit, tax-exempt corporation, which, as one of its primary purposes, supports the functions of the body or board or to which the body or board has a legal obligation to give particular consideration, and provided further that this interest is noted in its official records."

- **Khalsa Advice Letter No. A-17-248**

City librarian would not be prohibited from participating in the making or administration of any future agreements with a nonprofit organization in her role as librarian if she also served as an uncompensated volunteer member of the organization's board of directors. Because the nonprofit organization ". . . was created to showcase historical research and support the creation of 3D models of local building, landmarks, and street scenes," the Commission determined that its primary purposes supported the functions of the city and, therefore, the noninterest exemption contained in section 1091.5(a)(8) applied.

- **Barneich Advice Letter No. A-18-073**

City councilmember, who is also a member of the board of directors of a non-profit organization, may take part in the city council's decisions to donate to or enter into contracts with the organization. Because the organization's primary purposes includes aiding the city's homeless population by providing food, shelter, and medical and mental health services, it supported the

[3] The Advice Letter points out that "[t]he reference to "member" refers to persons who constitute the membership of an organization, rather than to those individuals that serve on its board of directors. [citing to 65 Ops.Cal.Atty.Gen. 41 (1982]."

[4] However, the Commission did find that the effect of the potential renegotiation decision on the official's personal finances was reasonably foreseeable and material due to a potential increase in dues. Therefore, the Commission ultimately determined that he did have a conflict of interest under the Act.

function of providing community services to the city's homeless population. Therefore, the Commission determined that the noninterest exemption contained in section 1091.5(a)(8) applied.

4. Behested Payments

- **Peters Advice Letter No. I-18-065**

This advice letter provides good general guidance on the Act's behested payment reporting requirements.

Under the Act, an elected official who fundraises or otherwise solicits payments from one individual or organization to be given to another individual or organization ('behested payments") is required to report within a 30-day period the payment where the aggregate payment(s) equal or exceed $5,000 from the same source in a calendar year. (Regulation 18215.3.)

Under Regulation 18215.3, payments "made at the behest of" means "made under the control or at the direction of, in cooperation, consultation, coordination, or concert with, at the request or suggestion of, or with the express, prior consent of the elected officer . . . ." However, a payment is not "made at the behest of" an elected officer, and is not subject to the reporting requirements, if the payment is made in response to a fundraising solicitation from a charitable organization requesting a payment where the solicitation does not "feature" the officer. "Features an elected officer" means that the item mailed: (a) includes the elected officer's photograph or signature, or singles out the elected officer by the manner of display of his or her name or office in the layout of the document, such as by headlines, captions, type size, typeface, or type color; or (b) if the roster or letterhead listing the governing body contains a majority of elected officers.

C. REGULATIONS

1. New Regulations 18308, 18308.1, 18308.2, and 18308.3 (Governance Regulations)

These new regulations, discussed below, outline in great detail the specific authority of the Commission, the Chair, and the Executive Director, respectively.

2. Amendment to Regulation 18700.2 (Parent, Subsidiary, Otherwise Related Business Entities)

The Commission adopted an amendment to Regulation 18700.2 to clarify when an official with an interest in a business entity also has an interest in a parent, subsidiary, or related business entity. The amendment creates two exceptions to when an official has an interest in a parent or subsidiary of a business entity: (1) when the subsidiary has not been listed on reports filed by the parent corporation with the SEC; and (2) when an official's ownership interest in the business entity is below a certain threshold. The amendment is as follows:

§ 18700.2. Parent, Subsidiary, Otherwise Related Business Entity: Defined.

(a) For purposes of Section 82034 and Section 87209, in determining if a business entity has an interest in real property or does business or plans to do business in the jurisdiction, or has done business in the jurisdiction at any time during the two years prior to the time any statement or any other action is required under the Act, the business entity includes a "parent," "subsidiary," or "otherwise related to" another business entity as those terms are defined in subdivision (b) below.

(b) Parent, Subsidiary, Otherwise Related Business Entity, defined.

(1) Parent - A business entity is a "parent" if it is a corporation that controls more than 50 percent of the voting stock of another corporation. The parent corporation is also a parent to any subsidiaries of the corporation that it controls.

(2) Subsidiary - A business entity is a "subsidiary" if it is a corporation whose voting stock is more than 50 percent controlled by another corporation. The subsidiary corporation is also a subsidiary to any corporation that controls its parent corporation.

(3) Otherwise related business entity. Business entities, other than a parent corporation as defined in subdivision (b)(1), are otherwise related if:

(A) The same person or ~~a majority of the same~~ persons together direct or control each business entity; or

(B) The same person or ~~a majority of the same~~ persons together have a 50 percent or greater ownership interest in each business entity.

(c) An official with a financial interest in a business entity also has an interest in a parent or subsidiary of the business entity or an otherwise related business entity except when the business entity meets the criteria provided in subdivision (d).

(d) An official with a financial interest in a business entity does not have an interest in a parent or subsidiary of the business or an otherwise related business entity if:

(1) The official's only interest is that of a shareholder and the official is a passive shareholder with less than 5 percent of the shares of the corporation.

(2) The parent corporation is required to file annual Form 10-K or 20-F Reports with the Security and Exchange Commission and has not identified the subsidiary or related business entity on those forms or its annual report.

3. Proposed Regulations

a. Enforcement Streamline Settlement Program

The Commission plans on discussing the potential adoption of regulations codifying the Enforcement Division's Streamline Settlement Program, which was established for prosecution of those violations with a lesser degree of public harm.

b. Bitcoin

The Commission plans on considering the question whether Bitcoin or other cryptocurrencies are permitted currencies for campaign contributions.

c. 500-foot Property Rule

The Commission plans on discussing the materiality thresholds under the Act's conflict of interest provisions including bright-line materiality standards and clarification of the 500-foot property rule.

D. ACTIVITIES OF THE COMMISSION

1. Review of Enforcement Division's Practices and Procedures

Earlier this year, the Commission agreed to conduct a holistic review of the Enforcement Division's practices and procedures. The stated purpose of the review is to inform and achieve the following three goals:

1. The establishment by the Commission of step-by-step procedures that Enforcement will follow going forward, which shall include task lists, timelines, exceptions to timelines, procedures for obtaining extensions on those timelines from the Commission, investigations, and contact with the press regarding existing matters;

2. The reduction of those procedures to a writing subject to Commission approval in the form of a procedures manual that can be reviewed/revised with public comment from time to time as the Commission deems fit; and

3. The making public of said procedures manual, as it is created and/or revised, by placing and maintaining it on the Commission's website.

At its May 2018 meeting, the Commission voted to create a task force group to assist in this review. The League will be represented on the task force.

2. New Governance Structure

A power struggle between several of the Commission's part-time Commissioners and the full-time Chair largely consumed the attention of the Commission over the last couple of months. This resulted in the adoption of four new regulations which significantly change the governance structure of the Commission and diminish the power of the Chair. Just days before the Commission voted to adopt the new regulations, Chair Jodi Remke resigned.

a. Background

The Commission consists of five members, no more than three of the same political party. (§ 83100.) The Governor appoints the Chair and one additional member who may not be from the same political party. (§ 83101.) The Attorney General, the Secretary of State and the Controller each appoints one member. (§ 83202.)

The Chair is a full-time position and is compensated at the same rate as the president of the Public Utilities Commission. (§ 83106.) The other members of the Commission are part-time and are compensated at the rate of $100 for each day they engage in official duties. (§ 83106.)

According to one commentator, since the adoption of the Political Reform Act, "the part-time commissioners have chafed at the power of the chair." [5] This led to proposed legislation in 1981 to make the chair part-time rather than full- time. However, this proposal was eventually withdrawn.

In October of 2017, the Commission established an ad hoc committee to review the Commission's Statement of Governance Principles, which were originally adopted in 2001. The recommendations of the ad hoc committee ultimately were incorporated into proposed regulations promulgating governance rules for the Commission, discussed below. The proposed regulations were supported by three of the five Commissioners.[6] This was despite strong opposition from the Governor's Office, which believed that the proposed regulations risked "undermining and impeding the important work of the Commission."[7]

[5] Stern, Robert, "The FPPC Chair Should be Part-Time, Not Full-Time," (http://www.foxandhoundsdaily.com/2018/05/fppc-chair-part-time-not-full-time/) Mr. Stern was the FFPC's first General Counsel from 1975-1983.

[6] The Commissioners supporting the proposed regulations included: Maria Audero (appointed by Governor Brown in 2015); Brian Hatch (appointed by Secretary of State Alex Padilla in 2017); and Allison Hayward (appointed by Controller Betty Yee in 2017).

[7] In an April 18, 2018 letter to the Commission from the Governor's Legal Affairs Secretary, Peter Krause, Mr. Krause also pointed out what he considered to be a number of "significant flaws" with the proposed regulations, and that ". . . the proposed regulations appear to have been drafted with little or no staff involvement."

b. Governance Regulations

The governance provisions are contained in new Regulations 18308, 18308.1, 18308.2, and 18308.3 ("Governance Regulations"). Regulation 18303 outlines the purpose of the Governance Regulations – "[t]o ensure that the accountability and authority for governance and management of the [FPPC] is clearly stated . . . ." Regulations 18308.1, 18308.2, and 18308.4 outline in great detail the specific authority of the Commission, the Chair, and the Executive Director, respectively.

Under the Governance Regulations, most work of the Commission will now take place through two two-member advisory standing committees: the Budget & Personnel Committee; and the Law & Policy Committee. The Chair nominates the committee members from among the other Commissioners (notably, the Chair may not serve on a committee). Almost every aspect of the Commission's work will now be subject to a committee recommendation before formal Commission action is taken.

The Governance Regulations also give very limited authority to the Chair and specify in detail how Commission agendas are established with "review and approval" of the Commission as a whole. Now, the primary role of the Chair is to conduct Commission meetings pursuant to Robert's Rules of Order and other rules adopted by the Commission.

Finally, the Governance Regulations provide that almost every management decision made by the Executive Director (including personnel decisions) must be made "in consultation" with either the Budget & Personnel Committee or the Law & Policy Committee.

3. Resignations

On June 1, 2018, a few of days before the Commission voted to adopt the Governance Regulations, Chair Jodi Remke resigned her position. She was appointed Chair in 2014 by Governor Brown. Remke accepted a new position as the presiding administrative law judge for appellate operations for the Unemployment Insurance Appeals Board.

One week after Chair Remke resigned, Commissioner Maria Audero resigned from the Commission. Commissioner Audero was appointed in 2015 by Governor Brown. She will assume a new role as a U.S. magistrate judge for the Central District of California.

4. New Chair

After Jodi Remke resigned as Chair of the Commission, Governor Brown appointed Alice Germond to fill the remainder of her term which expires on January 31, 2019. Chair Germond has held senior roles in the campaigns of Jerry Brown, Bill Clinton, Gary Hart and Michael Dukakis. She also previously served as Secretary of the Democratic National Committee.

According to Chair Germond, she would like to focus on the following in her time as Chair:

- Having the Commission meet in locations throughout the state in order for the public to become more familiar with the work of the Commission and be invited to participate if they choose;

- Partnering with educational systems and other communities both to share goals and wisdom and to increase civility and participation in the election process; and

- Making the Commission's internal process, from start to finish, "reflect California common sense."

May 3, 2018

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VIA FACSIMILE AND MAIL

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Fair Political Practices Commission
1102 Q Street, Suite 3000
Sacramento, CA 95811

Re: FPPC Enforcement Action Against Los Angeles County (Regulation 18420.1)

Dear Chairman Remke and Members of the Commission:

The California State Association of Counties ("CSAC") and the League of California Cities ("League") submit these comments in support of Los Angeles County in the pending administrative enforcement action against the County concerning communications the County made to inform its residents about a March 2017 ballot measure (Measure H).

The Commission is considering whether the County failed to properly disclose payments made for communication that allegedly covered by Section 18420.1 of the FPPC's regulations.

Because Regulation 18420.1 goes beyond the scope of the FPPC's jurisdiction, and is in conflict with the definition of "independent expenditure" in the Government Code, CSAC and the League respectfully request that the Commission dismiss this enforcement proceeding and repeal Regulation 18420.1.

Regulation 18420.1 is Beyond the Scope of the FPPC's Jurisdiction, and Should Therefore not be Applied to LA County's Communications in an Enforcement Action

In adopting Regulation 18420.1, the FPPC purported to rely on the California Supreme Court decision in *Vargas v. City of Salinas* (2009) 46 Cal.4th 1, to define a contribution or independent expenditure in cases where a government agency uses public money to make certain campaign-related communications. However, the *Vargas* case addressed the constitutionally permissible use of public funds to communicate with a public agency's constituents, and specifically rejected the use of the Political Reform Act standards in that context. Regulation 18420.1 is therefore beyond the scope of the FPPC's jurisdiction.

A. *Vargas v. City of Salinas* (2009) 46 Cal.4th 1

In *Vargas*, the California Supreme Court expressly reaffirmed the law set forth in *Stanson v. Mott* (1976) 17 Cal.3d 206, holding that while a governmental agency cannot use public funds "for materials or activities that reasonably are characterized as campaign materials or activities," it "may generally publish a 'fair presentation of facts' relevant to an election matter." (*Vargas, supra,* 46 Cal.4th at 8, 25 quoting *Stanson v. Mott*, 17 Cal.3d at 222.) For activities that fall in the middle of this spectrum, "the propriety or impropriety of the expenditure depends upon a careful consideration of such factors as the style, tenor and timing of the publication." (*Id.* at p. 25, quoting *Stanson v. Mott*, 17 Cal.3d at p. 222.)

Grounded in its interpretation of *Stanson v. Mott*, the Court provided guidance on which election activities conducted by governmental agencies are permissible, such as informational materials that provide a fair presentation of facts, and impermissible, such as bumper stickers, television and radio spots, billboards and door-to-door canvassing. (*Id.* at pp. 32-33.) Importantly, the Court recognized that while a public agency may not mount an election campaign to support or oppose a measure, it can "take sides" on a ballot measure and make that view known. "[T]he mere circumstance that a public entity may be understood to have an opinion or position regarding the merits of a ballot measure is not improper." (*Id.* at pp. 3-36.)

The Political Reform Act was only brought into the case tangentially by the Court of Appeal in *Vargas*, when it relied on the definition of express advocacy in the Act to draw the line between permissible and impermissible use of public funds. (*Vargas v. City of Salinas* (2005) 37 Cal.Rptr.3d 507, 525.) On review, the Supreme Court rejected the lower court's reliance on the Act as setting the proper standard for use of public funds. The Court instead held that the standard is set by *Stanson v. Mott*. (*Vargas v. City of Salinas*, 46 Cal.4th at 31-32.) Thus, the *Vargas* case does not provide a basis upon which to create a regulation implementing the Political Reform Act.

B. Regulation 18420.1

In December 2008, the Commission adopted the original version of Regulation 18420.1, which stated that a payment of public funds for a communication concerning a ballot measure could be a reportable expenditure if the communication were express advocacy, or it was not a "fair and impartial presentation of the facts." In other words, the regulation assumed that committee status had already been triggered under Government Code section 82031. Thus, even though the regulation as originally adopted went beyond mere express advocacy, it did not change the way in which committee status was defined.

As noted above, the *Vargas* opinion was issued the next year in 2009. In the opinion, the Court drew a line between the "regulation of campaign contributions and expenditures" and "the potential constitutional problems arising from the use of public funds for campaign activities" as defined in *Stanson*. (*Vargas, supra,* 46 Cal.4th at pp. 31-32.)

Notwithstanding the Court's separation of campaign regulations and constitutional speech, the FPPC amended Regulation 18420.1 following the *Vargas* opinion in 2009 to "appl[y] the Supreme Court's *Vargas* standard . . . to determine whether a government agency is making a contribution or independent expenditure under the Act." (FPPC May 29, 2009 Staff Memorandum, p. 2.) In subdivision (a) of the 2009 amendments, the Commission simply restates that any public agency communication that expressly advocates or unambiguously urges a particular result is either a "contribution" or "independent expenditure." However, subdivision (b) goes beyond that – and beyond the Political Reform Act itself – to incorporate the *Vargas* and *Stanson* standards concerning constitutional speech, including the Court's statement that use of television or other mass media advertising is per se communication that unambiguously urges a particular result.

The FPPC's adoption of Regulation 18420.1 exceeded its authority under the well-established limitations of regulatory power. "'[N]o regulation adopted is valid or effective unless consistent and not in conflict with the statute and reasonably necessary to effectuate the

purpose of the statute.'" (*Citizens to Save Cal. v. Fair Political Practices Com.* (2006) 145 Cal.App.4th 736, 746, quoting Gov. Code, § 11342.2 [invalidating FPPC regulation because it was at odds with the PRA and inconsistent with legislative intent underlying the PRA].)

> [I]t is well established that the rulemaking power of an administrative agency does not permit the agency to exceed the scope of authority conferred on the agency by the Legislature. [Citation.] "A ministerial officer may not . . . under the guise of a rule or regulation vary or enlarge the terms of a legislative enactment or compel that to be done which lies without the scope of the statute and which cannot be said to be reasonably necessary or appropriate to subserving or promoting the interests and purposes of the statute." [Citation.] And, a regulation which impairs the scope of a statute must be declared void. [Citations.]

(*Agnew v. State Bd. of Equalization* (1999) 21 Cal.4th 310, 321, citations omitted.)

The authority for Regulation 18420.1 cited by the FPPC is Government Code sections 82013, 82015 and 82031. But there is nothing in those sections that delineates certain types of communication as unambiguously urging a particular result. Further, as noted above, the Supreme Court rejected the Court of Appeal's attempt to incorporate Political Reform Act definitions into the constitutional speech questions raised by *Vargas*. Indeed, *Stanson* and *Vargas* concern an area of law, the use of public funds, that is separate from and unrelated to the Political Reform Act. Thus, purporting to rely on the Political Reform Act as authority to incorporate the constitutional standard for use of public funds in election speech is a notion that has no support in the statute or in the case law.

By going beyond the Political Reform Act into the realm of constitutional speech, the FPPC has aggregated to itself the right to judge what government communications are permissible under *Vargas* and, as a practical matter, has usurped the proper role of the judiciary to decide such matters. Regulation 18420.1 contains ambiguity in how it may be applied to various local government activities. Subsection (b)(1), for example, relates to campaign material or campaign activity ". . . including, but not limited to, television, electronic media or radio spots." Would that apply to community television channels that broadcast City Council or Board of Supervisor meetings? It is not uncommon for local governing bodies to publicly discuss ballot measures and take positions by adopting resolutions, which the courts have found permissible. Would these televised discussions now be considered "campaign activity?" What about placing informative documents concerning the impact of a ballot measure on the agency's website? Is that considered unambiguously urging a particular result in an election because it is placed on "electronic media?" The enforcement activity undertaken in this proceeding raises these types of concerns for cities and counties across this State, and illustrates why the FPPC should not be in the business of enforcing constitutional speech standards.

For all of these reasons, the FPPC acted beyond its jurisdiction in enacting the regulation, and it should therefore not be enforced against Los Angeles County in this proceeding.

Regulation 18420.1 is Inconsistent with Government Code section 82031

In addition to being beyond the scope of the FPPC's jurisdiction, Regulation 18420.1 is also inconsistent with Government Code section 82031, a section that purportedly authorizes the regulation.

As noted above, for purposes of this pending enforcement action, Regulation 18420.1 states that a payment made in connection with a communication that unambiguously urges a particular result in an election is an independent expenditure under Government Code section 82031. Regulation 18420.1 goes on to state that a communication is considered to unambiguously urge a particular result if the communication is made via mass media advertising, including, but not limited to, television, electronic media or radio spots.

However, shortly after the Commission adopted Regulation 18420.1, the Governor signed Assembly Bill No. 9.[1] AB 9 amended Government Code section 82031 to include payments by a state or local government agency in the same definition of "independent expenditure." As a result, the same definition is now used for all persons, including local government agencies. And that definition does not identify television advertising as a communication that unambiguously urges a particular result.

To the contrary, the courts have specifically found that a television communication on a political subject does not automatically amount to an independent expenditure under Government Code section 82031. (*Governor Gray Davis Committee v. American Taxpayers Alliance* (2002) 102 Cal.App.4th 449.) In the case, defendant produced and placed on the air television ads that were critical of Governor Davis. The ads did not use express words of advocacy, but plaintiff asserted that in context, they were either express advocacy or communications that unambiguously urged a particular result, and therefore amounted to expenditures that should have been reported under Government Code section 82031.

The court, however, rejected that argument and found that the communications were protected political speech, rather than campaign ads regulated by the Political Reform Act, notwithstanding the fact that the communications were made via television. Instead, the court took a narrow view of the Political Reform Act in this context:

> We must therefore read and construe the scope of the provisions that define reportable expenditures in Government Code sections 82031 and 82025, and California Code of Regulations, title 2, section 18225, narrowly in accordance with First Amendment standards to apply only to those communications that "contain express language of advocacy with an exhortation to elect or defeat a candidate." Appellant's television spot does not contain the express or explicit words of advocacy that are subject to regulation. No campaign or election is mentioned. Nor does the advertisement overtly encourage the viewer to vote against Governor Davis. To be sure, the advertisement criticizes Governor Davis on the issue of the energy crisis, but it fails to associate the condemnation with any express endorsement of defeat of his candidacy for Governor. . . . Nothing in the explicit language of the advertisement "unambiguously urged Gray Davis'[s] defeat in the gubernatorial election," as

[1] Chapter 363, Statutes of 2009, signed by the Governor on October 11, 2009, with an effective date of January 1, 2010.

> respondent claims. . . . We conclude based upon the advertisement at issue here that appellant cannot be compelled to comply with the disclosure and reporting obligations of the Political Reform Act.

(*Governor Gray Davis Committee*, supra, 102 Cal. App. 4th at pp. 471-472 (citations omitted).)

It is important to note that the amendment to Government Code section 82031 that added public agencies to the existing definition of independent expenditure was made after the court's decision in *Governor Gray Davis Committee*. As such, the Legislature is presumed to know the narrow construction of this provision when it decided to use the same standard for both public and private entities to determine when a communication constitutes an independent expenditure.

What Government Code section 82031 does not do is list materials that are, by definition, campaign materials regardless of whether their content actually expressly advocates or unambiguously urges a particular result. Regulation 18420.1 does just that, but only for public agency activity, which is directly contrary to the Legislature's decision to treat both public and private agencies the same under Government Code section 82031. In so doing, the Commission not only reached into constitutional speech issues that are beyond the scope of the Political Reform Act, but also created a conflict between the Act and this regulation.

III. CONCLUSION

Regulation 18420.1 is not authorized by Government Code section 82031 or *Vargas v. City of Salinas*. The misuse of public funds is governed by the Constitution, case law and other statutory provisions, not the Political Reform Act. Further, the Political Reform Act treats both public and private entities the same under Government Code section 82031. As such, the regulation's attempt to impose additional reporting requirements for independent expenditures by public agencies that do not exist for private entities conflicts with the Political Reform Act.

Regulation 18420.1 is not valid because it exceeds the scope of the FPPC's authority, and is inconsistent with Government Code section 82031. CSAC and the League therefore respectfully request that it not be used in an enforcement action against Los Angeles County, and that the Commission consider repealing Regulation 18420.1.

Sincerely,

Jennifer Bacon Henning
Litigation Counsel
California State Association of Counties

Navigating Conflict Issues in Engaging Professional Consultants

Thursday, September 13, 2018 General Session; 8:00 – 9:30 a.m.

Michael N. Conneran, Partner, Hanson Bridgett LLP

Notes:_____

City Attorneys Department
League of California Cities
Annual Conference
September 13, 2018

Sorting Out the Conflicts: Consultants and Alternate Methods of Project Delivery

by Michael N. Conneran

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INTRODUCTION

The intent of this paper is to address two evolving trends in public contracting in California. When taken together, these trends raise unique challenges for contracting entities and their legal counsel. The first is the movement away from the traditional design/bid/build approach to project delivery and towards design/build and other methods of "alternate project delivery." These delivery methods often alter the roles that consultants, particularly design professionals, play in the delivery of public projects. The other trend is the changing interpretations of the prohibitions on conflicts of interest with regard to consultants that are contained California Government Code Section 1090.[1] The changing role of consultants under these new project delivery methods comes at a time when the courts have stated a wider scope for the application of Section 1090's prohibition on consultants being self-interested in contracts. This new scope includes the application of the law to consulting firms and applies criminal sanctions to violations of that law. Thus, at a time when consultants are taking on new roles in the contracting sphere, they must also navigate a different legal landscape. And cities, as they explore potentially more effective project delivery methods, must be diligent regarding these changing rules and roles. This paper will also be of benefit to cities that are not using alternate contracting approaches, but can benefit from additional guidance as to the roles of consultants in their employ.

In order to devote sufficient attention to these unique issues, and to not restate information already provided elsewhere, we want to direct the reader to three existing papers available from the League:

1. Harrison and Prinzing, "Navigating Pitfalls Under Government Code Section 1090 When Contracting Consultants" (2018)

2. Gehrig, "Alternate Project Delivery Methods for Public Works Projects in California" (2009)

3. Conneran, "The ABC's of PPP's: The Basics Regarding Public-Private Partnerships" (2009)

We recommend that the reader consult these valuable resource materials on the finer points of the topics they address. The goal of this paper is to explore common areas of concern that arise as a result of the changing roles of consultants under these new project delivery methods and to suggest approaches that will assist cities with their general contracting approaches under the new consultant rules. While we want to avoid unnecessary duplication of the wisdom contained in these prior guides, at the same time we need to make this paper independently useful. Therefore, we will present a very basic outline of the issues that arise with regard to consultants and Section 1090, but will trace the historical development of the statute at it bears on the current regulatory landscape.

GOVERNMENT CODE SECTION 1090—CALIFORNIA'S HISTORIC BAN ON SELF-DEALING IN PUBLIC CONTRACTS

Most simply stated, Section 1090 prohibits public officers and employees from participating in the making of contracts in which they have a financial interest. Contracts made in violation of this stricture are void, and parties that have an interest in such contracts can be criminally prosecuted under Government Code Section 1097. For purposes of this paper, our focus is on

[1] All code references are to the California Government Code unless specifically noted.

not only who qualifies as a "public officer of employee" but, and perhaps more importantly, what is meant by "participating in the making of a contract," particularly under these new approaches to project delivery. Issues such as the ability of boards to act on contracts, the application of the rule of necessity for contract approval and the various types of remote interests and non-interests under Section 1090 et seq. are beyond the scope of the paper.[2]

The evolution of the application of Section 1090 to consultants.

Section 1090 provides in relevant part: “Members of the Legislature, state, county, district, judicial district, and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members.” Section 1090 is an old statute, derived from common law that dates to 1851, which prohibited self-dealing.[3] As stated by the California Supreme Court, Section 1090 "[C]odifies the long-standing common law rule that barred public officials from being personally financially interested in the contracts they formed in their official capacities." (*Lexin v Superior Court* (2010) 47 Cal.4th 1050, 1072.) "The common law rule and section 1090 recognize “[t]he truism that a person cannot serve two masters simultaneously.... [Citations.]" (*Id.* at 1073.) Another court stated the concept this away: “The evil to be thwarted by section 1090 is easily identified: If a public official is pulled in one direction by his financial interest and in another direction by his official duties, his judgment cannot and should not be trusted, even if he attempts impartiality.” (*Carson Redevelopment Agency v. Padilla* (2006) 140 Cal.App.4th 1323, 1330.)

As might be expected with a statute that is derived from the common law, the reach of Section 1090 has been extended from time to time by the courts as they are presented with new situations that raise concerns with potential corruption. Some of these court decisions have later been embodied as revisions to the statute itself. The statute originally adopted as Government Code 1090 in 1943 did not mention "employees" and was not initially applied to outside contractors. In 1956, the court in *Shaeffer v Berinstein* ((1956) 140 Cal.App.2d 278) found that the statute should be applied to an outside attorney, who had been "employed" by a city as special counsel, and had arranged to purchase properties being sold at a tax sale through a shell company. The court, in making its ruling regarding the attorney involved in the tax deed scam, relied upon a city charter provision that specifically mentioned "officers and employees," and held that Section 1090 applied to the defendant outside attorney as well. (*Id.* at 291.) The statute was then modified in 1963 to add the words "or employees" in two places. (Stats. 1963, Ch. 2172.) It is significant to note that California Supreme Court, in the recent decision in *People v. Superior Court (Sahlolbei),* commented that the Legislature had endorsed *Schaefer* in its adoption of the 1963 amendment, as the case appears in legislative history of that amendment. (*People v. Superior Court* (*Sahlolbei*) (2017) 3 Cal.5th 230, 236-7.)

[2] Readers are directed to the Harrison and Prinzing paper cited above, the League's publication, "Providing Conflict of Interest Advice," and the Attorney General's publication "Conflicts of Interest."

[3] "As early as 1851, the Legislature acted to bar any government official or legislator from being “interested in any Contract made by such Officer or Legislature of which he is a member; or be[ing] a purchaser, or be[ing] interested in any purchase at any sale made by such Officer, or a seller at any purchase made by such Officer in the discharge of his official duties.” (Stats. 1851, ch. 136, § 2, p. 522; see *Brandenburg v. Eureka Redevelopment Agency*, supra, 152 Cal.App.4th at p. 1362, 62 Cal.Rptr.3d 339.) The prohibition was later codified in former section 920 of the Political Code and, in 1943, moved with only minor changes to the Government Code. (Former Pol.Code, § 920, enacted 1872, repealed by Stats.1943, ch. 134, § 1, p. 956; see now Gov.Code, § 1090.)" (*Lexin v Superior Court* (2010) 47 Cal.4th 1050, 1072, n. 10)

Subsequent decisions (many involving attorneys) extended and confirmed the reach of 1090 to outside parties. (See *Campagna v. City of Sanger* (1996) 42 Cal.App.4th 533, 541–542 and *People v. Gnass* (2002) 101 Cal.App.4th 1271, 1287, fn. 3; 1302, fn. 10) Several of these decisions contained terms and concepts that are now commonly used by the FPPC in determining whether a consultant is covered by Section 1090.

One of the first cases to extend 1090 to consultants was *California Housing Finance Agency v. Hanover/California Management & Accounting Center, Inc.* (2007) 148 Cal.App.4th 682) (hereafter *Hanover*). In that case, the director of insurance of a state housing finance agency conspired with the agency's legal counsel to form a business to process payments for mortgage insurance, collecting a "processing fee" for its services. A subsequent case, cited by the more recent consultant cases, is *Hub City Solid Waste Services, Inc. v. City of Compton* (2010) 186 Cal.App.4th 1114 (hereafter *Hub City*), in which the court found that the term "public official" included "*independent contractors whose official capacities carry the potential to exert considerable influence over the contracting decisions of a public agency.*" "An individual's status as an official under that statute turns on the extent to which the person influences an agency's contracting decisions or otherwise acts in a capacity that demands the public trust. (See *Hanover, supra,* 148 Cal.App.4th at pp. 692–693.)" The phrase "influence over the contracting decisions of a public agency," which first appears in *Hub City*, shows up repeatedly in the FPPC advice letters, and with good reason—if the official has such influential role, they are in a position to easily steer contracts in a way that benefits their own personal financial interests.

However, until the ruling in *Davis v. Fresno Unified School District* (2015) 237 Cal.App.4th 261 (hereafter *Davis*), it was not clear that a consulting firm could be held liable for a violation of 1090. In *Davis*, a taxpayer challenged a school district's use of a statute that permitted such agencies to utilize the "lease/leaseback" method of project delivery. Under that procedure, the district leases a site to a contractor/developer, who then constructs the facility desired by the school district and subleases the facility back to the school district. At some point after construction is completed, the lease is terminated and the facility reverts back to the school district, presumably after sufficient "rent" has been paid to make the contractor/developer whole. The procedure does not require the work to be competitively bid and, in this case, there was an allegation that the contractor that entered into the arrangement had improperly participated in the development of the preliminary plans and specifications for the desired improvements, in essence helping to design the project they later contracted (via a lease) to build.

A prior case, *People v. Christiansen* (2013) 216 Cal.App.4th 1181, 157 Cal.Rptr.3d 451 (hereafter *Christiansen*), had declined to apply criminal sanctions in a case involving a school district employee who had a separate consulting business, relying on the common law definition of "employee" to hold that criminal liability should not be imposed on a party, who is acting as a consultant and who may have been unaware of the application of 1090 to a person in their position. The *Davis* court distinguished *Christiansen*, preferring to rely upon *Hub City* and *Hanover*. (*Davis, supra,* 237 Cal.App.4th at 827.) The court in *Sahlolbei* later overruled *Christiansen* altogether, finding that the line of 1090 cases from *Schaefer* to *Hub City* had not applied the common law employee definition with regard to consultants. (*Sahlolbei, supra,* 3 Cal.5th 230 at 247.) "As the case law makes clear, section 1090 liability extends only to independent contractors who can be said to have been entrusted with "'transact[ing] on behalf of the Government' (*Stigall*, supra, 58 Cal.2d at p. 570, 25 Cal.Rptr. 441, 375 P.2d 289)." (*People v Superior Court (Sahlolbei*) (2017) 3 Cal.5th 230, 240.)

Much of the work in sorting out conflict issues in the consultant arena involves both determining (1) whether the consultant is acting as a public official and (2) whether they are participating in the making of a contract in which they have a financial interest. In many ways these issues become intertwined, as the ability to exercise considerable influence over the contracting decisions of a public agency helps define the consultant's status as a public official and, assuming that influence is exercised with regard to a particular contract, their role in "making" the contract. But the state of the law is now clear that consultants, whether individuals or firms, can violate Section 1090 if they exert their "considerable influence," over contracting decisions of a government agency in a way the provides them (or the firm) with a financial benefit. The exertion of that influence is the prohibited "participation in the making" of the contract. The following sections focus on some unique ways in which contracts are now being made, with the aim of applying these new rules on consultants and their conflicts to those situations.

THE EVOLUTION OF APPROACHES TO PUBLIC CONTRACTS

For many decades, public construction contracting has relied on the traditional approach known as Design-Bid-Build, where a design is obtained by the agency (from its staff or through a design professional under contract) and then included in a contract package advertised for bid. These contracts were almost always awarded on the basis of the lowest monetary bid. This practice has served a number of important public policies, which were felt (by the Legislature at least) to surmount other concerns of cost and efficiency.

When outside design professionals are engaged, this will almost always be done in accordance with the "little Brooks Act" (Gov't. Code §4526), the state equivalent to the federal Brooks Act, which requires that design professionals be selected based upon their qualifications. Only if the agency and design professional were unable to reach agreement on price and terms could the agency proceed to consider the next most qualified designer. This practice ensures that design work is only undertaken by the best qualified professionals—furthering the Legislature's goal of allowing agencies to avoid the cut-rate designer. The little Brooks Act has helped to ensure the quality of the services provided for public construction projects.

Public construction contracts, on the other hand, were to be awarded strictly on the basis of price. After a public opening of bids, the contract was awarded to the lowest responsible bidder, leaving little room for consideration of their abilities unless a contractor was found to be non-responsible, a fairly difficult standard to meet. While this practice helps to prevent corruption and favoritism in the award of public projects (although occasional bid-rigging does occur) it may result in poor quality work or in the award of projects to contractors who, having cut their prices to the bone to obtain the contract, become quite aggressive in submitting change orders for additional compensation and ultimately filing construction claims to ensure a healthy profit. Such claims are often based on alleged flaws in the contract documents (supported by a legally-implied warranty on the part of the public entity as to their completeness and correctness), which left agencies caught between a designer who they believe may have erred in their design and a contractor alleging such flaws. Anecdotes abound of contractors being aware of flaws and ambiguities in contract documents but, rather than raising questions during the solicitation process, waiting to exploit them post-award. Another concern is a lack of dialogue between those who design a project and those who are asked to build it, resulting in disconnects between the conceptual and constructable.

A new approach surfaced from the private sector, the idea of entering into a single "design/build" contract, with the designer and the contractor teaming up to submit a proposal as a single entity to both design and construct the facility. Under this approach, the owner normally

develops a conceptual or "bridge" design (often to the 30% stage) and then uses it as the basis for soliciting proposals from design/builders. This approach was seen as desirable for two primary reasons. First, it only required a single contracting process and could therefore be awarded and constructed more quickly. Second, by putting the designer and builder on the same "team," it not only reduced the finger-pointing and claims, it also allowed the teammates to consult with each other early in the process, permitting the builder to provide advice and suggestions on the constructability of the designer's design. Of course, selecting a designer and contractor in a single process for public projects required new statutory authority to avoid the conflict between statutes requiring qualifications-based awards for design professionals and those requiring an award to the lowest bidder. For most public agencies (other than charter cities) special legislation authorizing this new "design/build" contracting method was necessary.

While there have been a number of statutes authorizing design/build for various agencies, the statute with the widest application was enacted by SB 785 in 2014 and is codified at Public Contract Code Section 22160 *et seq*.. This statute authorizes local agencies, including cities, to utilize the design/build method, and authorizes the "best value" method for awarding contracts, permitting agencies to balance the skill and quality of the proposed contractor with the price. Significantly, this new statute, which applies to a wide range of "local agencies," has a requirement that any entity using the statute, must adopt an "organizational conflicts of interest policy." (See Pub. Contract Code § 22162(c).) A fuller discussion of the concept of an "organizational conflict of interest" follows later in this paper, and we provide examples of the policies some agencies have adopted.

Another alternate contracting approach, one not yet available to cities, is known as the "Construction Manager at Risk" or the "Construction Manager/General Contractor" ("CM/GC"). This approach centers around a Construction Manager or "CM," who is often procured based on qualifications, but generally after the design of the project has been commenced by a different firm. The CM options include having the CM be "at risk," which means they are bound to a guaranteed maximum price following a price-setting process and can award subcontracts (or perform the work themselves). Although used in the private sector, this approach runs counter to several statutory schemes (public bidding, subcontractor listing, etc.) and involves the potential self-award of contract work. The latter approach is particularly troublesome with regard to Section 1090, as it provides the CM with the ability to award a separate contract to itself to perform some of the contract work. There are only a few public agencies, including counties, the University of California, and some transit agencies, that are currently permitted by statute to use this method (although charter cities may have the flexibility to do so if their charter so provides).

A more common alternative, one that has been particularly popular among educational agencies, is the Lease-Leaseback method, where a publicly-owned site is leased to a contractor, who constructs the new facility and then leases it back to the public agency. This method, which avoids competitive bidding, has been the subject of some recent court decisions that have been critical of the way in which the method was applied, particularly when the leasehold is terminated quickly after construction is completed, giving the appearance of an attempt to circumvent competitive bidding rather than an attempt to finance the project using the lessee's capital. One reason this method is popular is the ability of the agency to choose the party with whom it enters into the transaction. As discussed above, conflict of interest issues have arisen when the eventual lessee/contractor has been involved not only in pre-contract negotiations, but also in the initial design of the building. (See *Davis v. Fresno Unified School District, supra,* 237 Cal.App.4th 261*; McGee v. Balfour Beatty Construction LLC* (2016) 247

Cal.App.4th 235; and *California Taxpayers Action Network v. Taber Construction, Inc.* (2017) 12 Cal.App.5th 115.)

Additional, and more complicated, contracting arrangements may be approved for larger projects that involve the financing and on-going maintenance of projects, perhaps over a long term. The contracts go by various acronyms, such as DBOM (Design/Build/Operate/Maintain) and DFBOM (Design/Finance/Build/Operate/Maintain). There are multiple issues to be considered by agencies using these methods, including the length and complexity of the contracts, as well as the involvement of multiple parties at different stages of the project.

Where can conflicts arise?

Under the traditional design-bid-build process, it was fairly easy to monitor potential conflicts—the designer just couldn't serve as the contractor. That was simple enough. Occasionally, there could be questions with regard to parties playing roles at the beginning or end of the project, such as if the designer serves as the construction manager or if a former city employee or consultant who played a role in the decision to undertake the project seeks to participate in a subsequent phase of the project. Conflicts can also arise with regard to sub-consultants on the design team (under a number of arrangements). A number of these scenarios are discussed below in the review of the advice letters issued by the FPPC. But, in general, the clear delineation of the roles of designer and contractor in Design-Bid-Build contracts limits the range of potential conflicts.

The design/build context provides more opportunities for conflicts, particularly with the need for design services on both sides of the main contract. The design/build contract requires a preliminary design, often called a "bridge design," that outlines the basic parameters of what is being sought, leaving the main details of the design to the design/build team. Nevertheless, some design knowledge is required on the owner side of the process, and this can require the use of outside consultants, particularly for highly technical projects where city staff does not possess the necessary expertise to assemble the design/build RFP package. While a city can and should clearly inform the consultant who prepares the bridge design that they will be ineligible to bid on the larger contract, if the project involves a particular technical discipline, a city may have difficultly engaging a consultant to undertake the smaller, preliminary work to assemble the preliminary design. In these situations, the specialized consultants with the necessary technical expertise may decline to assist the public owner in the pre-bid work, lest they be prevented from bidding on the larger (and likely more lucrative) design/build work.

Another issue arises out of the recent trend of mergers of major engineering firms, or their combining with contractors to form design/build entities. This can arise when outside consultants are providing staff-level services as temporary or "seconded" employees. In one instance, a firm employing a seconded engineer, who was acting in a staff capacity supervising a large construction contract, merged with the very firm whose work that engineer was supervising. That required that the seconded employee be quickly reassigned, lest they be supervising the very firm they worked for. This can get complicated when mergers are announced in the press but are not actually consummated for some time, and even then may be accomplished by means of a holding company, further clouding the issue of the corporate identity of the consultant and contractor. In addition, both engineering and contracting firms have begun to develop each other's expertise in-house to enable them to contract for design/build work without having to partner with the other discipline.

As we have seen in *Davis* (and similar cases, *McGee v. Balfour Beatty Construction LLC* (2016) 247 Cal.App.4th 235 and *California Taxpayers Action Network v. Taber Construction, Inc.* (2017) 12 Cal.App.5th 115), firms that are seeking to enter into lease/leaseback arrangements with school districts have been involved at the front-end design work prior to entering into the lease/leaseback transaction. While these cases involved demurrers, the appellate courts in both instances ordered a trial on the 1090 issues arising from behavior that involved pre-lease design work. The *Christiansen* case involved the defendant's work with a large firm that is an active bidder on public projects involving alternate project delivery methods. While such conflicts will not necessarily arise on all projects using alternative project delivery methods, the use of these methods is new to many public agencies and the number of market participants are limited, which may increase the chances for misconduct arising. In fact, as is often the case with innovative ideas, they are initially marketed by firms seeking to be engaged to do the work. This entrepreneurial approach, combined with a lack of standard practices and experience on the part of the public agencies, may increase this risk. However, it should be viewed as a reason to proceed carefully, rather than to reject these approaches altogether.

One potential concern is that, with some of these agreements running 20 or 30 years in the operational phase, firms that could be barred by their early participation in the "making" of the initial contract, may come back (via contract or even merger) later in the contract term to work on the other side. There is also the concern that, as is the case with many complex projects, that the only parties who are technically sophisticated about a project are the ones who will end up bidding. Not surprisingly, these parties often lobby agencies to adopt their technology, and some seek to be paid for providing that advice, not realizing that accepting such work may preclude them from later participating in its implementation. It can be a challenge to keep track of all of the parties and their shifting roles.

Another series of issues arise when agencies undertake major "programs" that involve multiple projects, which are inevitably proceeded by "Master Plans" or "Capital Improvement Programs." These types of planning documents, while certainly advisable for intelligent project implementation, end up involving many consultants and sub-consultants, often in technical disciplines, who wish to work as consultants or sub-consultants on the individual projects as they are undertaken, which can be years or even a decade after the initial planning document. It is not entirely clear when or how to draw the line on such involvement, even after reviewing the FPPC advice letters on this topic, because each situation is different.

The FPPC has addressed some of these situations, but no comprehensive guidance is available to help agencies sort out who should be disqualified and who can participate among parties that were involved in the early planning stages. One approach would be for the agency to clearly state in their contracts that parties playing certain identified roles will be prohibited from subsequent participation, although agencies may be reluctant to do this for fear of scaring off potential firms. Many include a provision that cites to the various conflict of interest statutes, but leaves it to the consultant to determine if their work at the front end may come back to bite them at the later stages.

However, agencies can go further by requesting potential bidders (such as at the RFQ stage) to fill out a disclosure indicating their past work for the agency. This is especially useful in light of the many mergers that have occurred in the engineering profession, in case work was done by a prior incarnation of the firm. Proposers can also be asked to certify the absence of conflicts. Finally, particularly where the solicitation will involve the formation of multi-disciplinary teams, such as design/build or P3 projects, the agency can formally list the firms that have already participated in the project and will be barred from bidding. Not only will this assist those forming

teams to propose on the project, but it may also cut down on the volume of inquiries to the agency regarding potential conflicts.

A related concept more prevalent in federally-assisted contracts is the "organizational conflict of interest." This concept addresses both perceived financial conflicts, such as having a vested interest in future stages of a project moving forward, but also the issue of fairness if a currently-engaged contractor is to bid on an additional element of a project and has a great deal of inside knowledge that will give them a competitive advantage over a new proposer. Federal policies, primarily Federal Acquisition Regulation 9.5, specify prohibitions on such practices, but also allow for agencies in some cases to cure such issues. For example an agency can provide information on the project to prospective proposers to bring them up to speed on the status of the project, thereby leveling the playing field. By separating out fairness issues from corruption issues, the federal policy provides more flexibility and thereby may allow greater efficiency by permitting a knowledgeable consultant to continue working on a project. An example of comprehensive "organizational conflict of interest policy," along with a disclosure form, used on a recent rail project is attached.[4] You can easily locate "organizational conflict of interest" policies that entities have adopted pursuant to Public Contract Code Section 22162(c) by doing a quick search on the internet.

FPPC ADVICE LETTERS

Given the fairly recent extension of Section 1090 to the full consulting profession, there is not yet a significant body of case law addressing the various issues related to consultant conflicts under Section 1090 (other than the cases we have already discussed). Certainly none of these cases provide wide-ranging advice that we can apply to multiple situations, other than the very critical fact that any consultant, be they an individual or a firm, can be considered to have a conflict. However, if we wish to inform ourselves regarding potential issues and their solution, we must look to the series of advice letters that the FPPC has issued in order to develop a series of data points that will guide in the various permutations that can arise under all of these various contracting scenarios. The FPPC began issuing advice regarding Section 1090 following the enactment of Section 1097.1, adopted by SB 1304 in 2013.

For ease of analysis, I have broken these down into a number of general topics, and will discuss relevant issues that arise for the various contracting methods under each topic.

Follow On Contracts

[4] This solicitation also contained the following provision to address Section 1090: "By submitting a Qualifications Statement, or a proposal in the later stage of this contract award process, the Offeror represents and warrants that no director, officer or employee of the JPB is in any manner interested directly, or indirectly, in the proposal or in the Contract which may be made under it or in any expected profits to arise therefrom, as set forth in Article 4, Division 4, Title I (commencing with Sec. 1090) of the Government Code of the State of California. The Offeror warrants and represents that it presently has no interest, and agrees that it will not acquire any interest, which would present a conflict of interest under California Government Code sections 1090 et seq. or sections 87100 et seq. during the performance RFQ phase, the RFP phase, or the performance of services under this Agreement. The Offeror further covenants that it will not knowingly employ any person having such an interest in the performance of this Agreement. Violation of this provision may result in this Agreement being deemed void and unenforceable. Additional Conflict of Interest requirements will apply during the term of any contract awarded."

An area that is ripe for 1090 conflicts is that of the follow-on contract. While many contracts need to modified, through change order, addendum or amendment (or, heaven forbid, the fourth amendment to the sixth addendum!), this practice, as necessary as it often is, particularly with complicated projects, is vulnerable to a charge that the consultant is now participating in the making of the follow-on contract that is required to extend their services to some additional phase of the project. An early example of this is the 2014 advice letter to *Parsky* (A-14-096), regarding an attorney taking on litigation regarding a construction matter. The FPPC advised that, if the attorney's contract with the agency contemplated that he or she might handle such litigation, it was permissible for them to participate in advising the agency whether or not to initiate such litigation (even if such litigation work was compensated at a higher hourly rate). However, if the contract did not contemplate litigation, they could not participate in that decision. Based on that advice, it would make sense to have the scope of work for attorneys or consultants, who may be in a similar position with regard to a future phase of work, anticipate that additional work or potential litigation. Otherwise, a city may find itself having to get a different counsel to handle the litigation of a matter, despite the fact that the first counsel knows the subject matter quite well. From a practical standpoint, this does not seem like a good result, but, according to the FPPC, such an approach may be necessary if the contract did not contemplate such work ahead of time.

A similar result occurred in *Fowler* (A-15-228), where a consultant that advised a city that its development impact fees needed to be updated was barred from working on the update. The FPPC found that the consultant was "intricately involved" in the work that led up to the city issuing an RFP to have the fee study done. The advice letter emphasizes the extent to which the consultant had become integrated with city staff and elected officials. Viewed from the Commission's perspective, one can certainly see why there were concerns about the fairness of the upcoming RFP process, as well as the prospect that a consultant may recommend that more work be undertaken, anticipating that they will get such work. However, from an efficiency standpoint, the succeeding consultant, assuming they are not just doing a bare accounting function, may need to reestablish those relationships in order to complete the scope of work of the RFP. Assuming that the time spent re-mobilizing is being compensated by the City, there is a clear economic cost to barring the initial consultant from performing the work. On the other hand, from a fairness perspective, one can see how competing consulting firms might perceive the award of the fee study as a fait accompli and might not expend the energy to submit a competing proposal if the initial consultant is eligible.

One must also speculate whether this entire problem could have been avoided if the initial contract had contained an option to do the additional work. That is not to say that the advice of the initial consultant might not be colored by their desire to obtain the additional work, but it would appear that having the city exercise an option or implement an additional phase of a scope of work may not run afoul of 1090 (although we don't have an advice letter precisely on that point). In *Ciciozzi* (A-17-049) a consultant had done a feasibility study for the construction of a new sheriff's facility and then, as the County prepared to issue a design/build RFP based on criteria documents prepared by a different consultant, submitted a proposal to serve as the construction manager for the construction phase. The FPPC found no problem with the consultant taking that role, based on the fact that they had not played a role in the development of the RFP for construction management services nor in the development of the design or technical specifications of the underlying project. A similar result occurred in *Grossman* (A-17-167), where a consultant prepared an "assessment and inventory" of a city's 11 sewer pump stations and then sought an engagement to design the replacement of one of those stations. The FPPC found that the consultant hadn't participated in the making of the second contract by virtue of the work they had done on the "assessment and inventory."

However, a different result occurred in *Simon* (A-17-148), where a consultant had done extensive work in conducting needs assessments, planning activities and preparing funding applications and then sought to be engaged to design the facility and provide architectural services through construction. Despite the fact that the contract provided for a potential increase in the scope of services, the FPPC advised that the consultant could not provide the design services without violating 1090. The rationale was that the consultant had "extensive involvement assisting the County with preliminary work on the jail project" and therefore had "participated in the making of the contract for the architectural design of the new jail and services through the construction process." The letter does not contain further discussion that would help us distinguish it from *Ciciozzi* or *Grossman*, but the length and scope of the involvement of the consultant likely played a role.

The final data point (*Page* A-16-044) is a bit convoluted, but involves a consultant that was hired to perform services on one aspect of a "information technology enterprise services" project and then, after there were problems with the consultant on the second aspect, was allowed to take on that additional work since their contract contained terms that allowed the issuance of a work order to do additional services in place of the other consultant. This advice would seem to support the idea that if a contract contemplates additional services, that such work would not violate 1090. While this seems quite sensible, it also appears that a prudent contracting approach is to include options for potential additional work in the initial engagement to avoid losing an experienced consultant if the unforeseen occurs. However, the result in *Simon* is concerning. One approach may be to have the contract more clearly spell out the scope of the later services, as clearly the concern is adding additional services, not necessarily limiting multiphase engagements.

When is the preparation of a "plan" not part of the making of a "contract"?

A related topic, touched on above, is the situation where the consultant works for the agency in preparing a "feasibility plan" or "capital improvement plan." There are several examples of the FPPC finding that consultants who performed early planning work on projects that resulted in construction contract were not barred from follow-on work involving those contracts. We have previously discussed *Grossman* (A-17-167) in which the consultant did an "assessment and inventory" of the city's pump stations, but then was allowed to design a project to improve one of the stations that it studied. Similarly, in *Ciccozzi (*A-17-49), a consultant did "conditions assessment" and an "Operations Assessment and Facilities Study," but was allowed to serve as construction manager for one of the projects studied. On the other hand, in *Canger* (A-17-205), an architect did a space assessment, but wasn't allowed to bid on the ultimate construction work. In seeking distinction here, one wonders whether the fact that the subsequent contract was for construction may have influenced the decision. However, in *Chadwick* (A-15-147) sub-consultants that worked on a plan were allowed to participate on a construction team, but that could be explained by the rather technical nature of their services. That may have been the case in *Ciccozzi*, supra, where the follow-on work was as a construction manager. The one concern these letters don't seem to reflect is the potential for the initial advice to result in future work for the consultant who provides it. Without an adopted capital improvement plan, there may not be future work for consultants to implement it. It is not clear where to draw the line in assessing the motives of consultants who provide such high-level guidance, then assist in the implementation of their recommendations. One factor might be when multiple projects are contemplated in a plan as opposed to planning work on a single project.

Is life safer for sub-consultants?

There are also a series of advice letters that find that sub-consultants, whose work is often of a technical nature and who do not have as significant a role in guiding contract decisions, are not barred by 1090 from accepting work on the contractor's side of the eventual contract. In *Chadwick* (A-15-147), sub-consultants who provided services to a firm that designed a golf course were permitted to participate on the "build" side of the project, while the design firm was barred. The letter concluded that the sub-consultants did not "exert considerable influence" on contracting decisions. Similarly, in *Green* (A-16-084) a technical expert that developed a materials list was allowed to bid on the work to install those materials, while in *La Salle* (A-17-074), a scheduling expert was allowed to participate in later design contract. These situations seem to have a stronger rationale, given the ability to determine how much influence the particular discipline would have on contracting decisions.

CONCLUSION

The practical "take-aways" from these cases, and the many FPPC advice letters applying the law, can be summarized as follows. General program planning activities, including the preparation of feasibility studies and capital improvements plans, will not generally result in disqualification. However, when the later work involves actual construction, as opposed to consulting services, a less flexible view may apply. Sub-consultants, particularly in technical disciplines, will face few problems in assisting in later stages of a project. A real area of concern involves "follow-on" contracts, where the work of a consultant is needed in later phases of a project, particularly where the advice or work-product of the consultant plays a significant role in the scope of the future work (or whether the project proceeds at all). As we have seen with cases involving attorneys, work that may result in fixed fees, particularly in the bond issuance context, are very problematic. In many cases, however, where future tasks can be identified and the city wants to have the same consultant perform that work, the initial contract can provide the city with the power to expand the scope of work under the terms of the initial contract. In that way, no new contract is being "made," although an argument could still be made that the issuance of a change order or exercise of an option is essentially a new contract. It would be helpful if there could be more certainty in this area, but the all-or-nothing approach of Section 1090 does not easily lend itself to that. For now, the use of the FPPC's advice function is perhaps the best option for obtaining a degree of certainty in making these contracting decisions.

The evolution of the rules concerning the application of Section 1090 to consultants and consulting firms appears to have settled on an approach under which virtually all such parties are potentially public officials/employees, depending upon their ability to exert considerable influence on contracting decisions. As a result, the key questions involve the degree of such parties' participation in the "making" of various types of contracts. These questions have only gotten more complicated with the changing structure of public contract relationships. Unlike the federal context, in which a more fact-based analysis is done to see how much influence is present, with an eye to whether the consultant's bias may cloud the agency's decision, California takes an all or nothing approach. Nevertheless, the impetus behind Section 1090, as acknowledged from the very beginnings of our state, is still quite strong—the need to make sure that public officials, employees and, yes, even outside consultants, are not serving two masters.

APPENDIX C
ORGANIZATIONAL CONFLICTS OF INTEREST
DISCLOSURE STATEMENT

PENINSULA CORRIDOR JOINT POWERS BOARD

ORGANIZATIONAL CONFLICT OF INTEREST POLICY

FOR

CALTRAIN MODERNIZATION PROGRAM

I. Purpose

This Organizational Conflict of Interest Policy (–Policy‖) prescribes ethical standards of conduct applicable to persons and entities entering into contracts with the Peninsula Corridor Joint Powers Board (–JPB‖), and applies to subcontractors/subconsultants as well as prime contractors/consultants. This Policy is supplemental to the JPB's adopted Conflict of Interest Code ("Code") and does not modify or supersede any requirements contained in that Code.

This Policy is intended to accomplish the following goals:

A. Promote full and open competition, integrity, transparency and fairness in the JPB's procurements and contracts;

B. Prevent bidders and proposers from obtaining or appearing to obtain an unfair competitive advantage with respect to the JPB's procurements and contracts;

C. Ensure that consultants/contractors provide services to the JPB in an impartial and objective manner;

D. Provide guidance to enable consultants/contractors to make informed decisions while conducting business with the JPB; and

E. Protect the validity of the JPB's contracts and protect the JPB's interests and confidential and sensitive information concerning the Caltrain Modernization Program (–CalMod Program").

This Policy neither purports to address every situation that may arise in the context of the JPB's procurements and contracts, nor to mandate a particular decision or determination by the JPB. The JPB retains the ultimate and sole discretion to determine on a case-by-case basis whether an Organizational Conflict of Interest (as defined below) exists and what actions may be appropriate to avoid, neutralize or mitigate any actual or potential Organizational Conflict of Interest or the appearance of any such Organizational Conflict of Interest.

II. Definitions (applicable to this Organizational Conflict of Interest policy)

A. An **–Affiliate**ll of a Contractor is:

1. Any shareholder, member, partner or joint venture member of the Contractor,

2. Any person or entity which directly or indirectly through one or more intermediaries controls, or is controlled by, or is under common control with, the Contractor or any of its shareholders, members, partners or joint venture members; and

3. Any entity for which ten percent or more of the equity interest in such entity is held directly or indirectly, beneficially or of record by (i) the Contractor, (ii) any of the shareholders, members, partners or joint venture members of the Contractor, or (iii) any Affiliate of the Contractor under clause (b) of this definition.

For purposes of this definition the term —controlll shall mean the possession, directly or indirectly, of the power to cause the direction of the management of an entity, whether through voting securities, by contract, family relationship or otherwise.

B. **"CalMod Program"** means the Peninsula Corridor Joint Powers Board's approximately $1.5 billion early investment program in the peninsula rail corridor consisting of (1) installation of an advanced signal system (CBOSS/PTC), (2) electrified Caltrain service by 2019 and (3) procurement of electric multiple unit (EMU) rail vehicles. The CBOSS/PTC project is already underway. Corridor electrification currently is in the environmental phase. Rail vehicles procurement currently is in the planning stage. The early investment program not only will modernize Caltrain service but also will be designed to support the Blended System of high speed rail in the future. Funding for the early investment program will be derived from a variety of federal, state (including Proposition 1A high speed rail funds), regional and local sources. For further information about the CalMod program, please visit **www.caltrain.com**.

C. **—Contractor**ll means any individual or legal entity retained by the JPB to perform Program Implementation Services (defined below) for the CalMod Program, or proposing to perform such work, including joint venture members and general partners of any such entity; any consultant, subconsultant or subcontractor of such individual or legal entity (at all tiers); and each individual employee of such individual, legal entity or subcontractor.

D. **—Consultant**ll means any individual or legal entity retained by the JPB to perform Procurement Services for the JPB or proposing to perform such

services, including joint venture members and general partners of any such entity; any subconsultant of such individual or legal entity (at all tiers); and each individual employee of such individual, legal entity or subconsultant. The services performed include, but are not limited to architecture, safety services, quality services, information technology services, real estate acquisition, engineering, environmental services, systems integration services, land surveying, project management, program management, planning, or construction management.

E. **—Organizational Conflict of Interest‖** means a circumstance arising out of a Consultant's or Contractor's existing or past activities, business or financial interests, familial relationships, contractual relationships, and/or organizational structure (i.e., parent entities, subsidiaries, Affiliates, etc.) that results in (i) impairment or potential impairment of a Consultant's or Contractor's ability to render impartial assistance or advice to the JPB or of its objectivity in performing work for JPB, (ii) an unfair competitive advantage for any bidder or proposer with respect to an JPB procurement; or (iii) a perception or appearance of impropriety with respect to any of the JPB's procurements or contracts or a perception or appearance of unfair competitive advantage with respect to a procurement by the JPB (regardless of whether any such perception is accurate).

F. **—Procurement Services‖** mean services provided by a Consultant for the CalMod Program for the benefit of the JPB that relate to, but are not limited to, any of the following:

1. Development and preparation of procurement documents, including requests for qualifications, requests for proposals, invitations for bids, contract documents and technical specifications, but excluding development and preparation of preliminary design, operations planning studies and reports or similar ‑low level‖ documents for incorporation by others into a procurement package.

2. Development of bid/proposal evaluation criteria, process or procedures;

3. Management and/or administration of a procurement;

4. Evaluation of bidder/proposer submittals (e.g., qualification submittals, proposals, etc);

5. Negotiation of a contract; and

6. Advising the JPB in any other aspect of the procurement that the JPB determines, in its sole discretion, should be considered "Procurement Services."

G. **"Program Implementation Services"** mean services related to the CalMod Program provided by a Contractor or consultant for the benefit of the JPB relating to, but not limited to, any or all of the following:

1. Electrification: Design, construction, installation, quality control, integration, testing and commissioning of 50+ miles of 25 kV AC 60 Hz overhead Contact system, traction power substations, communications, SCADA, rail signaling conversion from DC to AC, CBOSS/PTC, train control facilities, and wayside improvements;

2. Rail Vehicles – EMUs: design, manufacture, assembly, fabrication, delivery, quality control, burn-in, integrated testing and commissioning of 96 EMUs; and

3. Miscellaneous Capital Improvements: Design and construction of various wayside improvements and adjustments as required by JPB to accommodate the CalMod Program.

III. Applicability

A. This Policy applies to all Consultants and Contractors that have entered into, or wish to enter into, contracts with the JPB to perform work on the CalMod Program.

B. To the extent that the JPB has previously consented in writing to performance of work by a Consultant or Contractor that would not have been permitted under this Policy, adoption of this Policy does not modify or alter the prior consent. The foregoing does not, however, mean that the JPB is required to consent to a Consultant's or Contractor's participation in future proposals or contracts.

IV. Federal Requirements

The JPB must comply with Federal Transit Administration (–FTA‖) and Federal Railroad Administration (–FRA‖) requirements and regulations applicable to federally funded procurements and contracts. Nothing in this Policy is intended to limit, modify, supersede or otherwise alter the effect of other relevant federal, state, or local regulations, statutes or rules.

V. Organizational Conflicts of Interest Disclosure and Determination Process

A. Obligation to Disclose

Each and every Consultant or Contractor who submits or plans to submit a proposal or bid in response to a solicitation for CalMod Program services shall submit a Conflict of Interest Disclosure (COID) that identifies past, present and known future relationships with the a) CalMod Program, and b) California High Speed Rail project within, or having effect within, the geographic limits of the CalMod Program. The COID shall state that the Consultant or Contractor has no past, present or known future conflicts of interest, or it shall disclose past, present or future known or potential conflicts of interest for the review by and consideration of the JPB. Each Consultant or Contractor shall submit its COID to the JPB at:

Cheryl Cavitt, Director of Contracts and Procurement
CalModCOI@Caltrain.com

Consultants and Contractors are referred to the specific solicitation documents for disclosure schedules, JPB review timelines, and other specific requirements of each solicitation.

B. JPB's Determination

The JPB will analyze the disclosure, in accordance with Section VII below, which provides a structure for a case-by-case analysis of actual or apparent Organizational Conflicts of Interest. As provided in Section VII, the JPB will determine on a case-by-case basis whether an Organizational Conflict of Interest exists that would preclude a Consultant's or Contractor's participation in the subject solicitation and if so, whether it may be waived or overcome through mitigating actions.

The JPB's determination will take into consideration services that a Consultant or Contractor has provided or is providing to the JPB (both in the CalMod Program context and outside of that context) and services that a Consultant or Contractor has provided or is providing to the California High Speed Rail Authority.

A fundamental ground rule with regard to the CalMod Program is the following: A Consultant or Contractor that serves as a prime consultant or contractor for either Procurement Services or Program Implementation Services may not also serve as a prime consultant/contractor for the other category of services. It is conceivable that such Consultants or Contractors may be permitted to serve as subconsultants or subcontractors for a prime consultant or contractor in the other category of services, but such work will be subject to the Organizational Conflicts of Interest analysis set forth in Section VII below.

The disclosure to the JPB shall describe the facts and circumstances giving rise to any Organizational Conflict of Interest and shall also propose alternatives/mitigation measures for addressing or eliminating the Organizational Conflict of Interest. If at any time, the JPB becomes aware of an Organizational Conflict of Interest in connection with a Consultant's or Contractor's performance of services for the JPB, the JPB shall similarly notify the Consultant or Contractor and its Affiliates.

The procurement documents or subject contract may provide an alternative process for such disclosure, in which case the alternative process shall control over the process described herein. The failure to disclose any actual, perceived or potential Organizational Conflict of Interest may result in serious consequences to the Consultant or Contractor and its Affiliates as described below.

In the event an Organizational Conflict of Interest is presented, whether disclosed by a Consultant or Contractor or discovered by JPB, the JPB will review the matter, consider alternatives/mitigation measures proposed, and make a determination, in accordance with this Policy, as to whether the particular Consultant or Contractor or bidder/proposer has an Organizational Conflict of Interest with respect to its participation in a procurement or performance of a contract for the JPB. The JPB's determination will be given in writing. The JPB will provide a determination to the Consultant or Contractor in accordance with the schedule in the specific solicitation documents.

The JPB's decision on the matter shall be final and binding and shall not be subject to appeal by the Consultant or Contractor in question or any other Consultant or Contractor.

C. Continuing Obligation to Disclose

An Organizational Conflict of Interest may arise at any time, and a Consultant's/Contractor's obligation to disclose is ongoing. If a Consultant or Contractor becomes aware of an actual, perceived or potential Organizational Conflict of Interest at any time during its participation in a procurement or performance of a contract, the Consultant or Contractor shall promptly disclose the matter as described herein. Consultants or Contractors participating in contracts with the JPB and bidders/proposers for JPB contracts shall use all reasonable efforts to arrange their affairs so as to prevent Organizational Conflicts of Interest from arising. Consultants or Contractors should undertake reasonable due diligence, including necessary conflict searches, to determine whether new actual, perceived or potential Organizational Conflicts of Interest have arisen. Each Consultant or Contractor shall consider whether disclosure is required in connection with new hires, changes in the company's board of directors, mergers, or new business relationships including joint ventures and contractor/subcontractor relationships.

Consultants or Contractors whose responsibilities to the JPB include review, supervision or oversight of work by other entities should pay careful attention to their relationships with the other entities and their Affiliates and should take care to avoid relationships with such other entities that would give rise to an Organizational Conflict of Interest. Due diligence should extend to investigation of past relationships and, if the Consultant or Contractor is a corporate entity, to officers or directors of the Consultant or Contractor.

A Consultant or Contractor shall not be the JPB's agent for review, approval, or acceptance of its own or its Affiliate's work product.

D. Failure to Comply

If the JPB determines, in its sole discretion, that a Consultant or Contractor has failed to comply with this Policy in any respect (including any failure to disclose an actual, perceived or potential Organizational Conflict of Interest) either prior to award of the contract or during performance of the contract, the JPB may, among other things, take the following actions:

1. Preclude and/or disqualify the Consultant or Contractor and its Affiliates, as well as any other persons or legal entities on the Consultant's or Contractor's team, from participation in a JPB procurement;

2. Require the Consultant or Contractor and its Affiliates, as well as any other persons or legal entities on the Consultant's or Contractor's team, to implement mitigating measures;

3. Terminate or amend the contract under which the Consultant or Contractor is performing work for the JPB; and/or

Failure to comply with this Policy may subject the Consultant or Contractor to damages incurred by the JPB in addressing Organizational Conflicts of Interest that arise out of work performed by the Consultant or Contractor.

VI. Conflict of Interest Standards Applicable to Environmental Consultants

Consultants responsible for preparing documents under the California Environmental Quality Act (–CEQA‖) are required to comply with all state and federal laws and regulations applicable to such services, including requirements relating to Organizational Conflicts of Interest. With regard to such conflicts, the JPB will follow the guidance provided by the FTA, including the FTA's Best Practices Procurement Manual (–BPPM‖). Among other things, the BPPM recommends precluding any consultant that is responsible for preparing an Environmental Impact Statement (–EIS‖) from having any financial or other interest in the outcome of the project that is the subject of the EIS until after the EIS is complete. Accordingly, any Consultant that is responsible for preparing an EIS for the CalMod Program will be precluded from providing Procurement Services or Program Implementation Services until after the Record of Decision has been issued.

Subconsultants to a CEQA Consultant may request permission to be released from further CEQA work to allow them to provide or join a team that will or is providing Procurement Services or Program Implementation Services being analyzed in the CEQA document. The JPB has no obligation to agree to release the subconsultant from its responsibilities relating to the CEQA document. The JPB's decision on the matter shall be final and binding and shall not be subject to appeal.

VII. Organizational Conflict of Interest Factors to Consider

The JPB will consider the following relevant factors, including case-specific factors, in determining whether a Consultant or Contractor should be permitted to participate or to continue to participate in a procurement or the performance of a contract:

A. Relevance or Materiality of the Information

1. This factor includes considering whether the Consultant or Contractor has in its possession information that will not and should not be made public or disclosed to other participants in the procurement, as the case may be, or that will give an unfair advantage to the Consultant or Contractor, including the following:

    a. Planning, budgetary, or business information;

    b. The JPB' strategies, tactics, plans, alternatives or other inside information concerning the procurement; or

    c. Information prepared for use by the JPB for the purpose of evaluating proposals, for defining the scope of the work, or for determining terms, conditions or specifications.

2. This factor includes considering the —agell of the information, including whether the length of time between the acquisition of the information, combined with interim developments within a project (e.g., transaction structure, design, changed circumstances, etc.), is sufficient to render the information irrelevant, immaterial, or of little or no value.

3. This factor includes considering the extent to which the information is or will be available to other participants in the procurement and the time other participants had or will have to analyze and assimilate the information.

B. Materiality of the Relationship

1. This factor involves considering whether the subject relationship involves branch offices, subsidiaries, joint venture partners, or a parent company of the Consultant/Contractor, and the degree of separation of work teams and information between the offices and companies.

2. This factor includes considering the substance of a subject relationship, including whether the relationship is so indirect or remote that an actual or perceived Organizational Conflict of Interest is sufficiently mitigated (e.g., no effective risk of passing or use of confidential information or bias in the discharge of functions).

C. Resources and Expertise

1. This factor includes considering the expertise required by the JPB for successful Program Implementation and whether the expertise is readily available from suitably qualified and skilled Consultants or Contractors.

2. This factor includes considering the magnitude of the resources required to deliver the CalMod Program in a quality, cost-effective and timely manner.

3. This factor includes disclosing these exigencies in a competitive process, including to any relevant governing association or body to obtain its concurrence.

D. Professional Governing Body Rules - Common Law

1. This factor includes considering the rules, if any, that are put in place by professional or other governing bodies regarding actual and perceived Organizational Conflicts of Interest and determining whether delivery of a certification or acknowledgement by a prospective or existing Consultant or Contractor of its compliance with any such rules would be sufficient mitigation.

2. This factor includes obtaining the advice of any such professional or governing body to the participation of a Consultant or Contractor.

3. This factor includes considering the case law relevant to Organizational Conflicts of Interest matters.

VIII. Safeguards and Mitigation Efforts

If the JPB, after considering the relevant factors set forth in Section VIII above, including case-specific factors, is of the view that a Consultant or Contractor should be permitted to participate or to continue to participate in a particular procurement or contract, then the JPB, in its sole discretion, may require the Consultant or Contractor to implement suitable safeguards, including those described below, to mitigate any Organizational Conflict of Interest.

A. The JPB may require a Consultant or Contractor to establish ethical walls and related safeguards and procedures, including the segregation of individuals and information within a Consultant or Contractor firm or company, thereby allowing the Consultant or Contractor firm or company to participate or continue to participate in the CalMod Program.

B. Segregated information may include confidential information obtained as a result of a Consultant's or Contractor's or prospective Consultant's

or Contractor's former contracts with the JPB or confidential information obtained from former or current JPB employees.

C. The JPB may require assurances or demonstration of the type of ethical walls and the effectiveness of the ethical walls.

D. The JPB may require information (including in affidavit form) as to when ethical walls were put into place, how they operate, and whether there is any form of notification within the subject firm or company of their existence.

E. The JPB may audit, or direct others to audit on its behalf, for compliance with ethical walls and related safeguards and procedures.

F. The JPB may require such other safeguards or mitigation measures at it deems appropriate to address a specific instance of an Organizational Conflict of Interest.

IX. Application of Policy to Employees

If the JPB determines that a potential or actual Organizational Conflict of Interest exists for a particular Consultant or Contractor, an Organizational Conflict of Interest shall also be considered to apply to any employee of such Consultant or Contractor that has participated in a material way in the performance of work giving rise to the determination. If such individual leaves the Consultant's or Contractor's employment, the potential or actual Organizational Conflict of Interest shall apply to such individual's new employer in the same manner as it applies to the original Consultant or Contractor. However, the individual's new employer (if not an Affiliate of the original employer) will not be considered to have an Organizational Conflict of Interest provided the new employer adopts and implements safeguards and mitigation measures – as described in Section VIII - satisfactory to the JPB its sole discretion.

(END OF APPENDIX C)

Peninsula Corridor Joint Powers Board Organizational Conflict of Interest Disclosure Form for Caltrain Modernization Program

Proposers planning to participate in the Caltrain Modernization (CalMod) Program either as a Prime Consultant or Subconsultant must be in conformance with the "JPB Organizational Conflict of Interest Policy for the CalMod Program" and must complete this form. The Conflict of Interest (COI) Policy is available on the Internet at: http://procurement.samtrans.com

Proposers planning to utilize one or more Subcontractors/Subconsultants must ensure that its Subcontractors/Subconsultants complete this form. If applicable, this form should be submitted by the date provided in the solicitation.

Submittal of this form certifies that:

(a) the Proposer's disclosures are complete, accurate, and not misleading; and

(b) proposed Subcontractors/Subconsultants (all tiers) shall be required to complete this form.

I hereby certify that I am authorized to sign this COI Disclosure Form as a Representative for the Firm identified below:

*** Required**

*** Please select the applicable Project**

- ☐ Design Build of Electrification - 14-PCJPB-P-053
- ☐ Procurement of Electric Multiple Units (EMU) - 14-PCJPB-P-056

*** Legal Name of Proposer Firm:** _____

*** Address:** _____

*** City, State, and ZIP code:** _____

*** Telephone Number:** _____

*** E-mail Address:** _____

*** Name of Authorized Representative:** _____

*** Title of Authorized Representative:** _____

Disclose work being performed or previously performed for the JPB, CHSRA and other agencies

Please select one: ☐ JPB ☐ CHSRA

Describe all work performed as a prime contractor and/or subcontractor or subconsultant, including:
(1) identify the contract or work directive no.; (2) dates that work was performed or, if currently underway, date work started and its expected duration; (3) the dollar value of the contract(s); (4) a description of the services provided; and (5) a description of proposed alternatives/mitigation measures.

Worked Performed as: ☐ Prime ☐ Subcontractor/Subconsultant

Please identify the contract or work directive no. _____

Period of performance: **From** _____ **To** _____

Dollar value of contract or work directive _____

Description of services provided:

In the event that real or apparent organizational conflicts exist, please provide a description of proposed alternatives/mitigation measures:

Disclose work being performed or previously performed for the JPB and CHSRA

Please select one: ☐ JPB ☐ CHSRA

Describe all work performed as a prime contractor and/or subcontractor or subconsultant, including: (1) identify the contract or work directive no.; (2) dates that work was performed or, if currently underway, date work started and its expected duration; (3) the dollar value of the contract(s); (4) a description of the services provided; and (5) a description of proposed alternatives/mitigation measures.

Worked Performed as: ☐ Prime ☐ Subcontractor/Subconsultant

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Period of performance: **From** _____ **To** _____

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Please identify the contract or work directive no. _____

Period of performance: **From** _____ **To** _____

Dollar value of contract or work directive _____

Description of services provided:

In the event that real or apparent organizational conflicts exist, please provide a description of proposed alternatives/mitigation measures:

Signature Page

Peninsula Corridor Joint Powers Board Organizational Conflict of Interest Disclosure Form for Caltrain Modernization Program

Conflict of Interest Disclosure Certification

Instructions: Please complete and submit this form electronically via the "Submit Form" button above. In addition, please print and sign this Signature Page and return it via e-mail to: CalModCOI@caltrain.com to complete your certification.

Proposers' signatures certify that the information disclosed:

a) is complete, accurate, and not misleading; and

b) that proposed Subcontractors/Subconsultants (all tiers) shall be required to complete this form.

I hereby certify that I am authorized to sign this COI Disclosure Form as a Representative for the Firm identified below.

Legal Name of Proposer Firm: _____

Name of Authorized Representative: _____

Title of Authorized Representative: _____

Signature: _____

Date: _____

(Rev. 7-17-13)

General Municipal Litigation Update

Thursday, September 13, 2018 General Session; 1:00 – 2:30 p.m.

Javan N. Rad, Chief Assistant City Attorney, Pasadena

Notes:_____

General Municipal Litigation Update

Cases Reported from May 4, 2018
Through August 17, 2018

Prepared by
Javan N. Rad
Chief Assistant City Attorney
City of Pasadena

League of California Cities
2018 Annual Conference
City Attorney's Department Track

Table of Contents

I. Employment

***Palm v. Los Angeles Department of Water & Power*, 889 F.3d 1081 (9th Cir. 2018)**

Holding: Plaintiff lacked a protected property interest in probationary promotional (supervisor) position, when, upon failing to pass probation, he was returned to his (non-supervisor) permanent position with the city.

Facts: After working as an assistant at a city steam plant for 25 years, Plaintiff was promoted to a supervisor position, which carried with it a six-month probationary period. During that time, Plaintiff filed an administrative complaint listing 33 conflicts with his supervisors, including complaints about compliance with health, safety, and labor laws, and altering Plaintiff's time records. Plaintiff was given the option of either "forced resignation" or termination from his probationary supervisor position. Plaintiff resigned, and returned to his permanent assistant position. Plaintiff then filed suit, asserting a variety of claims. As relevant here, Plaintiff alleged that the city's threatened termination of him from his probationary supervisor position violated his due process rights under the Fourteenth Amendment. The District Court granted the city's Motion to Dismiss the due process claim, and denied Plaintiff's Motion for Reconsideration. Plaintiff appealed.

Analysis: The Ninth Circuit affirmed the dismissal of Plaintiff's due process claim. The court held that Plaintiff cannot maintain a due process claim based on his termination from the supervisor position, and his return to his permanent position at the steam plant. In reviewing the city's charter and personnel rules, the court noted that even a probationary employee could have a reasonable expectation of continued employment. Here, however, the city's charter and personnel rules do not provide probationary employees with a vested property interest. The court concluded that the city's probationary rules still apply to Plaintiff, regardless of the fact that Plaintiff was a permanent employee in another city position.

***Fisher v. State Personnel Board*, 25 Cal.App.5th 1 (2018)**

Holding: Termination of State Personnel Board administrative law judge upheld where ALJ joined a private law firm that did business in front of the SPB, and ALJ did not inform, nor seek approval from, the SPB.

Facts: Plaintiff was appointed to the position of administrative law judge with the State Personnel Board in 2010. In 2011, Plaintiff, while still employed as an ALJ, joined a private law firm specializing in administrative law. Plaintiff verbally discussed with the firm the concept of establishing an ethical wall so he would not be involved in an SPB case, but that was not reduced to writing. Plaintiff never requested permission from supervisors at SPB before joining the law firm, as Plaintiff "did not believe it was important," and Plaintiff knew of at least one other SPB ALJ who was performing outside legal work. Plaintiff also said that the chief ALJ and then-presiding ALJ gave him permission to work at the law firm, but they "testified adamantly and persuasively otherwise." Plaintiff also failed to list the law firm on his statement of economic interest (Form 700) for the 2013 reporting period. Additionally, after Plaintiff had joined the law firm, Plaintiff attended a meeting of ALJs, where another ALJ discussed her perception of a high-profile case, in which Plaintiff's law firm was representing a CalTrans employee. The other ALJ sent Plaintiff and other ALJs a draft of her proposed decision. Nonetheless, Plaintiff still did not inform his SPB colleagues about his employment at the law firm. Plaintiff's employment at the law firm was first discovered by a SPB colleague, who was at a local bar association event, and was asked whether Plaintiff was the same person who worked at the law firm. Plaintiff was later terminated after an administrative hearing in front of an ALJ, and the SPB adopted the ALJ's decision. Plaintiff filed a petition for writ of mandate, seeking to overturn his termination. The trial court upheld the SPB's termination of Plaintiff, and dismissed the writ petition.

Analysis: The Court of Appeal affirmed the dismissal. The court found it immaterial that the SPB did not give Plaintiff prior notice that his work at the private law firm constituted an incompatible activity. The court found that Government Code Section 19990 (the incompatible activities statute for State officers and employees) does not somehow allow public employees to engage in incompatible activities, until they receive actual notice of the violation. Additionally, the Court of Appeal found that the penalty of termination was appropriate, under the circumstances. Finally, the court ordered the clerk and the Plaintiff to forward a copy of the appellate opinion to the State Bar of California.

II. Torts

Ramirez v. City of Gardena, ___ Cal.5th ___, 2018 WL 3827236 (2018)

Holding: City entitled to police pursuit immunity, even where police department may not have obtained written certifications from all officers that they have received, read, and understood the department's police pursuit policy.

Facts: Police attempted to bring a vehicle pursuit to an end with a "Pursuit Intervention Technique," which resulted in the suspect vehicle striking a streetlight pole, killing the passenger in the vehicle. Plaintiff (the mother of the decedent passenger) filed suit. The year of the incident, 81 of the 92 police officers in the department had completed training on the department's pursuit policy. The department also contended that all officers had completed forms certifying that they had received, read, and understood the police pursuit policy, but some forms may have been lost during the police department's move to a new police station. Plaintiffs filed suit, alleging negligence and battery claims. The city filed a motion for summary judgment, asserting immunity under Vehicle Code Section 17004.7, which relates to police vehicle pursuits. Section 17004.7 provides for immunity from police motor vehicle accidents if the agency adopts a pursuit policy, provides annual training, and requires officers to certify, in writing, that they have received, read, and understood the policy. The trial court granted the city's motion, and the Court of Appeal affirmed. The Supreme Court granted review.

Analysis: The Supreme Court affirmed. Section 17004.7 does not, itself, require officers to execute written certifications as a condition of immunity for the city. Otherwise, if written certifications were required to be produced for all officers in the agency, it could be very difficult for Gardena, and "almost impossible for a large entity employing thousands of peace officers." Additionally, the statute provides that an officer's failure to sign a certification should not be used as a reason to "impose liability on an individual officer or a public entity." Therefore, the city need not prove "total compliance" with the certification requirement to obtain immunity.

Gund v. County of Trinity, 24 Cal.App.5th 185 (2018)

Holding: Exclusive remedy rule of workers' compensation laws bars state law tort action by Plaintiff husband and wife for assisting sheriff's deputy with 911 call.

Facts: A California Highway Patrol dispatcher received a 911 call from the vicinity of an airstrip. The caller whispered "help me" and said she lived at the end of the airstrip. The county dispatcher tried calling the 911 caller back, and there was no answer, so the dispatcher passed the information to a sheriff's deputy. The deputy called Plaintiffs, who lived hear the airstrip, advised them that the call was likely related to inclement weather (not that the caller was whispering), asked them to check on the caller, and advised that it was "probably no big deal." Plaintiffs drove to the caller's residence, and were brutally attacked by a man who had just committed a double-murder. Plaintiffs filed suit against the county and the deputy for negligence and misrepresentation. Defendants moved for summary judgment on the state law claims, on the ground that workers' compensation was Plaintiffs' exclusive remedy under Labor Code Section 3366 (persons engaged in active law enforcement are deemed to be employees for purposes of workers' compensation laws). The trial court granted the motion, and Plaintiffs appealed.

Analysis: The Court of Appeal affirmed, finding the Plaintiffs were engaged in assisting in "active law enforcement service." Initially, the court noted that the underlying premise of the exclusivity of the workers' compensation remedy is a "presumed bargain that the employer assumed liability for industrial injury without regard to fault," although the employee gives up the "wider range of damages potentially available in tort." As to the merits, the court reviewed cases discussing "active law enforcement" in a variety of contexts, and concluded that the phrase contemplates one is exposing themselves to risks inherent in preventing a crime or breach of peace. The court reasoned that, since the deputy could have responded to the 911 call, the deputy would have clearly been engaged in active law enforcement if doing so. Regardless of the deputy's misrepresentations to the Plaintiffs, the "Plaintiffs still knew they were responding to a 911 call for help."

***Newland v. County of Los Angeles*, 24 Cal.App.5th 676 (2018)**

Holding: County employee was not in the course and scope of his employment when driving home from work in his personal vehicle.

Facts: Defendant Prigo had worked as a deputy public defender since the early 1980's. At the time of the subject motor vehicle accident, Prigo was performing felony trial work from his office in a local courthouse. Prigo was not expressly required to provide a vehicle for carrying out his job duties, although Prigo used

his personal vehicle to carry out job-related functions, such as going to court, and meeting with clients. On the date of the accident, Prigo had six cases on calendar at the courthouse, but did not have to travel outside the courthouse for work. On Prigo's way home from work, he was turning into the post office to mail his rent check. Prigo's vehicle was hit by another driver, and the other driver was forced off the road and injured Plaintiff, a pedestrian. Plaintiff sued, Prigo, the county, and the other driver. The jury found Prigo's negligence caused the accident, that he was required to use his personal vehicle to perform his job for the county, and that the county was liable to Plaintiff for nearly $14 million in damages. The trial court denied the county's post-trial motions, and the county appealed.

Analysis: The Court of Appeal reversed, finding the county's motion for judgment notwithstanding the verdict should have been granted. The court found there was no evidence that Prigo was driving his car within the course and scope of his employment when the accident occurred. Prigo was not commuting in his car at the time of the accident solely because the county required him to have his car available. Rather, he drove to the courthouse "because he did not have any reasonable public transportation options from Long Beach." The court also distinguished several opinions where the employee was required to drive to work on the day of the accident, or was providing a benefit to the employer that the employee have a car available at work.

III. Civil Rights/Fourth Amendment

***Felarca v. Birgeneau*, 891 F.3d 809 (9th Cir. 2018)**

Holding: Officers and university administrators entitled to summary judgment against claims of excessive force during efforts to control a crowd of protestors.

Facts: Thousands of protestors planned to rally at the University of California at Berkeley to support the Occupy Wall Street movement. Two days before the rally, university administrators warned students in a campus-wide email that the school's no-camping policy would be enforced. The protest started off peaceful during the afternoon, but protestors then began erecting tents. University police officers then took the tents down, but protestors set up more tents. Officers returned in riot gear. Protestors began forming a human chain to prevent the police from reaching the tents. Officers then gave warnings, which had no effect. Officer used their hands and batons to gain control over the crowd. Similar disputes arose during the

protests in the evening. Some of the protestors filed suit against university administrators and police officers, alleging excessive force was used. For example, each Plaintiff (except for one) was hit by a baton in the torso or extremities. The District Court denied Motions for Summary Judgment from the officers and administrators, and they appealed.

Analysis: The Ninth Circuit reversed. First, the court found that the force used by two involved officers was not excessive, particularly because "the university was not required to permit the 'organized lawlessness' conducted by the protestors." The protestors understood police orders to disperse, and they interfered with the officers' efforts in that regard. Next, as relevant here, the court found that the university administrators in the police chain of command were not liable for supervisory force claims, as Plaintiffs "have not connected the force applied by each officer to the actions of these administrators." Finally, the court found the on-scene lieutenant and sergeant were entitled to qualified immunity, as Plaintiffs failed to show the law was clearly established that the officers' baton strikes violated their constitutional rights. Here, Plaintiffs failed to identify a case where, after several dispersal warnings were given, the officer uses baton strikes on the torso or extremities for the purpose of controlling a crowd "actively obstructing the officer. . ."

***Carpenter v. United States*, ___, U.S. ____, 138 S.Ct. 2206 (2018)**

Holding: The government generally needs a warrant if it seeks a suspect's historical cell-site location information (CLSI) from a cell phone carrier.

Facts: Four men were arrested for robbing a series of electronic and cell phone stores, and one of the suspects confessed, identifying 15 accomplices. The prosecutors ultimately applied for court orders for the cell phone records of Carpenter, pursuant to the Stored Communications Act, which allows disclosure in this instance where the records "are relevant and material to an ongoing criminal investigation." Two magistrate judges issued orders for cell phone carriers to disclose CSLI for Carpenter during the four-month period of the robberies. Ultimately, the carriers produced a total of 129 days of CLSI, with 12,898 location points for Carpenter. Carpenter was charged with robbery and carrying a firearm during a federal crime of violence. Carpenter moved to suppress the CLSI, as it was not obtained by a warrant, and the District Court denied the motion. At trial, the CLSI was used to place the Carpenter at the location of each robbery, at the time a robbery occurred. Carpenter was convicted of all but one count, and

sentenced to over 100 years in prison. Carpenter appealed, and the Sixth Circuit affirmed. The U.S. Supreme Court granted certiorari.

Analysis: The Supreme Court, in a 5-4 opinion, reversed, finding that the government's acquisition of historical CLSI (i.e., the "mine run criminal investigation") is a search within the meaning of the Fourth Amendment, and the government generally must obtain a warrant before acquiring such records. The court noted its decision was narrow, and does not inform the validity of either (a) real-time CLSI; or (b) "tower dumps" (a list of all the devices that connected to a cell site during a period of time). As to the historical CLSI, the court found it "gives police access to a category of information otherwise unknowable," and "this newfound tracking capacity runs against everyone. . . Whoever the suspect turns out to be, he has effectively been tailed every moment of every day for five years . . ."

***Byrd v. United States*, ___, U.S. ____, 138 S.Ct. 1518 (2018)**

Holding: The mere fact that a driver of a rental car is not listed as an authorized driver on the rental agreement will not defeat the driver's reasonable expectation of privacy under the Fourth Amendment.

Facts: Defendant, in his car, drove a friend to a car rental facility. The friend rented a vehicle, and listed only herself as an authorized driver of the rental car. The two then left in separate cars – Defendant in the rental car, and the friend in Defendant's car. Defendant was then pulled over on the highway for a possible traffic infraction. Defendant provided the car rental agreement to a trooper, and advised a second trooper that a friend had rented the vehicle. The troopers asked Defendant to search the vehicle several times while conversing with him, but they also stated they did not need consent, as Defendant was not listed on the rental agreement. As the troopers began to search the trunk, they located a laundry bag containing body armor, and Defendant began to run away shortly thereafter. The troopers caught up to Defendant, and he surrendered. Defendant also admitted there was heroin in the car, and the troopers found 49 bricks of heroin in the trunk. Defendant was prosecuted, and he moved to suppress the evidence found in the trunk of the car. The District Court denied his motion, and Defendant later entered a conditional guilty plea, reserving the right to appeal the denial of his Motion to Suppress. The Third Circuit affirmed, and the U.S. Supreme Court granted certiorari.

Analysis: The Supreme Court, in a unanimous opinion, vacated the Third Circuit's opinion. The court found it "too restrictive" under the Fourth Amendment to find that drivers not listed on rental agreements always lack an expectation of privacy. The court noted a number of innocuous reasons why an unauthorized driver might drive a rental car, particularly where it may be safer for the unauthorized driver to drive the vehicle. The court noted that the "risk allocation between private parties" (consequences for breaching the rental agreement) has little to do with one's reasonable expectation of privacy under the Fourth Amendment. As to the facts of this case, the court expressly did not decide (and left for the Third Circuit on remand to address) whether the search was valid if (a) Defendant intentionally used his friend to procure the rental car to commit a crime; and (b) probable cause justified the warrantless search in any event.

***Collins v. Virginia*, ___, U.S. ____, 138 S.Ct. 1663 (2018)**

Holding: The automobile exception does not permit an officer without a warrant to enter a home or its curtilage to search a vehicle therein.

Facts: Police officers observed a motorcycle commit two separate traffic infractions, and then evade or elude officers from pulling over the motorcycle. The officers compared notes, and concluded the same motorcyclist was involved. The officers' investigation then yielded pictures on the Defendant's Facebook page showing a motorcycle parked at the top of a driveway of a house. One officer went to the house, and observed (from the sidewalk) what appeared to be a motorcycle covered with a tarp at the same angle and location in the driveway as the Facebook picture. The location where the motorcycle was parked was partially enclosed, and had side access to the house. The officer then walked up to the motorcycle, pulled off the tarp, revealing the motorcycle from the speeding incident. The officer took a photograph of the uncovered motorcycle, and awaited for Defendant to arrive home. When Defendant arrived, he informed the officer he bought the motorcycle without a title, was arrested, and was later charged for receiving stolen property. Defendant filed a motion to suppress, on the grounds that the officer obtained information about the motorcycle through a warrantless search. The trial court denied the motion, and Defendant was convicted. The Virginia Court of Appeals affirmed the conviction, as did the Virginia Supreme Court. The U.S. Supreme Court granted certiorari.

Analysis: The Supreme Court reversed, finding the automobile exception inapplicable here. At the outset, the court concluded that the part of the driveway

where the motorcycle was parked was curtilage. Next, the court declined to extend the automobile exception into the home and its curtilage. Doing so, the court concluded, "would unmoor the [automobile] exception from its justifications . . . Indeed, its name alone should make all this clear enough: It is, after all, an exception for automobiles." The court expressly did not decide whether the officer's actions with regard to the motorcycle may have been reasonable on a different basis, remanding for further proceedings.

IV. Civil Rights/Other

***Masterpiece Cakeshop, Ltd. v. Colorado Civil Rights Commission*, ___, U.S. ____, 138 S.Ct. 1719 (2018)**

Holding: State commission's comments and statements prevented a fair and impartial hearing under the Free Exercise Clause of the First Amendment.

Facts: Two men came into Masterpiece Cakeshop, a bakery, to order a cake for their wedding. The bakery owner informed the two men that he does not make cakes for same-sex weddings. One day later, the bakery owner explained to the mother of one of the men two reasons for his declination to bake a cake: (a) the bakery's religious opposition to same-sex marriage; and (b) Colorado (at the time) did not recognize same-sex marriages. The two men filed a discrimination complaint with the Colorado Civil Rights Commission, alleging they were denied service because of their sexual orientation. The Commission staff's investigation revealed that on multiple occasions, the bakery owner had declined to sell custom wedding cakes to same-sex couples. The matter proceeded to a formal hearing with an Administrative Law Judge, who ruled in favor of the couple and against the bakery. The Commission affirmed the ALJ's decision, in full. The bakery appealed to the Colorado Court of Appeals, and they affirmed the Commission's decision The Colorado Supreme Court declined to hear the case. The U.S. Supreme Court then granted certiorari.

Analysis: The Supreme Court reversed the Colorado Court of Appeals' decision in a 7-2 opinion. At the outset, the court explored the substantive arguments that could have been considered from both sides – both the couple's right to be free from discrimination based on sexual orientation in acquiring products and services, and the bakery owner's right to decline to use his artistic skills to make an expressive statement (a custom wedding cake). However, the court ultimately did

not resolve these arguments in its opinion. Rather, the court found the seven-member Commission's treatment of the case to have "some elements of a clear and impermissible hostility toward the sincere religious beliefs that motivated the [bakery owner's] objection." The court found several comments from commissioners appeared to be inappropriate and dismissive, and lacking respect for the bakery owner's arguments under the Free Exercise Clause. For example, one of the commissioners described the bakery owner's faith as "one of the most despicable pieces of rhetoric that people can use. . . " The court concluded that commissioners' statements "cast doubt on the fairness and impartiality" of the hearing. Also, the court noted there were at least three other instances of investigations by a Commission staff finding that bakers acted lawfully in refusing to create cakes with anti-same-sex marriage symbolism.

Hipsher v. Los Angeles County Employees Retirement System, 24 Cal.App.5th 740 (2018)

Holding: Public Employees' Pension Reform Act of 2013 (PEPRA) does not violate the Contracts Clause or the Ex Post Facto Clause of the California Constitution. However, the county retirement system (LACERA) failed to provide sufficient due process protections to retiree, before reducing pension benefits as a result of retiree's conviction of a job-related felony.

Facts: Plaintiff was a firefighter who began conducting an illegal gambling operation starting around 2001. In 2011, undercover law enforcement authorities joined Plaintiff's operation to collect unpaid or past due gambling debts. Plaintiff met with the undercover agents (posing as motorcycle gang members) at a fire station. Plaintiff gave the agents a tour of the fire station, showing the room where he conducted part of the gambling operation. The U.S. Attorney's office later charged Plaintiff for running an illegal gambling business. Plaintiff subsequently retired, entered a guilty plea and was convicted in 2014. In 2013, one year before the conviction, the Legislature passed PEPRA, which provided, among other things, that a public pensioner forfeits a portion of retirement benefits following conviction of a felony offense that occurred in their performance of official duties. In response to Plaintiff's conviction, LACERA adjusted Plaintiff's pension by, among other things, expunging over 12 years of service credits, and reducing Plaintiff's retirement allowance from approximately $6,800 to approximately $2,900. There were no administrative remedies to challenge LACERA's benefit adjustment determination. Plaintiff filed suit, challenging the reduction of pension benefits. The trial court found that LACERA's actions did not violate the

California Constitution's Contracts Clause or Ex Post Facto Clause. However, the trial court found that the county did not provide Plaintiff with sufficient due process protections related to his original retirement benefits. Plaintiff and the county appealed.

Analysis: The Court of Appeal affirmed, with modifications. The court found that the forfeiture provisions of PEPRA did not violate (a) the Contracts Clause, as applied to Plaintiff; and (b) the Ex Post Facto Clause, which only applies to civil legislation "in limited circumstances," and this case is not one of them. However, the court held that Plaintiff did not receive sufficient due process protections before his pension benefits were reduced, and that PEPRA required LACERA (not the county) to provide that due process – here, through LACERA's existing administrative appeal procedures.

***United States v. California*, ___ F.Supp.3d ___, 2018 WL 3301414 (E.D. Cal. 2018)**

Holding: Several provisions of the California Values Act (SB 54), California's response to address recent federal immigration enforcement programs, are not preempted by the Immigration and Nationality Act.

Facts: In 2017, the Legislature passed three bills aimed at addressing recent federal immigration enforcement programs, including SB 54. Among other things, SB 54 (a) prohibits California law enforcement agencies from sharing certain information for immigration enforcement purposes; and (b) limits transfers of individuals to immigration authorities. Plaintiff filed suit against California, asserting the invalidity of various provisions of the three bills, including the referenced restrictions of SB 54. Plaintiff then filed a Motion for Preliminary Injunction.

Analysis: As it pertains to the SB 54 restrictions, the District Court denied the Plaintiff's motion, finding Plaintiff's challenge was unlikely to succeed on the merits, rejecting two preemption arguments (of note) asserted by Plaintiff – conflict preemption and obstacle preemption. The court concluded that the SB 54 restrictions on information sharing (including release dates and home and work addresses) did not directly conflict with (and were therefore not preempted by) 8 U.S.C. Section 1373, which bars states from prohibiting or restricting sharing information "regarding the citizenship or immigration status" with federal immigration authorities. In other words, Section 1373 limits its reach to

information strictly pertaining to immigration status, and not release dates and addresses. The court also rejected Plaintiff's obstacle preemption challenge (pertaining to the Immigration and Nationality Act in general), noting that Congress has not required states to assist in immigration enforcement. Rather, immigration enforcement is merely an option available to the states. Additionally, if Congress prohibited states from restricting law enforcement involvement in immigration enforcement, aside from a narrowly drawn information sharing provision, such legislation may violate the Tenth Amendment and anti-commandeering principles.

V. Land Use

Lamar Advertising Company v. County of Los Angeles, 22 Cal.App.5th 1294 (2018)

Holding: Neither Outdoor Advertising Act nor county ordinance allowed non-conforming billboard to be eligible for re-erection, after original billboard was destroyed in a windstorm.

Facts: In 1967, the county issued a permit for a billboard along a freeway. The billboard consists of 10 wooden telephone poles supporting a 60-foot advertising face. Plaintiff later acquired ownership in the billboard. In 1995, the county adopted an ordinance banning billboards in the area of Plaintiff's billboard, so the structure became a non-conforming use. The amortization period passed, Plaintiff did not obtain a permit to have the billboard remain, and the county did not seek to remove the billboard. In 2008, a windstorm blew over the billboard and one of the support poles. Plaintiff then installed a new advertising face and support structures. The county issued an order to the Plaintiff to remove the billboard. Plaintiff appealed the administrative order, and a hearing officer denied the appeal. Plaintiff filed a petition for writ of mandate, and the trial court denied the petition. Plaintiff appealed.

Analysis: The Court of Appeal affirmed the denial of Plaintiff's writ petition. First, Plaintiff's reconstruction of the billboard was not somehow permissible as "customary maintenance" under California Department of Transportation regulations implementing the Outdoor Advertising Act, Business & Professions Code Section 5200 *et seq.* The regulations require, among other things, that customary maintenance not alter existing dimensions or the approved

physical configuration. Here, however, Plaintiff's reconstruction of the billboard was more than customary maintenance. Plaintiff altered the existing dimensions, and had added new components to the billboard. Additionally, even if the CalTrans regulations authorized reconstruction of the billboard, the county's own ordinance (relating to structures that are "partially destroyed") did not exempt Plaintiff from the county's requirement for a permit. The billboard had entirely lost its functionality, so, under the plain meaning of the phrase, it was not partially destroyed – it was completely destroyed, thus falling outside of the exemption in the county ordinance.

County of Ventura v. City of Moorpark, 24 Cal.App.5th 377 (2018)

Holding: Settlement agreement for beach restoration project found valid, in large part, but the agreement improperly surrendered a geologic hazard abatement district's police power authority to modify sand hauling routes.

Facts: The state formed the Broad Beach Geologic Hazard Abatement District (BBGHAD) to restore a 46-acre stretch of beach in Malibu. Initially, 300,000 cubic yards of sand would be deposited at the beach, with four subsequent deposits of up to 75,000 cubic yards at subsequent five-year intervals. Each of the five deposits will generate 44,000 one-way truck trips for three to five months. Much of the sand would come from rock quarries located approximately 35 miles north of Malibu, between the cities of Fillmore and Moorpark. Moorpark objected to the project, and ultimately entered into a settlement agreement that prohibits trucks used in the project from driving through Moorpark, except in cases of emergency. Fillmore and the County of Ventura challenged the settlement agreement by filing a petition for writ of mandate alleging violations of the California Environmental Quality Act, among other things. The trial court denied the petition, in part, and granted it, in part.

Analysis: The Court of Appeal affirmed in part, and reversed in part, with directions. The court held that the settlement agreement is "part of the whole of the action" of the beach restoration project, and not a separate, nonexempt CEQA project. The settlement agreement is, in fact, a statutorily exempt "improvement" for purposes of geologic hazard abatement districts. The court also found that the settlement agreement is not preempted by Vehicle Code Section 21, which preempts local traffic control ordinances and resolutions. Here, the settlement agreement is a contract – not an ordinance or resolution. The court further concluded that the settlement agreement was not an unlawful attempt by Moorpark

to exercise its regulatory power outside of city limits. The settlement agreement only designates permissible sand hauling routes for BBGHAD's contractors, and BBGHAD could have refused to sign the settlement agreement. Finally, the court held that certain provisions of the settlement agreement are void because they surrender BBGHAD's discretion to alter hauling routes in the future. BBGHAD has the police power to determine hauling routes, and may not surrender that authority to exercise its discretion if circumstances may change. As to the agreement itself, the court held that the settlement is valid and may remain in force, with the exception of provisions relating to the duration of and BBGHAD's limited discretion to modify the route restrictions, which the court voided, in part, and modified, in part.

VI. Finance

***Strategic Concepts, LLC v. Beverly Hills Unified School District,* 23 Cal.App.5th 163 (2018)**

Holding: Government Code Section 1090 applies to former employee who persuaded school district to (a) convert her to an independent contractor, with annual fees exceeding $1.3 million; (b) issue a no-bid $16 million contract to administer a bond fund.

Facts: Christiansen worked for the school district as a director of planning and facilities, with a salary of $113,000 per year, plus a $150-per-month automobile allowance. After one year of employment, the school district terminated her status as an employee, and hired her as a consultant, performing the same duties. The consultant agreement provided that Christiansen's compensation was $160 per hour, with a maximum compensation of $170,000 per year. One year later, Christiansen assigned her contract to Strategic Concepts, a company solely owned by Christiansen. Invoices were approved and paid to Strategic Concepts in the annual amounts of over $250,000, $1.3 million, and $1.3 million, despite the $170,000 not-to-exceed contract authority. Christiansen then proposed that the school district, without seeking proposals from other persons or entities, retain Strategic Concepts to manage projects funded by a proposed bond measure, with fees potentially exceeding $16 million. The school district board retained Strategic Concepts, without seeking proposals. The bond measure passed, and Strategic Concepts collected more than $2 million in fees, even though no specific project had been approved. Christiansen was prosecuted for violating Government Code

Section 1090, was found guilty by a jury, and ordered to pay $3.5 million in restitution. The Court of Appeal reversed the conviction, reasoning that Section 1090 did not apply to independent contractors, in *People v. Christiansen*, 216 Cal.App.4th 1181 (2013). Christiansen and Strategic Concepts filed a civil action seeking a determination that their contracts were not void under Section 1090. Prior to trial, the trial court ruled that Section 1090 does not apply, following the 2013 appellate opinion. Through a jury verdict, and inclusive of interest and attorney's fees, Strategic Concepts obtained a judgment exceeding $20 million. The school district appealed.

Analysis: The Court of Appeal reversed. While the appeal was pending, the California Supreme Court decided *People v. Superior Court (Sahlolbei)*, 3 Cal.5th 230 (2017), which held that Section 1090 may apply to independent contractors, particularly "outside advisors with responsibilities for public contracting similar to those belonging to formal employees . . . " The Supreme Court in *Sahlolbei* also expressly disapproved of the 2013 *Christiansen* opinion in that regard. In its subject 2018 opinion, the Court of Appeal held that Christiansen "used her position of trust as an employee to ingratiate herself with District's administrators." For example, she went from earning $113,000 per year (as an employee) to over $1.3 million per year (as a contractor). Then, Christiansen "used her influence" to obtain a $16 million no-bid contract to administer the school district's new bond fund.

VII. Public Records

National Conference of Black Mayors v. Chico Community Publishing, Inc., 25 Cal.App.5th 570 (2018)

Holding: Public records requestor not entitled to fees when litigating against public agency over records the agency has already agreed to disclose.

Facts: The Sacramento News and Review (SNR), a local newspaper, was investigating the mayor's and his staff's use of city resources to take over, and the eventual bankruptcy, of the National Conference of Black Mayors (NCBM). SNR made a public records request to the city for emails sent from private accounts associated with the mayor's office. The city provided approximately 900 pages of records on city servers, but it identified some potentially attorney-client communications between the mayor and the NCBM's law firm. The city informed the NCBM it would disclose the records, absent a court order. The NCBM filed an

ordinary mandamus petition under CCP Section 1085, seeking to prevent disclosure of the privileged emails to SNR. The city did not oppose NCBM's petition. In litigation, the trial court reviewed 113 records, which the NCBM requested to be reviewed in camera. The court ultimately ordered 58 emails to be disclosed in unredacted form, and 17 to be redacted and disclosed. SNR moved for attorney's fees against the mayor under the Public Records Act and the Private Attorney General Statute, CCP Section 1021.5. As to the Public Records Act, SNR argued that the mayor was acting as a city official when the mayor (with the NCBM) sought nondisclosure of the records. The trial court denied the fee request. SNR appealed the denial of fees against the mayor under the Public Records Act.

Analysis: The Court of Appeal affirmed the denial of fees against the mayor under the Public Records Act. The court noted that the city was not required to oppose the writ petition for several reasons, including the fact that the attorney-client privilege can only be asserted by the holder of the privilege – which, in this case, was not the city. The court also noted that "the City did not withhold public records from the newspaper, thus the newspaper could not initiate litigation under the exclusive procedure provided in the [Public Records] Act." The newspaper is simply not entitled to fees under the Public Records Act because it did not "prevail" under its provisions.

VIII. Attorneys

Monster Energy Company v. Schechter, ___ Cal.App.5th ___, 2018 WL 3829255 (2018)

Holding: Attorneys who signed a settlement agreement "approved as to form and content" were not parties that were bound by the settlement agreement, including its confidentiality provisions.

Facts: The Fourniers filed a civil suit against Monster, and the Fourniers were represented by a law firm where attorney Schechter worked. The lawsuit resulted in a settlement, the settlement agreement provided that it was signed on behalf of the "Parties . . . [and] their . . . attorneys. . . " The settlement agreement further provided that the "Plaintiffs and their counsel agree" to keep the settlement confidential. The settlement agreement explained that the confidentiality extended to disclosure to "Lawyers & Settlements [and] VerdictSearch (or the like)," and

stated that any public comment would be limited to "This matter has been resolved." The settlement agreement was signed by the Fourniers and Monster. Under the parties' signature block, the parties' respective attorneys signed a block that said "approved as to form and content." One month after the settlement agreement was signed, Schechter was interviewed by a reporter for lawyersandsettlements.com, where Schechter discussed the general terms of the settlement. The online article reporting the settlement also concluded with an advertisement for persons injured by Monster energy drinks to "click on the link" to connect with a lawyer. One employee of lawyersandsettlements.com also works for Schechter's law firm. Monster filed suit against Schechter and his law firm, alleging a breach of the settlement agreement. Schechter and his law firm filed an anti-SLAPP motion, on, among other things, the breach of contract claim, on the ground that Schechter's statements to the reporter were protected speech. The trial court denied the motion, and Schechter and his law firm appealed.

Analysis: The Court of Appeal reversed, in relevant part. The court held that Schechter's statements to the reporter protected under the anti-SLAPP statute. Monster failed to conclusively prove that Schechter's firm did, in fact, receive advertising leads from lawyersandsettlements.com – and thus the commercial speech exemption from the anti-SLAPP statute did not apply. As to the merits of the breach of contract cause of action, the court concluded that Monster failed to demonstrate a probability of prevailing. The court concluded that "approved as to form and content" means only that an agreement "has the attorney's professional thumbs-up." Schechter and his law firm were not parties to the settlement agreement, including its confidentiality provisions. While the settlement agreement compelled the attorneys to keep the settlement confidential, the attorneys only approved the agreement as to form and content. The attorneys "could not actually be bound unless the manifested their consent." Neither Schechter nor his law firm were identified on the Fourniers' signature line of the settlement agreement. And even if the Fourniers represented that they could sign for their attorneys, that would not be binding on the attorneys. Rather, the agreement only compelled the Fourniers to direct Schechter and his law firm to keep the agreement confidential. And finally, the court noted that, while not present in this case, "[i]t seems easy" to draft a settlement agreement that explicitly makes the attorneys a "party" for purposes of a confidentiality provision, and requiring attorneys to sign the agreement – not just approving as to form and content. Otherwise, the "attorney is free to blab" about the settlement.

Prevailing Wage Compliance Monitoring: Practical Advice for City Officials

Thursday, September 13, 2018 General Session; 1:00 – 2:30 p.m.

Michael J. Maurer, City Attorney, La Habra Heights and San Jacinto
Kevin Wang, Attorney, Best Best & Krieger

Notes:

Prevailing Wage Compliance:
Practical Advice for City Officials

Michael J. Maurer, City Attorney, San Jacinto and La Habra Heights
Kevin Wang, Best Best & Krieger

INTRODUCTION

Over the past decade, cities have had to evolve in response to two significant paradigm shifts – the expansion of the prevailing wage law and the elimination of redevelopment. The reach of the prevailing wage law has become more and more broad, particularly for charter cities. Under long-established precedent, charter cities did not have to pay prevailing wages for projects constituting municipal affairs. Though this precedent was upheld in the *City of Vista* case, the Legislature adopted SB 7, making charter cities ineligible for state funding unless they comply with state prevailing wage laws. SB 7 effectively imposed prevailing wage requirements on charter cities for the first time, at least in relation to projects constituting municipal affairs.

SB 7 is not an outlier; it is just one example of the State's relatively recent policy of expanding the reach of prevailing wage rules. Though prevailing wage laws have existed in California for nearly a century, the Legislature has continued to significantly broaden and redefine the types projects that require the payment of prevailing wages. Though originally oriented toward traditional public works, a more diverse array of project are now within the ambit of prevailing wage requirements, including solar projects, tenant improvement projects, and even the installation of freestanding modular office furniture. Along with changes in the laws, a series of cases has nearly eliminated cities' ability to partner with or subsidize private projects without subjecting the private developer to prevailing wage requirements. The courts have moved firmly to a "project-based" approach that looks to any sort of public subsidy when determining whether a project is subject to prevailing wages.

This broadening of the scope of the prevailing wage law has coincided with the State's elimination of redevelopment in 2011. As redevelopment agencies became successor agencies, a significant tool for economic and housing development disappeared. To fill this void, many cities may be looking into new ways of partnering with private interests to support new economic development and housing. Thus, as cities become more active in supporting private development, a greater need arises to understand and address potential prevailing wage issues that may arise for private developers. This paper therefore provides an overview of state prevailing wage law, codified at Labor Code section 1720 *et seq.*, with a particular emphasis on its application to various types of private projects.

ANALYSIS

State prevailing wage law applies to all projects that fall within the scope of the term "public work," as it is defined in the Labor Code. In most circumstances, the projects in question are public projects being contracted for directly by an agency. However, prevailing wage requirements will also apply in some situations to work performed by a private party. This paper addresses the application of prevailing wage requirements on the following private project scenarios:

- Private developer constructs public improvements on private property which are then dedicated to the agency for public use. The agency contributes no public funds[1] for the public improvement work.

- Private developer constructs public improvements on private property which are then dedicated to the agency for public use. The agency contributes public funds for the public improvement work.

- Private developer constructs public improvements on private property which are then dedicated to the agency for public use. Private developer is required to construct the public improvements to be of sufficient capacity to accommodate subsequent developments in the immediate area. The agency does not contribute public funds for the public improvement work but does obligate other developers that are developing properties benefited by the public improvement work to cover their proportionate share of the cost of the public improvement work.

Additionally, this Paper discusses the common exceptions to the prevailing wage law that may apply on private projects, and the unique issues that may arise in relation to affordable housing development.

I. "PUBLIC WORKS" THAT ARE SUBJECT TO THE PREVAILING WAGE LAW

As a preliminary matter, the determination of whether prevailing wage will apply to a private development project requires the same analysis as the determination of whether prevailing wage will apply to a publicly-owned project. The analysis starts with addressing whether the project fits within one of the definitions of "public works" under Labor Code section 1720(a). The prevailing wage law also establishes a number exceptions, which may either prevent or limit application of the prevailing wage for certain private projects. Thus, even if a private project meets the definition of a "public work," it may still be exempt from prevailing wage requirements.

A. Work "Paid For In Whole Or In Part Out Of Public Funds"

The most oft-used definition is set forth in Labor Code section 1720(a)(1), which defines "public works" to mean "[c]onstruction, alteration, demolition, installation, or repair work done under contract and paid for in whole or in part out of public funds[2]...." There are two key components to this definition – the nature of the work and the source of the funding.

Labor Code section 1720(b) contains examples of payments that are made in whole or in part out of public funds; the list is broad and includes virtually any type of public subsidy. Not

[1] "Public funds" can be made up of local, state and federal monies. (8 Cal. Code Regs., § 16000.)
[2] Labor Code section 1771 also includes "maintenance" within the definition of "public works." (See 8 Cal. Code Regs., § 16000 for the definition of maintenance.)

only does the direct payment of money constitute a payment of public funds, but also the performance of work, transfer of an asset for less than fair market value, reduced or waived fees or other payments, contingent loans, and credits against repayment obligations.

B. Improvement Work Done Under Public Direction or Supervision

The definition in section 1720(a)(1) is the only definition that uses public funding as a trigger. The prevailing wage law contains several other definitions where prevailing wage will apply even in the absence of public funding. Most notably, Labor Code section 1720(a)(3) defines "public work" to also mean "[s]treet, sewer, or other improvement work done under the direction and supervision or by the authority of any officer or public body of the state, or of any political subdivision or district thereof…." Under this scenario, a city's direction or supervision, rather than financial support, is determinative.

C. Tenant Improvement Work for Publicly-Leased Property

Under Labor Code section 1720.2, tenant improvement work that is done under a private contract is subject to prevailing wage if a city is going to lease 50% or more of the assignable square footage of the property. The rule attaches if the lease is entered into prior to the construction contract or if the construction contract is performed according to plans furnished by the city.

D. Renewable Energy and Energy Efficiency Work

Under section 1720.6, renewable energy or energy efficiency work is subject to prevailing wage if the work is done on public property and either 50% of the energy is purchased by a public agency or the energy efficiency improvements reduce public energy costs.

II. PRIVATE DEVELOPMENT - NO PUBLIC FUNDING SCENARIO

In this scenario, the private developer is required to perform certain public improvement work as a condition of approval imposed by the city on the development project but will receive no payment or reimbursement for the public improvement work. This scenario does not implicate the definition of public works under Labor Code section 1720(a)(1) because there is no public funding on the project. However, Labor Code section 1720(a)(3) may still apply. As noted above, section 1720(a)(3) applies if the improvement work is done under the direction and supervision or by the authority of the city.

In some instances, the Department of Industrial Relations ("DIR") has applied the 1720(a)(3) definition to work done by a private developer as a condition of approval of a private development project. In *City of Clovis Sewer Improvements Project*, Public Works Case No. 2001-041, the city required a private developer to construct certain off-site sewer improvements as a condition of the city's approval of the construction of a residential subdivision. The city and the private developer entered into a reimbursement agreement that required the private developer

to construct and install the sewer improvements according to city-approved plans and obligated the city to reimburse the private developer for the costs of construction. In finding that the project qualified as a public work under Labor Code section 1720(a)(3), DIR noted that the reimbursement agreement between the developer and the city provided that the sewer improvement plans must be approved by the city, required agency approval of all contracts for the sewer improvement work prior to commencing construction, required the sewer improvement work to be completed within 90 days subject to a liquidated damages clause in the event of delay by the private developer and transferred ownership of the sewer improvements to the city after completion. Under these circumstances, DIR determined that the sewer improvement work was done under the direction of the city and was therefore a public work under Labor Code section 1720(a)(3).

Applying DIR's reasoning here, the public improvement work performed by the private developer for the agency as a condition of approval *may* require compliance with prevailing wage law notwithstanding the lack of public funding if the improvement work is "done under the direction or supervision" of the agency pursuant to Labor Code section 1720(a)(3). There is no bright line rule as to what qualifies as "work done under the direction or supervision" of the city, which will need to be resolved on a case-by-case basis. Based on an analysis of the above DIR determination, as well as several others, it is clear that the more involvement the agency has as to the performance of the public improvement work, the more likely the work will be deemed to have been done under the direction or supervision of the agency, thereby qualifying it as a public work under Labor Code section 1720(a)(3). (See *Field Technician Observation and Testing*, Public Works Case No. 2001-068.) Notably, both DIR determinations addressing this issue involve reimbursement agreements for offsite improvements – that is, situations in which the developer was essentially contracting for work on behalf of the city even though the work was performed as a condition of approval of a private project.

Unfortunately, there is no coverage determination or case that provides an example of public improvement work that is *not* performed under public direction or supervision. The limits of section 1720(a)(3) remain unclear. Despite the lack of clarity, section 1720(a)(3) should not automatically subject all street or other public improvement work that work will be dedicated to a city to prevailing wages. Such an interpretation would render "direction and supervision" meaningless and would be inconsistent with the overall statutory scheme. (See, e.g., section 1720(c)(2), stating that improvement work required as a condition of approval "shall thereby become" if there is public funding; see also *Azusa Land Partners v. Department of Industrial Relations* (2011) 191 Cal.App.4th 1, 30-31 and fn. 11, implying that public funding triggers the requirement on work constructed as a condition of approval.) However, given that there is no bright line rule, cities should consider including indemnification provisions and other protections in contracts such as subdivision improvement agreements where improvements are constructed to city standards and specifications.

III. PRIVATE DEVELOPMENT - PUBLIC FUNDING SCENARIO

In this scenario, the project will likely qualify as a public work under Labor Code section 1720(a)(1) because it will involve "construction, alteration, demolition, installation or repair work" that will be "done under contract" between the developer and its contractor and will be "paid for in whole or in part out of public funds" through the reimbursement by the agency. The project also could qualify as a public work under Labor Code section 1720(a)(3) if the project is done under the direction and supervision of the agency.

Once a project is deemed to be a "public work" as defined under Labor Code section 1720(a), the entire project becomes subject to prevailing wage requirements. (*Azusa Land Partners v. Department of Industrial Relations* (2011) 191 Cal.App.4th 1, 29.) In *Azusa Land Partners*, the California Court of Appeal held that proceeds received from community facilities district bonds do constitute "public funds" and use of such funds for a development project constitutes a "payment of public funds" that triggers state prevailing wage requirements. The developer argued only those specific improvements that were paid for using bond funds should be subject to prevailing wage requirements. The court concluded that "once the determination is made that the project is a 'public work' under section 1720, subdivision (a)(1), the entire project is subject to [prevailing wage law]." (*Id*. at 36.) The court's holding highlights an important rule of prevailing wage law – subject to an exception, the entire project is subject to prevailing wage law even if only a portion is paid for with public funds.

It is also important to note that creative contracting is not a failsafe way to avoid prevailing wage requirements. The California Court of Appeal's decisions in *Cinema West, LLC v. Baker* (2017) 13 Cal.App.5th 194, 210-14, *Oxbow Carbon & Mineral, LLC v. Department of Industrial Relations* (2011) 194 Cal.App.4th 538, 547 and *Hensel Phelps Const. Co. v. San Diego Unified Port Dist.* (2011) 197 Cal.App.4th 1020, suggest that the court will look to the underlying facts rather than to the explicit terms in the contract to determine if prevailing wage law applies. Courts recognize the strong incentives of an awarding body and the other party to the contract to avoid prevailing wage law and to structure their contracts to circumvent it. (*See Cinema West,* 13 Cal.App.5th at 210-14; *see also Oxbow Carbon,* 194 Cal.App.4th at 547.) Accordingly, courts look to the "totality of the underlying facts" rather than the contract itself to determine whether prevailing wage law applies. (*Id*.)

In *Hensel Phelps*, the San Diego Port District granted the Hilton Hotel a reduction in rent to build a hotel on the publicly owned property. The Hilton argued that the construction was not "done under contract" because the Port District did not enter into a construction contract with the Hilton to build the project. The Port District only entered into a lease for raw land with the Hilton. According to the Hilton, there was no construction under contract because it was not possible to "connect the dots" to establish that money went from the Port District to the Hilton. The Court of Appeal rejected this argument and determined that since the lease called for the Hilton to construct a building on the property according to the Port District's specifications, the project was properly classified as construction done under contract. Moreover, the court also

looked to the factual history behind the transaction, which showed that the purpose of the Port District entering into the lease with the Hilton was to obtain construction of the hotel. The factual history also showed that the rent credit the Port District provided under the lease was intended to subsidize the construction of the project; the costs of constructing the project had increased from initial estimates and the Hilton asked the Port District to subsidize some of those increased costs so that the project could go forward. The court concluded these facts establish that the rent credit was given for the purpose of subsidizing the construction thereby triggering prevailing wage on the project.

In *Oxbow Carbon*, the City of Long Beach leased its port facility to Oxbow, which used the facility for storage. After a change to the Air Quality Management District Act required enclosed storage, Oxbow needed to reconstruct its facilities with new conveyors and a new roof. The city amended its lease with Oxbow and agreed to reimburse Oxbow for construction of new conveyors. Even though the lease amendment did not include reimbursement for, or even mention, construction of the roof, the court held that *both* the construction of the conveyors and the roof were subject to the prevailing wage law. To reach this conclusion, the court looked to the "totality of the underlying facts," which showed that: (1) the Air Quality Management District Act's rule changed; (2) the facility became unusable; (3) Oxbow negotiated and made plans with the city "to make the site usable again"; and (4) a memorandum from the city's director stated, "in order to accomplish the City's and Oxbow's goal of maximizing the use of the facility in compliance with the new rule, both the conveyors and roof will have to be constructed." Thus, the the construction of the conveyors and the roof were components of a single integrated project.

Despite the all-or-nothing nature of the prevailing wage law, a project does not become retroactively subject to prevailing wages. In *Quisenberry Letter*, Public Works Case No. 2009-039, a developer constructed and sold a property to a redevelopment agency through a disposition and development agreement. As part of the transaction, the developer and redevelopment agency entered into a separate tenant improvement agreement. DIR determined that the tenant improvement work, which was pursuant to a separate contract with a public agency, was paid for out of public funds. However, at the time the construction contract was entered, there was no public funding, and so only the tenant improvement work – not the initial construction work – was subject to prevailing wages.

IV. THIRD-PARTY PRIVATE FUNDING SCENARIO

In this scenario, the agency requires a private developer to perform certain public improvement work as a condition of approval and agrees to require other third parties that will benefit from the public improvement work to reimburse the private developer. That is, this situation might not involve any public funding (or city direction or supervision) if the third-party funding is solely from private sources. For example, if neighboring developers agree to share the cost of public improvements serving their developments, there is no public money in the project.

However, the analysis becomes more complicated if the city serves some role in administering the private funds.

When determining whether a project involves public funding, DIR looks to whether the funds were ever held in the public coffers. (See *Azusa Land Partners, supra*, 191 Cal.App.4th at 24, citing *Tustin Fire Station*, Public Works Case No. 93-054.) In most instances where multiple developers are contributing funds to complete a public improvement, the funds generally pass through the city's coffers. Rather than a private reimbursement agreement amongst the developers, one of the developers may complete the project in exchange for impact fee credits or reimbursement from the city. Even if the impact fee credits or reimbursement funds are ultimately paid by other developers, and are not from the city's general fund, the credits are still considered a form of public funding. (See Labor Code § 1720(b)(4) & (6); *The Commons at Elk Grove*, Public Works Case No. 2008-037.)

The "public coffer" analysis also arises in the form of public bond financing. Mello-Roos bonds, for example, are considered a form of public funding even though the debt service is paid entirely from a tax on private property owners. The bond proceeds are held by the city, which is able to authorize expenditures and control disbursement of the funds. (See *Azusa Land Partners, supra*, 191 Cal.App.4th at 24.) Other types of public bond financing might not trigger prevailing wage requirements if the public bonds never actually pass through public coffers. (See *Southwest Community Health Center*, Public Works Case No. 2010-008; *Rancho Santa Fe Village*, Public Works Case No. 2004-016.)

Finally, though not involving a private development, it is worth noting that the "public coffer" analysis also applies in the context of work paid for out of insurance proceeds. If a contractor's (or other private party's) insurance company directly performs repair work, then DIR has determined that prevailing wage does not apply. (See *Insurance Company Replacement of Esperanza High School Burned Out Wing*, Public Works Case No. 26-PW-20473; *Rebuilding of the Agricultural Commissioner Office Building*, Public Works Case No. 2007-011.) However, in Public Works Case No. 2007-011, *Rebuilding of the Agricultural Commissioner Office Building*, a county's insurance policy paid insurance proceeds to the county for replacement of the damaged facilities and the county controlled disbursement of those proceeds to the contractor performing the work. DIR determined that prevailing wage requirements applied because public funding came from two sources: (i) the insurance premiums the county paid for the policy and (ii) the insurance proceeds paid to the county that entered the public coffers before it was paid out to the contractor.

V. EXCEPTIONS TO PREVAILING WAGE REQUIREMENTS FOR PRIVATE DEVELOPMENT PROJECTS

There are four main private development specific exceptions under prevailing wage law that either eliminate or mitigate the application of prevailing wage requirements.

A. Private Residential Projects

Under Labor Code section 1720(c)(1), a private residential project built on private property is not subject to prevailing wage requirements unless the project is built pursuant to an agreement with a state agency, redevelopment agency, successor agency or local public housing authority. Though it appears obvious, DIR has concluded that a private residential project funded by a *city* meets this exception. (See *Mayfield Place Housing Project*, Public Works Case No. 2016-033.) In *Mayfield*, DIR determined that the project at issue did not receive any public funding, but even if it did, it would not be subject to prevailing wage because the only potential public funding was through a development agreement with a city and not a state agency, redevelopment agency or local public housing authority. The *Mayfield* represented a shift from DIR's position in *South Gate Senior Villas*, Public Works Case No. 2013-024, which attempted to limit the (c)(1) exception to private projects receiving no public funding. This determination was ultimately reversed by the court. (See *South Gate Senior Villas, L.P. v. Christine Baker, et al*, Case No. BS152917.)

B. Public Funding Limited to Public Improvement Work

The second exception is found at Labor Code section 1720(c)(2). Under this exception, if the agency requires a private developer to perform public improvement work as a condition of regulatory approval on an otherwise private development project, and the agency contributes no more money to the overall project than is required to perform this additional public improvement work and maintains no proprietary interest in the overall project, then only the public improvement work is subject to prevailing wage requirements. This exception does not result in the complete exemption of the project from prevailing wage requirements but instead limits the application of prevailing wage requirements to only the public improvement work. (See *Azusa Land Partners, supra*, 191 Cal.App.4th at 35-37.) This exception would apply in each of the scenarios discussed above by limiting the application of prevailing wage requirements to the public improvement work required by the agency.

C. Costs of Work that are Normally Borne By the Public

The third exception is found at Labor Code section 1720(c)(3) and provides that reimbursements to a private developer for costs that would normally be borne by the public will not subject an otherwise private development project to the prevailing wage law. There is a dearth of guidance or authority on the application of this exception. In general, the concept of the exception appears to be that a cost that is normally borne by a public agency is not a subsidy and therefore does not subject the rest of the project to prevailing wages.

This exception is distinct from the exception for work done as a condition of approval. To illustrate: if a condition of approval requires a developer to install a new sewer main, and the city pays for part of the sewer main, it is not a cost normally borne by a public agency. The developer normally pays for required public improvements, and hence there is a public subsidy. In this case, the exception at 1720(c)(2) applies. On the other hand, if the developer is *not* required to install a new sewer main, but the city requests that the developer install a new sewer main prior to paving above it, then section 1720(c)(3) would apply. The sewer main work is, of course, subject to prevailing wages, but the developer would not have to pay prevailing wages on the rest of the project simply because it agreed to perform the sewer main work for the city.

The key difference between the (c)(2) and (c)(3) exceptions is whether the cost of the work should be borne by the developer or the city. If normally borne by the developer, (c)(2) applies and all of the public improvement work is subject to prevailing wages, but the other components of the private development project are not. If normally borne by the city, (c)(3) applies and only the work that is subject to reimbursement from the city is subject to prevailing wages.

D. *De Minimis* Public Subsidy

The final exception is also contained at Labor Code section 1720(c)(3). This exception is generally referred to as the *de minimis* exception and it will only apply where the agency reimburses or provides a subsidy to the private developer. In this scenario, the public funds paid by the agency will not trigger prevailing wage if they are considered *de minimis* in the context of the cost of the entire project. The prevailing wage statutes do not provide guidance regarding what ratio of public funding to total project cost is considered *de minimis*, but DIR has provided guidance in a number of public works coverage determinations. The highest percentage of total project cost found by DIR to be *de minimis* under Labor Code section 1720(c)(3) is 1.75%. (See *Blue Diamond Agricultural Processing Facility*, Public Works Case No. 2011-033; see also *The Commons at Elk Grove*, Public Works Case No. 2008-037 [DIR considered a public subsidy of 1.1% of the total project cost to be *de minimis*]; *New Mitsubishi Auto Dealership*, Public Works Case No. 2004-024 [DIR considered 1.64 percent to be *de minimis*].)

Assembly Bill 251 (Levine) from the 2015 session attempted to codify a definition of de minimis as the lessor of 2% or $250,000. The Legislature passed the bill, but the Governor vetoed it. The Governor's veto message states that the,

> "Longstanding practice has been to view the subsidy in context of the project and use 2% as a general threshold for determinations. There has been no showing that the current practice is unreasonable. While I remain a staunch supporter of prevailing wages I am concerned that this measure is too restrictive and may have unintended consequences."

Though a veto message does not establish law, the Governor's statement at least provides support for a *de minimis* finding in the general vicinity of 2% of the total project cost. This message along with the DIR determination history implies that is a reimbursement or subsidy provided by a city to a private developer does not exceed 1.75% of the total cost of the private development project, the *de minimis* exception will likely apply to exclude the project, including the public improvement work[3], from state prevailing wage requirements.

VI. SPECIAL RULES RELATED TO AFFORDABLE HOUSING

A. Exceptions for Affordable Housing in the Labor Code

In addition to the exception contained at section 1720(c)(1), the prevailing wage law contains several limited exceptions related to affordable housing projects. Sweat equity projects – where the home buyers perform 500 hours of construction work associated with the homes – are exempt from the prevailing wage law, as are certain projects involving not-for-profit emergency or transitional housing for homeless persons. (See Labor Code § 1720(c)(5)(A) - (B) & (D).) Homebuyer assistance programs are also exempt if the public funding is in the form of mortgage, downpayment, or rehabilitation assistance for a single-family home. (See Labor Code § 1720(c)(5)(C).) Finally, the prevailing wage law contains a general exemption for below-market interest rate loans for projects in which at least 40% of the units are restricted to individuals and families earning no more than 80% of the area median income for a period of at least 20 years.

B. Common Law Exception for Tax Credits

The prevailing wage law expressly exempts projects funded with tax credits prior to 2003, but it does not address whether new projects funded with state or federal low-income housing tax credits are publicly fund. (See Labor Code § 1720(d)(3).) In *State Building and Construction Trades Council v. Duncan* (2008) 162 Cal.App.4th 289, the court determined that the provision of state low income-housing tax credits to a developer does not constitute the payment of public funds. DIR has applied this ruling to projects funded through the federal low-income housing tax credit program. Thus, LIHTC projects generally will not be otherwise subject to prevailing wages; meaning that if cities contribute funding or other subsidies to LIHTC projects, they should consider whether the nature of the contribution meets the exceptions for private residential properties and/or affordable housing. (See, e.g., Labor Code §§ 1720(c)(1) and (c)(5).)

[3] In *Sewer Line Construction*, Public Works Case No. 2008-010, DIR concluded that both the public improvement work required as a condition of regulatory approval and private improvement work was not subject to prevailing wage as a result of the *de minimis* exception.

C. Prevailing Wage Requirements in the 2017 Housing Package

In the 2017 legislative session, the Legislature approved a package of 15 bills, often referred to as the Governor's housing package, which were designed to address the State's housing crisis and encourage construction of more affordable housing units. Despite the various prevailing wage exceptions for affordable housing projects, this recent legislation actually imposes *new* prevailing wage requirements on private projects that receive no direct public subsidy and would otherwise be outside the scope of the prevailing wage law.

The most notable bill from last year's housing package is Senate Bill 35, which created a streamlined process for affordable housing projects. In order to encourage such development and prevent NIMBYism, SB 35 prohibits cities who have failed to produce enough housing under their Regional Housing Needs Assessments from requiring conditional use permits or other discretionary review of such projects. (See Gov. Code § 65913.4.) The removal of discretionary review also makes applicable projects exempt from environmental review. However, developers may only utilize this streamlined ministerial process if they certify to the city that they will require payment of prevailing wages on the entire project. (Gov. Code § 65913.4(a)(8).) Developers are therefore going to balance whether the benefit of a streamlined process outweighs the costs of paying higher wage rates.

Senate Bill 540 enables cities to form "workforce housing opportunity zones," which are areas specifically planned for affordable housing. (See Gov. Code §§ 65620 et seq..) Cities may apply for grants from the Department of Housing and Community development to offset the costs of preparing the specific plan and environmental review to form the zone. Affordable housing developers who certify that they will pay prevailing wages on the entire projects within the zone are exempt from further environmental review. (Gov. Code § 65623(c)(9).)

Assembly Bill 73 goes even further than SB 35 and SB 540. The bill enables cities to form "housing sustainability districts," which essentially are overlay zones where affordable housing development is permitted as a matter of right. (See Gov. Code §§ 66200, et seq.) Cities who form housing sustainability districts are eligible for funding from the Department of Housing and Community Development to offset the planning and environmental costs of district formation. In order to form a district, however, cities must adopt an ordinance requiring all developers to pay prevailing wages on all projects in the district. (See Gov. Code § 66201(f)(4)(A).) Cities have to determine whether the benefit of HCD incentive funding outweighs the costs of imposing a new hyper-local prevailing wage requirement on developers within housing sustainability districts.

Therefore, while there are several tools enabling cities to support affordable housing without subjecting developers to prevailing wage requirements, the new tools created through the housing package do the opposite; they extend prevailing wage requirements to otherwise exempt projects. In considering policies to encourage the construction of more affordable housing, cities will need to factor in the potential labor costs of various approaches.

CONCLUSION

As the prevailing wage law continues to evolve, cities must remain diligent and mindful of new requirements and changes in the law. In addition to common understanding of prevailing wage applications – the classic public works scenario – cities need to be prepared to work with developers and other private stakeholders who may need to consider prevailing wage implications on their otherwise private projects.

Municipal Tort and Civil Rights Litigation Update

Thursday, September 13, 2018 General Session; 2:45 – 4:00 p.m.

Timothy T. Coates, Managing Partner, Greines, Martin, Stein & Richland

Notes:

MUNICIPAL TORT AND CIVIL RIGHTS LITIGATION UPDATE

FOR

THE LEAGUE OF CALIFORNIA CITIES

FALL CONFERENCE

September 13, 2018

Presented By: Timothy T. Coates
Managing Partner
Greines, Martin, Stein & Richland LLP
Los Angeles California

I. CIVIL RIGHTS—RETALIATORY ARRESTS, FREE SPEECH, AND FREE EXERCISE OF RELIGION.

A. *Lozman v. City of Riviera Beach, Fla.*, __U.S. __, 138 S. Ct. 1945 (2018).

- **Probable cause does not defeat a retaliatory arrest claim against a public entity.**

In *Lozman v. City of Riviera Beach, Fla.*, __U.S. __, 138 S. Ct. 1945 (2018), the Supreme Court granted review to determine the circumstances, if any, in which a plaintiff could assert a claim for retaliatory arrest for engaging in protected First Amendment activity, even where probable cause existed for the arrest. The case arose from a more than decade-long series of disputes between the plaintiff, Lozman, and the City of Riviera Beach. During the public comment portion of a city council meeting, Lozman began to speak about matters concerning county, not City officials. A council member directed Lozman to stop making those remarks, and when Lozman continued speaking, the council member requested the assistance of a police officer. The officer approached Lozman and asked him to leave the podium, and when Lozman refused, the council member told the police officer to "carry him out." The officer handcuffed Lozman and removed him from the meeting, subsequently arresting him for disorderly conduct and resisting arrest. Although the State Attorney determined there was probable cause to arrest Lozman, all charges were dismissed.

Lozman filed suit under 42 U.S.C. § 1983, asserting that the arrest was in retaliation for his First Amendment activity. A jury was instructed that in order to succeed on his retaliatory arrest claim, Lozman would have to prove there was no probable cause for the arrest. A jury found for the City. Lozman appealed to the Eleventh Circuit, arguing that probable cause was irrelevant to his retaliatory arrest claim, and that probable cause would not defeat a First Amendment claim for retaliation. The Eleventh Circuit affirmed the district court, noting that under its precedents, the existence of probable cause would defeat a retaliatory arrest claim.

In granting certiorari, the Supreme Court was set to address an issue that it had left open for well over a decade. In *Hartman v. Moore*, 547 U.S. 250 (2006), the Court had held that in order to succeed on a claim for retaliatory prosecution, a plaintiff had to establish the absence of probable cause. In intervening years, the Court had granted review in a case presenting the retaliatory arrest question but eventually resolved it based on qualified immunity without addressing the precise elements of any such claim. *See Reichle v. Howards*, 566 U.S. 658, 663 (2012).

In *Lozman*, the Court once again sidestepped the underlying question. The Court expressly declined to determine the circumstances, if any, in which the existence of probable cause might defeat a retaliatory arrest claim against a police officer making a routine arrest. 138 S. Ct. at 1954. Instead, the Court confined its analysis to the circumstances in which a public entity could be held liable under *Monell v. Dep't. Soc. Servs.*, 436 U.S. 658 (1978), where a retaliatory arrest is supported by probable cause. The Court held that the existence of probable cause would not bar a retaliatory arrest claim against a public entity and that where a plaintiff can show that retaliation was a "but for" cause of the arrest under *Mt. Healthy City Bd. of Education v. Doyle*, 429 U.S. 274 (1977), a public entity could be held liable for violation of the First Amendment. *Id*. at 1954-55. The Court therefore remanded the matter to the lower court to determine whether the evidence would support Lozman's retaliatory arrest claim under the newly articulated standard. *Id*. at 1955.

Although *Lozman* would seem to encourage retaliatory arrest claims against public entities, the language of the opinion makes it clear how extremely rare such cases are likely to be. This is because, under *Monell*, a plaintiff must show a custom, policy or practice of retaliatory animus and directly link that animus to the underlying arrest. The Court noted that Lozman's case was unique in that he had transcripts of internal city council meetings at which he was discussed, as well as video of the actual arrest which demonstrated a direct link between his exercise of free speech and the council member's

direction to have him arrested. Following *Lozman*, it might well be prudent to reaffirm existing policy, or if necessary, create new policy making it clear that police officers at city council meetings are charged with an independent obligation to assess probable cause for arrest, and must not simply follow the directive of city council members in dealing with potentially disruptive members of the public.

B. *Masterpiece Cakeshop, Ltd. v. Colorado Civil Rights Comm'n*, __U.S.__, 138 S. Ct. 1719 (2018)

- **Expression of hostility to religion by an adjudicatory body supports a claim for violation of the Free Exercise Clause of the First Amendment.**

In *Masterpiece Cakeshop, Ltd. v. Colorado Civil Rights Comm'n*, __ U.S. __, 138 S. Ct. 1719 (2018), a baker was charged with violating the state's Anti-Discrimination Act when he refused to create a wedding cake for a same-sex couple. The baker argued that requiring him to create a cake for a same-sex marriage would violate his right to free speech by compelling him to exercise his artistic talents to express a message with which he disagreed and would violate his right to free exercise of religion. The state's Civil Rights Commission, as well as the Colorado appellate courts, affirmed the finding that he had violated the state statute.

Although the case raised broad issues concerning the extent to which baking constituted an expressive activity, as well the need to strike a balance between the right to free exercise of religion and the strong public policy of preventing discrimination, the case ultimately turned on very narrow grounds. Writing for the majority, Justice Kennedy found that the underlying administrative proceeding had been conducted in a manner that violated the free exercise of religion, and hence the order finding a violation of the statute had to be set aside. Specifically, a transcript from the administrative proceedings revealed that at least one decision-maker had made disparaging remarks

about religious practices. This violated the state's obligation to be neutral with respect to religious matters. *Id*.

The most salient point for local public entities to be gleaned from *Masterpiece Cakeshop* is the need to be mindful of comments made when a governing body is serving in an adjudicatory capacity. The Court emphasized that while there is some debate about the extent to which the religious views of public officials expressed during legislative proceedings are to be given any weight by a court in assessing First Amendment claims, when a public body sits in adjudicatory capacity, it must be neutral. *Id*. at 1730. Public officials should therefore be reminded to be extremely cautious in their comments when the city council is sitting as an adjudicatory body, as stray remarks may well give rise to a claim, even in circumstances outside the First Amendment context.

C. *Minnesota Voters Alliance v. Mansky*, __ U.S. __, 138 S. Ct. 1876 (2018)

- **Government may regulate speech in a non-public forum, but must use specific criteria in doing so.**

In *Minnesota Voters Alliance v. Mansky*, __ U.S. __, 138 S. Ct. 1876 (2018), the plaintiffs challenged a state statute prohibiting any person from wearing a political badge, button, or other political insignias inside a polling place on election day. The lower federal courts ultimately dismissed plaintiffs' facial and as-applied challenge to the statute. The Supreme Court, however, reversed.

The Court noted that it recognized essentially three forums for speech -- traditional public forums, designated public forums, and nonpublic forums. *Id*. at 1885. In a traditional public forum, such as a park, street, sidewalk, and the like, the government may impose reasonable time, place, and manner restrictions on private speech, but restrictions based on content must satisfy strict scrutiny, and those based on viewpoint are prohibited. The same standards apply to designated public forums, which are spaces that have not traditionally been regarded as a public forum but which the government has intentionally opened up for that purpose. *Id.* A nonpublic forum is a space that is not by

tradition or designation a forum for public communication, and, as a result, the government has more flexibility to craft rules limiting speech in such areas.

The Court viewed the polling place as a nonpublic forum, and hence could properly be regulated by the state so long as there was no viewpoint discrimination. The state statute, however, ran afoul of the First Amendment because it was facially vague as to what sort of public speech was prohibited, thus leaving open the possibility that it might be enforced in such a way as to discriminate against a particular viewpoint. Specifically, the statute banned a voter from wearing a shirt that had a "political" message, but the term "political" was "unmoored" to any precise meaning. *Id*. at 1888-89.

Minnesota Voters Alliance is important for local public entities in that it reaffirms the government's right to regulate speech in non-public forums, and cautions that any such regulation must be crafted with specificity.

II. POLICE LIABILITY—WRONGFUL ARREST, EXCESSIVE FORCE, CONDITIONS OF CONFINEMENT.

A. *Felarca v. Birgeneau,* 891 F.3d 809 (9th Cir. 2018)

- **Supervisory liability, qualified immunity, and excessive force.**

In *Felarca v. Birgeneau,* 891 F.3d 809 (9th Cir. 2018), university students erected an encampment during a protest. University police officers were summoned to break up the demonstration and dismantle the camp, during which they used batons on some of the protesters. Several protesters subsequently filed suit against several University police officers, as well as administration officials, arguing that the use of force was excessive and violated the Fourth Amendment. The defendants moved for summary judgment, arguing that no clearly established law would have put the officers on notice that use of batons under the circumstances was improper, or that administrative officials could be

held liable based upon their limited involvement in the incident. The district court denied the motion and the defendants appealed.

The Ninth Circuit reversed, finding that as to some plaintiffs the undisputed evidence established that the force was reasonable as a matter of law. 891 F.3d at 818-19. The court observed that the plaintiffs had relatively minor injuries, indicating that a minimal amount of force was used against them, which was justified by the University's need to disperse the crowd and restore order. *Id*. at 818. As to the supervisory liability claims, the court found that none of the senior administrators who had been sued was in the police chain of command, and hence could not be deemed supervisors of anyone in the police department with respect to the use of force. *Id*. at 820. As to administration officials that were within the police chain of command, plaintiffs presented no evidence indicating they knew or should have known any of their actions would cause officers to inflict a constitutional injury. *Id*. The court observed that administrators could not be held liable "solely by virtue of their office." The court also found that plaintiffs could not assert claims against two officers directly in the chain of command, because they could not tie any alleged excessive force to any action or inaction by the supervisory officials. *Id*. at 821. Finally, as to those few plaintiffs who submitted evidence that they had suffered substantial injuries, and hence had been subjected to more than minimal use of force, the court held that the law with respect to the use of a baton was not clearly established, and hence both the officers and the supervisory officials were entitled to qualified immunity and could not be held liable. *Id*. at 822-23.

Felarca provides authority for several key defense arguments. The first is that minimal force may be utilized to further a legitimate state-interest in keeping order under tense, chaotic circumstances. Second, the case reaffirms the need for plaintiffs to draw a direct link between an alleged constitutional violation, and the actions of a supervisor in attempting to hold the latter liable for failure to take steps to prevent an employee from committing a constitutional violation. Finally, the case also underscores that in order to

avoid qualified immunity a plaintiff needs to point to clearly established law putting officers on notice that they can be held liable for the use of force under circumstances closely analogous to those in the underlying lawsuit.

B. *Pike v. Hester,* 891 F.3d 1131 (9th Cir. 2018)

- **Illegal search and collateral estoppel arising from state proceedings.**

In *Pike v. Hester*, 891 F.3d 1131 (9th Cir. 2018), the plaintiff asserted that following a personal dispute with a police officer, Brad Hester, he became the target of various acts of retribution by Hester. The plaintiff worked at a community center, and, while off-duty at night, Hester, accompanied by some on-duty officers, went to the then-closed community center, unlocked the door and had a K-9 search Pike's office, looking for drugs. The dog did not "alert," and no drugs were found.

When Pike later learned of the search, he obtained a temporary restraining order against Hester, asserting that the officer was improperly stalking him, citing the improper search as one of several acts committed by Hester. The state court judge granted the restraining order and in a footnote stated that on "this record," there did not appear to be probable cause for the search, and that it was likely prompted by Hester's animosity towards Pike and hence was not done under the Fourth Amendment or with lawful authority under state law. Hester did not appeal from the state court order.

Pike then filed a federal suit against Hester, asserting that the search of his office violated the Fourth Amendment, and the district court granted summary judgment to the plaintiff, concluding that the undisputed evidence demonstrated that the search was unlawful. *Id*. at 1136-37.

The Ninth Circuit affirmed in a 2-1 decision. The majority found it unnecessary to evaluate whether the search in fact violated the Fourth Amendment, concluding instead that the defendant was barred from re-litigating the lawfulness of the search, as the issue

had been adjudicated adversely to him in the state court restraining order proceedings. *Id*. at 1139-41. The court then found that the officer was not entitled to qualified immunity, because the law was clearly established that the Fourth Amendment governs searches of an employee's office and that a dog sniff search under such circumstances would be unconstitutional. *Id*. at 1141-42.

Pike is someone concerning with respect to the court's broad application of collateral estoppel arising from state court proceedings in which the finding of constitutional violation was somewhat equivocal and rendered in the context of an order that might not prompt an individual to seek review through the state courts. Where a civil rights suit is preceded by related state court adjudicatory proceedings, for example, an administrative proceeding concerning officer discipline or the like, *Pike* counsels that the earlier proceeding should be closely examined to determine what, if any, preclusive effect might be given to adverse determinations in any subsequent federal lawsuit.

C. *Easley v. City of Riverside*, 890 F.3d 851 (9th Cir. 2018)

- **Excessive force and qualified immunity.**

In *Easley v. City of Riverside*, 890 F.3d 851 (9th Cir. 2018), the plaintiff was shot while fleeing police officers on foot, clutching the waistband of his pants. *Id*. at 854. During the chase, plaintiff pulled a gun from his waistband in what he asserted was an attempt to throw it away, but which was perceived by the officers as an attempt to turn and shoot them, thus prompting them to fire and wound him. *Id*. at 854-55.

Plaintiff sued for excessive force and the district court granted summary judgment, concluding that the officers were entitled to qualified immunity because the law was not clearly established with respect to the specific circumstances confronted by the officers, namely, the need to make a split-second decision as to whether an individual was turning to fling a gun away or attempting to point it at the officers. *Id*. at 865. The Ninth Circuit affirmed, but found it unnecessary to address the issue of whether the law was clearly established because the majority concluded that the undisputed evidence demonstrated

that the officers' use of force was objectively reasonable. *Id*. at 856-57. The court noted that the facts concerning plaintiff's conduct were effectively undisputed, i.e., that he was attempting to fling a gun away, and that the officers had only several seconds to react to what could reasonably, even if mistakenly, appear to be a threat against them. *Id*.

Easley is a very strong defense case, given the court's focus on the need for officers to assess the reasonable use of force under tense, rapidly evolving circumstances, which require split-second decision making that should not be second-guessed after the fact. The court also underscores that the Fourth Amendment only requires officers to act reasonably and that an officer's use of force may be reasonable, even if the officer was ultimately mistaken about what was actually occurring.

D. *Caldwell v. City and County of San Francisco,* 889 F.3d 1105 (9th Cir. 2018)

- **Fabrication of evidence and causation.**

In *Caldwell v. City and County of San Francisco*, 889 F.3d 1105 (9th Cir. 2018), the plaintiff, who had spent nearly 20 years in prison for a murder he did not commit, filed a section 1983 action against various police officers, asserting that one had fabricated evidence and manipulated and in-person identification, while two other officers had allegedly improperly coerced a photo lineup identification of the plaintiff. The district court granted summary judgment, concluding that as to the two officers who had allegedly conducted the improper photo lineup, no evidence supported the contention that they had deliberately fabricated anything. *Id*. at 1108. With respect to fabrication of evidence by the other officer, and the improper in-person identification, the court concluded there were genuine issues of fact, but that in any event, the officer was insulated from liability because a prosecutor had made an independent decision to charge the plaintiff, thus cutting off the officer's liability. *Id*.

The Ninth Circuit affirmed as to the two officers who had conducted the photo lineup, concluding that there was no evidence that they had improperly coerced an

identification. However, the Ninth Circuit reversed as to the officer who had conducted the improper in-person identification and had otherwise fabricated evidence, holding that the prosecutor's decision was, in fact, not independent of the officer's misconduct, and hence could not cut off liability. In so holding, the court observed that although it had held in *Smiddy v. Varney*, 665 F.2d 261, 266 (9th Cir. 1981), that the filing of a criminal complaint immunizes investigating officers from liability for an improper prosecution because it is presumed the prosecutor exercised independent judgment in making the decision to file charges, that *Smiddy* was inapplicable because the instant case involved fabrication of evidence. The court noted that where a prosecutor relies on fabricated evidence, or where an officer has withheld evidence from a prosecutor, the presumption of independence is rebutted, and an officer is not insulated from liability. 889 F.2d at 1116-17.

Caldwell re-affirms what has been termed the "garbage in, garbage out" exception to the *Smiddy* rule of prosecutorial independence. A prosecutor's decision to charge a criminal defendant will not insulate an officer from liability where it is asserted that the prosecutor relied on fabricated evidence, or otherwise made a decision without full knowledge of the actual facts.

E. *Vos v. City of Newport Beach*, 892 F.3d 1024 (9th Cir. 2018)

- **Excessive force, qualified immunity, state law negligence, and ADA claims arising from the use of force.**

In *Vos v. City of Newport Beach*, 892 F.3d 1024 (9th Cir. 2018), officers responded to a call about a man behaving erratically and brandishing a pair of scissors in a convenience store. *Id*. at 1028. The suspect, Vos, had been running around the convenience store shouting and holding a pair of scissors, at one point grabbing and then immediately releasing an employee and stating, "I've got a hostage." Multiple officers arrived at the scene, and saw Vos inside the convenience store mimicking having a gun and asking them to shoot him. *Id*. at 1029. As more officers arrived, some with non-

lethal weapons, the officers secured the perimeter, and finally, Vos opened the door at the back of the convenience store and started to run around to the front. *Id*. Vos, with scissors, started running towards officers from a distance of approximately 30 feet, ignoring commands to drop the weapon. *Id*. When Vos did not drop the scissors and kept charging, an officer gave the command to shoot, and several officers fired, killing Vos. *Id*. at 1029-30.

Vos's parents filed suit, asserting claims for wrongful death under state law, excessive force under the Fourth Amendment, as well as a discrimination claim under the Americans With Disabilities Act ("ADA"). The district court granted summary judgment, and the plaintiffs appealed.

The Ninth Circuit reversed in a 2-1 decision. The majority concluded that there was a material issue of fact whether the force was excessive, in light of the fact that the officers had less lethal alternatives to deploy that might have subdued Vos, and that a jury could find that defendants improperly failed to take Vos's mental state into account. *Id*. at 1032-34. However, the court found that the officers were entitled to qualified immunity because no clearly established law would have put them on notice that the use of force would have been improper under the specific circumstances they confronted. *Id*. at 1035. The majority also found that the plaintiffs could properly state a claim for violation of the ADA, based upon *Sheehan v. City and County of San Francisco*, 743 F.3d 1211, 1231 (9th Cir. 2014)(*Sheehan I*), cert granted sub nom, *City and County of San Francisco v. Sheehan*, 135 S. Ct. 702 (2014), and reversed in part, cert dismissed in part sub nom, *Sheehan II*, 135 S. Ct. at 1778. The court observed that although the Supreme Court had granted cert on the ADA question in *Sheehan*, that ultimately the Supreme Court had not resolved the ADA issue, and hence *Sheehan I* was still controlling. The Ninth Circuit also reversed as to the state law claims, noting that under the California Supreme Court's decision in *Hayes v. County of San Diego*, 57 Cal. 4th 622 (2013), an officer's use of force must be assessed in light of the officer's entire

course of conduct, including steps taken prior to the use of force.. *Id*. at 1038. The court also found that the plaintiffs could assert a claim under California Civil Code section 52.1 since the officers' entitlement to qualified immunity did not immunize them from state law claims. *Id*.

Vos is an extremely troublesome case. Although the court granted qualified immunity to the officers, its discussion of the excessive force issue creates highly unfavorable precedent concerning the need to use less than lethal alternatives when available, as well as the requirement that officers take into account a suspect's mental impairment in determining whether a particular level of force is appropriate. As the dissent noted, the majority's opinion appears to depart from both Ninth Circuit and Supreme Court precedent in unduly singling out these two particular considerations as precluding summary judgment. In addition, in reaffirming that the ADA applies to use of force claims, the court has broadened potential liability given the frequency with which force must be employed again individuals who have mental impairments. That issue, in particular, seems ripe for Supreme Court review, given the Court's grant of certiorari in *Sheehan*. Finally, the majority opinion underscores the stark difference between state law claims and excessive force claims under section 1983, with the former providing a much broader basis for liability.

F. *Wheeler v. City of Santa Clara*, 894 F.3d 1046 (9th Cir. 2018)

- **Survivorship and standing to assert federal claims arising from use of force.**

In *Wheeler v. City of Santa Clara*, 894 F.3d 1046 (9th Cir. 2018), the plaintiff's biological mother died after a confrontation with police. The plaintiff had been formally adopted by other parents as an infant. Nonetheless, he filed suit on behalf of his biological mother, asserting Fourth Amendment claims under section 1983 as her successor-in-interest, along with claims under the ADA and the Rehabilitation Act. He also asserted a claim under the Fourteenth Amendment based upon the loss of

companionship resulting from the death of his biological parent. The district court dismissed the case, finding that the plaintiff had no cognizable interest in his relationship with his biological mother based upon the California survivorship statute, Code of Civil Procedure section 377.20.

In affirming the district court, the Ninth Circuit reaffirmed the principle that survivorship in federal civil rights claims is governed by state law survivorship statutes. It noted that under California law, adoption severs the parent-child relationship, and hence the plaintiff had no standing to assert a claim based upon the death of his biological mother.

Wheeler is useful in reaffirming the principle that California law generally governs the standing of individuals to bring survivorship claims in federal court.

G. *Shorter v. Baca,* 895 F.3d 1176 (9th Cir. 2018)

- **Inadequate medical care for pre-trial detainees.**

In *Shorter v. Baca*, 895 F.3d 1176 (9th Cir. 2018), plaintiff sued County jail officials, asserting they had violated her right to due process by providing her inadequate mental health care while she was a pre-trial detainee. Specifically, plaintiff contended that she was routinely shackled to the bars of her cell for extended periods of time, as part of the general jail policy of securing mentally impaired inmates in order to alleviate staffing shortages and the need for direct supervision. Plaintiff also alleged that the defendants conducted improperly invasive searches without justification. The district court granted partial summary judgment for defendants on some claims, and the other claims went to a jury, which ultimately decided in favor of defendants. Plaintiff moved for a new trial, which was denied.

The Ninth Circuit reversed, finding that the district court had improperly instructed the jury that the decisions of the jail administration were entitled to deference in light of the need for security within the facility. The court concluded that such a

"deference" instruction was only proper where the conduct that formed the basis of the lawsuit was indeed related to a legitimate security concern. The court noted that here, the various practices were not related to any legitimate security concern, but rather, where the result of staffing shortages, and hence the jury should not have been instructed to give the defendants' decision-making any deference. In addition, the court noted that the plaintiff's inadequate medical care claim had to be reevaluated under the objective reasonableness standard recently articulated by the court in *Gordon v. County of Orange*, 888 F.3d 1118 (9th Cir. 2018).

Shorter expands liability for inadequate medical treatment claims by pre-trial detainees. It greatly narrows application of the "deference" standard for decision-making by jail officials related to security concerns. It also reaffirms *Gordon*'s holding that such claims are governed by a broad objective reasonableness standard under the Fourteenth Amendment.

H. *Mendez v. County of Los Angeles,* __F.3d__, 2018 WL 3595921 (9th Cir. 2018)

- **Unlawful entry without a warrant may proximately cause subsequent use of force for purposes of liability under the Fourth Amendment and state law negligence.**

In *Mendez v. County of Los Angeles,* __F.3d__, 2018 WL 3595921 (9th Cir. 2018), officers received a tip from a confidential informant that an armed and dangerous individual for whom they had an arrest warrant was seen on a bicycle outside a residence. The officers went to the residence, asked for and were initially denied entrance by the owner, but eventually entered and searched the premises without finding the suspect. Other officers searched the grounds and came upon various outbuildings, including a one-room shack. Unbeknownst to the officers, Mr. Mendez was sleeping on a futon with his wife, with a BB gun across his lap. The officers entered without giving "knock notice." As a result, when the officers entered, Mr. Mendez thought it was the owner of

the house and picked up the BB gun so he could stand up, which the officers perceived as a threat, thus causing them to shoot Mendez and his wife.

Following a bench trial, the district court found that the officers had reasonably perceived a threat to their safety and, therefore, the force employed was reasonable under *Graham v. Connor*, 490 U.S. 386 (1989). However, the district court found that defendants could still be liable for excessive force under the "provocation rule" because the defendants' search of the shack independently violated the Fourth Amendment due to the absence of a warrant and the failure to give "knock notice."

In its initial opinion, The Ninth Circuit affirmed, finding that although the officers were entitled to qualified immunity on the knock-and-announce claim, nonetheless, the warrantless entry of the shack violated clearly established law and under the "provocation rule" they could, therefore, be liable for excessive force.

The Supreme Court granted review and reversed, holding that the "provocation rule" improperly conflated two independent Fourth Amendment claims—an unreasonable seizure for purposes of excessive force, and unreasonable search. However, while the Court repudiated the "provocation rule" with its essentially automatic imposition of a liability on a defendant for a prior constitutional tort, nonetheless the Court expressly held that under some circumstances an earlier Fourth Amendment violation by a police officer could give rise to liability for injuries officers subsequently inflict as a result of the use of force in the course of a search. Thus, although the Supreme Court eliminated the Ninth Circuit's "provocation rule," for the first time it has held that police officers might be held liable for injuries caused by the lawful use of force under *Graham*, so long as that use of force could be said to be proximately caused by a prior Fourth Amendment violation. The Court remanded the matter to the Ninth Circuit for a clearer determination of precisely what Fourth Amendment violation proximately caused the officers' use of force. The Court observed that it was unclear from the Ninth Circuit's prior opinion whether it believed that the use of force was caused by the officers' violation of the

"knock and announce" rule—for which the officers had been found qualifiedly immune—or whether the mere absence of the warrant itself could be said to have proximately caused the use of force and subsequent injury.

On remand, the Ninth Circuit again affirmed the judgment. For purposes of Fourth Amendment liability, the court found that the violation consisted of the unlawful entry, and not the mere failure to obtain a warrant. It noted that although the officers' failure to knock and announce their presence may have been one cause of the plaintiffs' injuries, that the entry itself was a concurrent cause of the subsequent use of force, and hence could independently give rise to liability. The court also reinstated judgment for the plaintiffs on their state law negligence claim, noting that subsequent to the district court's decision the California Supreme Court issued its decision in *Hayes v. County of San Diego*, 57 Cal.4th 622 (2013), which held that an officer's actions prior to the use of force could be considered in determining whether the officer acted negligently.

Mendez greatly expands potential liability for warrantless entries. It reaffirms the broad state law negligence liability standard of *Hayes*, and more significantly, creates Fourth Amendment liability for even the otherwise lawful use of force, where such force is preceded by an unlawful entry.

I. Hernandez v. City of San Jose, __F.3d__, 2018 WL 3597324 (9th Cir. 2018)

• No qualified immunity from Due Process claim arising from increasing danger to counter protesters from attacks by other protesters.

In *Hernandez v. City of San Jose*, __F.3d__, 2018 WL 3597324 (9th Cir. 2018) pro-Trump protesters sued a city and its police officers, asserting they had been injured by other protesters at a campaign rally. Plaintiffs contended that the police officers, pursuant to municipal policy, not simply failed to intervene to prevent the attacks, but specifically prevented the plaintiffs from escaping the conflict and directed them to an area where they would be attacked. The district court denied the officers' motion to

dismiss based upon qualified immunity, finding that the law was clearly established that officers may not increase the danger of someone being attacked through their affirmative conduct.

The Ninth Circuit affirmed. The court held there could be no qualified immunity, because the law was clearly established that police officers could be liable under the Due Process clause under those circumstances where they increased the potential danger to persons in their charge. Here, the plaintiffs' claim was not based upon a mere failure to protect them from the actions of other protesters, but rather affirmative conduct by the police officers in directing the plaintiffs to take a particular route which subjected them to attack by others.

Hernandez is significant, in that it clarifies the standards for imposing liability against police officers engaged in crowd control activities. It reaffirms that officers have no general duty to intervene, but that actions which may increase the likelihood of violence may give rise to liability.

III. MUNICIPAL TORT LIABILITY—RESPONDEAT SUPERIOR, WORKERS' COMPENSATION EXCLUSIVITY AND IMMUNITY.

A. *Newland v. County of Los Angeles*, 24 Cal. App. 5th, 676 (2018)

- **Respondeat superior and the coming and going rule.**

In *Newland v. County of Los Angeles*, 24 Cal. App. 5th, 676 (2018), a County public defender injured the plaintiff in an auto accident while on his way home from work. Plaintiff argued that the County was responsible for the accident under the doctrine of respondeat superior, asserting that the County required public defenders to use their vehicles in performing their job-related functions, and hence the "coming and going" rule that generally barred respondeat superior liability for accidents occurring

during an employee's commute did not apply. A jury found for the plaintiff and awarded almost $14 million in damages. 234 Cal. Rptr. 3d at 374, 381.

In a 2-1 decision, the Court of Appeal reversed with directions to enter judgment for the County. The court observed that there was no evidence to support the jury's determination that the public defender was impliedly required to use a vehicle to perform his job-related functions on the day of the accident. *Id*. at 377. The court found that the undisputed evidence at trial demonstrated that the public defender had only used his car sporadically over the years to perform various tasks, such as making occasional appearances in branch courts, visiting jails, or viewing crime scenes, but there was no evidence he needed his vehicle to perform any of those tasks on the day of the accident. *Id*. at 389. Nor was there any evidence that he was required to have his car available to handle any sort of emergency situation. *Id*. Rather, he was simply driving a normal, routine commute. *Id*. Moreover, there was no evidence showing that the public defender's use of the car provided any direct or incidental benefit to his employer, as there was no evidence suggesting that the County relied on or expected the public defender to make his car available on the days he did not have outside tasks. *Id*. In fact, the evidence was that the public defender performed his job for years while commuting to work using public transportation. *Id*.

Newland is important in establishing the limited nature of the required vehicle and incidental benefit exceptions to the coming and going rule. Public employees, and particularly public attorneys, may perform various tasks in the course of their duties that might call for the occasional use of an automobile, but *Newland* underscores that simple occasional use is insufficient to establish a general exception to the coming and going rule.

B. *Gund v. County of Trinity*, 24 Cal. App. 5th, 185 (2018)

- **Workers' compensation exclusive remedy for citizens aiding law enforcement.**

In *Gund v. County of Trinity*, 24 Cal. App. 5th, 185 (2018), police received a 911 call with a whispered statement that an individual needed help. 234 Cal. Rptr. 3d at 188. A deputy called the neighbor of the 911 caller and asked for them to check on them to see if everything was alright. *Id*. The neighbor then unwittingly walked into a murder scene and was savagely attacked by the person who had apparently just murdered the neighbor and her boyfriend. *Id*.

The neighbor sued the County and the deputy for negligence and misrepresentation, alleging that defendants had created a special relationship and thus owed them a duty of care by withholding information known to the officers, i.e., that the caller had whispered "help me," which indicated a possible crime. *Id*

The trial court granted summary judgment based upon Labor Code section 3366, which provides that any person engaged in assisting any peace officer in active law enforcement service at the request of the peace officer, is deemed an employee of the public entity for purposes of workers' compensation. The plaintiff appealed, and the Court of Appeal affirmed. The court noted the broad scope of Labor Code section 3366, which necessarily encompassed any activity that aided a law enforcement officer in the performance of a law enforcement related function.

Although somewhat unique in its factual situation, *Gund* is useful in reaffirming the exclusivity of workers' compensation as a remedy, particularly in those narrow circumstances in which lay personnel may be called to assist law enforcement officers in performing their duties.

C. Ramirez v. City of Gardena, __Cal.5th __, 2018 WL 3827236 (2018)

- **Immunity of Vehicle Code section 17004.7 shields public entity from liability arising from police pursuit so long as the policy provides that each officer certify that they have read and understand the policy, even if not all officers have done so.**

In *Ramirez v. City of Gardena*, __Cal.5th __, 2018 WL 3827236 (2018), the plaintiff sued a city for wrongful death, asserting that her son had died as a result of a collision caused by the city's police officers during a pursuit. The trial court granted summary judgment, finding that the city was shielded from liability under Vehicle Code section 17004.7 because it had a valid pursuit policy, which included the requirement that all officers certify that they had read and understood the policy.

After the Court of Appeal affirmed the judgment, plaintiff sought review in the California Supreme Court, arguing that the evidence demonstrated that although the policy required all officers to certify that they read and understood the policy, that in fact evidence indicated that not all officers had done so. The Supreme Court granted review to determine whether section 17004.7 merely required that the policy include a certification requirement, or whether the immunity only applied where the requirement was actually fulfilled by every officer.

In a unanimous opinion the Supreme Court affirmed the Court of Appeal. It held that by its plain terms, section 17004.7 merely required a policy to include a requirement that officers certify that they read and understood the city's pursuit policy, and did not require that a city actually demonstrate that in fact every officer had complied with the requirement.

Ramirez is a major victory for public entities in that it reaffirms the strong protections of section 17004.7 and recognizes the practical difficulties in assuring

individual compliance with every aspect of a pursuit policy. Significantly, however, the Supreme Court expressly left open the important questions of whether there may be circumstances where a lack of compliance with the certification requirement or meaningful implementation of a pursuit policy, may indicate that an agency is not satisfying the statute's requirements and hence forfeits any immunity.

Massage: Eradicating Illicit Conduct Using Revocable Registration

Thursday, September 13, 2018 General Session; 2:45 – 4:00 p.m.

David A. Silberman, Assistant County Counsel, San Mateo County

Notes:

An Ordinance Approach to Eliminating Illicit "Massage" Businesses

By David A. Silberman, Chief Deputy County Counsel

Use of "massage" establishments as a front for criminal pandering operations is a well-known problem that can often also involve victims of human trafficking. https://www.pri.org/stories/2018-01-25/across-us-many-illicit-massage-parlors-avoid-police-detection. Public Radio International reported this year that Praesidium Partners LLC, a Virginia-based anti-trafficking organization, identified 2,311 illicit "massage" businesses in California using the website Rubmaps.com—approximately four times the number located in any other state and more than a quarter listed nationwide.[1]

There are traditional abatement tools to address the problem, including the Red-Light Abatement Law [Penal Code Section 11225, et seq.]. However, some have complained that this remedy can be too time-consuming and expensive to be effective at eliminating an entrenched problem.

In 2012, the County of San Mateo pursued a different approach. It adopted an Ordinance requiring every Massage Business operating within the jurisdiction to obtain a Revocable Registration. Some of the key components included requiring all practitioners to be certified by the California Massage Therapy Council (obviating need for background checks); a broad definition of massage; employee lists that need to be regularly updated; and a prohibition on massage establishments at locations where enforcement action has been taken or is pending (to circumvent attempts by criminal enterprises to transfer ownership). A copy of the Ordinance is attached hereto as Exhibit A.

The Ordinance also contains a number of regulatory requirements intended to root out illicit business and protect public health and safety, e.g., requiring practitioners to wear CAMTC certification and owners to post CAMTC certificates on the wall; setting hours of operation prohibiting being in the facility after hours/living in facility; requiring records of services provided; setting basic health and safety protections (towels, instruments, lighting, ventilation); requiring appropriate attire; prohibiting the touching of genitals; requiring unlocked and unobscured lobbies; and prohibition practitioners from using nicknames.

[1] The article does not explore whether Rubmaps may be more likely to serve California.

Most importantly, the Ordinance includes a summary enforcement procedure to revoke a registration with a hearing before a “License Board” to occur within 30 days.

San Mateo County’s experience was extremely positive. In the 3-year period between 2012-2015, San Mateo County shut down 11 of 11 known illicit “massage” businesses located in the unincorporated area. Except for one that opened without a license in 2016 (and was also subsequently closed), no additional illicit “massage” businesses have opened since 2015 and none currently exist in the unincorporated area. It is of note that while a number of “massage” establishments had challenged their revocations, each revocation was affirmed by the License Board and subsequently each “massage” business closed with no further action needed. That indicated, the massage ordinance does make operating without a registration a nuisance per se, which would facilitate a fairly simple nuisance abatement action were one to become necessary.

Chapter 5.44 - MASSAGE BUSINESSES[1]

Sections:

(a) In enacting this chapter, the Board of Supervisors recognizes that commercial massage therapy is a professional pursuit which can offer the public valuable health and therapeutic services. The Board of Supervisors further recognizes that, unless properly regulated, the practice of massage therapy and the operation of massage businesses may be associated with unlawful activity and pose a threat to the quality of life in the local community. Accordingly, it is the purpose and intent of this chapter to protect the public health, safety, and welfare by providing for the orderly regulation of businesses providing massage therapy services, discouraging prostitution and related illegal activities carried on under the guise of massage therapy, and establishing certain sanitation, health, and operational standards for massage businesses.

(b) Furthermore, it is the purpose and intent of this chapter to address the negative impacts identified in the Board of Supervisor's findings to reduce or prevent neighborhood blight and to protect and preserve the quality of the County neighborhoods and commercial districts; and to enhance enforcement of criminal statutes relating to the conduct of operators and employees of massage businesses.

(c) It is the Board's further purpose and intent to rely upon the uniform statewide regulations applicable to massage practitioners and establishments that were enacted by the State Legislature in 2008 as Business and Professions Code sections 4600 et seq. by Senate Bill 731, and amended in 2011 by Assembly Bill 619, to restrict the commercial practice of massage in the unincorporated areas of San Mateo County to those persons duly certified to practice by the California Massage Therapy Council, and to provide for the registration and regulation of massage businesses for health and safety purposes to the extent allowed by law.

(Ord. No. 04601, § 3, 1-31-2012)

For the purposes of this chapter, unless the particular provision or the context otherwise clearly requires, the definitions in this section shall govern the construction, meaning, and application of words and phrases used in this chapter:

(a) "Business" includes, but not by way of limitation, everything about which a person can be employed, and means that which occupies the time, attention, and labor of men and women for the purpose of producing a livelihood or profit, and connotes the efforts of men and women by varied and diverse methods of dealing with each other, to improve their individual economic conditions, and for the purposes of this chapter shall include, without limitation, the advertising and soliciting of massages. The term "business" includes, but is not limited to, a massage practitioner who is the sole owner, operator and employee of a massage business operating as a sole proprietorship, as well as a massage establishment which employs massage practitioners.

(b) "California Massage Therapy Council" or "CAMTC" means the Massage Therapy Organization formed pursuant to Business and Professions Code Section 4600.5.

(c) "Certified Massage Practitioner" means any individual certified by the California Massage Therapy Council as a Certified Massage Therapist or as a Certified Massage Practitioner pursuant to California Business and Professions Code Sections 4600 et seq.

(d) "Client" means the customer or patron who pays for or receives massage services.

(e) "Compensation" means the payment, loan, advance, donation, contribution, deposit, exchange, or gift of money o of value.

(f) "County Registration Certificate" means a registration certificate issued by the Director of Environmental Health upon submission of satisfactory evidence that a massage business employs or uses only certified massage practitioners pursuant to this chapter.

(g) "Director of Environmental Health" means the Director of Environmental Health of San Mateo County and his or her authorized representatives or designees.

(h) "Employee" means any person employed by a massage business who may render any service to the business, and who receives any form of compensation from the business.

(i) "Health Officer" means the person appointed by the San Mateo County Board of Supervisors pursuant to the California Health and Safety Code or his or her authorized representatives or designees.

(j) "License Board" means the License Board of the County of San Mateo as it is defined and constituted in Chapter 5.04 of the San Mateo County Code.

(k) "Massage" or "massage therapy," means and refers to any method of treating the external parts of the body for remedial, health, or hygienic purposes for any form of compensation by means of pressure on or friction against, or stroking, kneading, rubbing, tapping, pounding, or stimulating the external parts of the body, with or without the aid of any mechanical or electrical apparatus or appliances; or with or without supplementary aids, such as rubbing alcohol, liniments, antiseptics, oils, powders, creams, lotions, ointments, or other similar preparations commonly used in this practice; or by baths, including but not limited to Turkish, Russian, Swedish, Japanese, vapor, shower, electric tub, sponge, mineral, fomentation, or any other type of bath.

(l) "Massage business" means any business that offers massage therapy in exchange for compensation, whether at a fixed place of business or at a location designated by the customer or client through outcall massage services. Any business that offers any combination of massage therapy and bath facilities - including, but not limited to, showers, baths, wet and dry heat rooms, pools and hot tubs - shall be deemed a massage business under this chapter. The term "massage business" includes a certified massage practitioner who is the sole owner, operator and employee of a massage business operating as a sole proprietorship.

(m) "Operator" or "massage business operator" means any and all owners of a massage business.

(n) "Outcall massage" means the engaging in or carrying on of massage therapy for compensation in a location other than the business operations address set forth in the massage business's county registration certificate.

(o) "Owner" or "massage business owner" means any of the following persons:

(1) Any person who is a general partner of a general or limited partnership that owns a massage business.

(2) Any person who has a five percent (5%) or greater ownership interest in a corporation that owns a massage business.

(3) Any person who is a member of a limited liability company that owns a massage business.

(4) Any person who has a five percent (5%) or greater ownership interest in any other type of business association that owns a massage business.

(p) "Person" means any individual, firm, association, partnership, corporation, joint venture, limited liability company, or combination of individuals.

(q) "Practitioner" or "massage practitioner" shall be used interchangeably and mean any person who administers massage to another person, for any form of consideration (whether for the massage, as part of other services or a product, or otherwise).

(r) "Reception and waiting area" means an area immediately inside the front door of the massage business dedicated to the reception and waiting of patrons of the massage business and visitors, and which is not a

massage therapy room or otherwise used for the provision of massage therapy services.

(s) "Registration" means the registration required by this Chapter to operate a massage business.

(t) "School of massage" means any school or institution of learning that is recognized as an approved school pursuant to Business and Professions Code Division 2, Chapter 10.5, as currently drafted or as may be amended.

(u) "Sheriff" means the Sheriff of San Mateo County and his or her authorized representatives or designees.

(v) "Sole proprietorship" means and includes any legal form of business organization where the business owner (sometimes referred to as the "sole proprietor") is the only person employed by that business to provide massage services.

(w) "Solicit" means to request, ask, demand or otherwise arrange for the provision of services.

(Ord. No. 04601, § 3, 1-31-2012)

5.44.030 - CAMTC certification and local registration required.

(a) Individuals. On and after July 1, 2012, it shall be unlawful for any individual to practice massage therapy for compensation as a sole proprietorship or employee of a massage business or in any other capacity within the unincorporated areas of San Mateo County unless that individual is a certified massage practitioner.

(b) Businesses. On and after July 1, 2012, it shall be unlawful for any business to provide massage for compensation within the unincorporated areas of San Mateo County unless all individuals employed by the massage business to perform massage, whether as an employee, independent contractor, or sole proprietorship, are certified massage practitioners and said business has obtained a valid county registration certificate as provided in this chapter.

(Ord. No. 04601, § 3, 1-31-2012)

5.44.040 - Massage business registration.

(a) Application. The registration application for a County Registration Certificate shall include all of the following:

(1) Legal name of the massage business.

(2) Address and telephone number of the massage business.

(3) Legal names of all owners of the massage business.

(4) A list of all of the massage business's employees and independent contractors who are performing massage and their CAMTC certification.

(5) Residence address and telephone number of all owners of the massage business.

(6) Business address and telephone number of all owners of the massage business.

(7) The form of business under which the massage business will be operating (i.e., corporation, general or limited partnership, limited liability company, or other form).

(8) Each owner or operator of the massage business who is not a CAMTC-certified massage practitioner shall submit an application for a background check, including the following: the individual's business, occupation, and employment history for the five (5) years preceding the date of the application; the inclusive dates of such employment history; the name and address of any massage business or similar business owned or operated by the individual whether inside or outside the County.

(9) For all owners, a valid and current driver's license and/or identification issued by a state or federal governmental agency or other photographic identification bearing a bona fide seal by a foreign government.

(10) For all owners, a signed statement that all of the information contained in the application is true and correc shall be responsible for the conduct of the business's employees or independent contractors providing mas and acknowledging that failure to comply with the California Business and Professions Code sections 4600 e state, or federal law, or the provisions of this chapter may result in revocation of the business's County regis certificate.

(b) Issuance. Upon provision by the massage business of the foregoing documentation, the Director of Environmental Health shall issue the massage business a County Registration Certificate, which shall be valid for two (2) years from the date of issuance. No reapplication will be accepted within one (1) year after an application or renewal is denied or a certificate is revoked. County Registration Certificates may not be issued to a massage business seeking to operate at a particular location if:

(1) Another massage business is or was operating at that particular location and that massage business is currently serving a suspension or revocation pursuant to section 5.44.110, during the pendency of the suspension or one year following revocation;

(2) Another massage business is or was operating at that particular location and that massage business has received a Notice of Suspension, Revocation or fine issued pursuant to sections 5.44.100 and 5.44.110, during the ten day period following receipt of the Notice or while any appeal of a suspension, revocation or fine is pending.

(3) Another massage business is or was operating at that particular location and that massage business has outstanding fines issued pursuant to section 5.44.100 that have not been paid.

(c) Amendment. A massage business shall apply to the County to amend its County Registration Certificate within thirty (30) days after any change in the registration information, including, but not limited to, the hiring or termination of certified massage practitioners, the change of the business's address, or changes in the owner's addresses and/or telephone numbers.

(d) Renewal. A massage business shall apply to the County to renew its County registration certificate at least thirty (30) days prior to the expiration of said County Registration Certificate. If an application for renewal of a County Registration Certificate and all required information is not timely received and the certificate expires, no right or privilege to provide massage shall exist.

(e) Fees. There shall be no fee for the registration application or certificate, or any amendment or renewal thereof. The provisions of this section shall not prevent the County from establishing fees for health and safety inspections as may be conducted from time to time by the Director of Environmental Health, and for the background checks, fingerprinting, and subsequent arrest notification for owners of a massage business who are not CAMTC-certified and who are subject to such background checks pursuant to this chapter.

(f) Transfer. A County Registration Certificate shall not be transferred except with the prior written approval of the Director of Environmental Health. A written request for such transfer shall contain the same information for the new ownership as is required for applications for registration pursuant to this section. In the event of denial, notification of the denial and reasons therefore shall be provided in writing and shall be provided to the applicant by personal delivery or by registered or certified mail. A County Registration Certificate may not be transferred during any period of suspension or one year following revocation pursuant to section 5.44.110, during the ten-day period following a massage businesses' receipt of a Notice of Suspension, Revocation or fine issued pursuant to sections 5.44.100 and 5.44.110 or while any appeal of a suspension, revocation or fine is pending. Further, a County Registration Certificate may not be transferred until all outstanding fines issued pursuant to section 5.44.100 have been paid.

(Ord. No. 04601, § 3, 1-31-2012; Ord. No. 04688, § 1, 2-25-2014)

5.44.050 - Operating requirements.

On or after July 1, 2012, no person shall engage in, conduct, carry on, or permit any massage within the unincorporated areas of the County of San Mateo unless all of the following requirements are met:

(a) CAMTC-certification shall be worn by and clearly visible on the massage practitioner's person during working hours and at all times when the massage practitioner is inside a massage business or providing outcall massage.

(b) Massage shall be provided or given only between the hours of 7:00 a.m. and 9:00 p.m. No massage business shall be open and no massage shall be provided between 9:00 p.m. and 7:00 a.m. A massage commenced prior to 9:00 p.m. shall nevertheless terminate at 9:00 p.m., and, in the case of a massage business, all clients shall exit the premises at that time. It is the obligation of the massage business, to inform clients of the requirement that services must cease at 9:00 p.m.

(c) A list of the services available and the cost of such services shall be posted in the reception area within the massage premises, and shall be described in readily understandable language. Outcall service providers shall provide such a list to clients in advance of performing any service. No owner, manager, operator, or responsible managing employee shall permit, and no massage practitioner shall offer or perform, any service other than those posted or listed as required herein, nor shall an operator or a massage practitioner request or charge a fee for any service other than those on the list of services available and posted in the reception area or provided to the client in advance of any outcall services.

(d) A copy of the CAMTC certificate of each and every massage practitioner employed in the business shall be displayed in the reception area or similar open public place on the premises. CAMTC certificates of former employees and/or contractors shall be removed as soon as those massage practitioners are no longer employed by or offering services through the massage business.

(e) For each massage service provided, every massage business shall keep a complete and legible written record of the following information: the date and hour that service was provided; the service received; the name or initials of the employee entering the information; and the name of the massage practitioner administering the service. Such records shall be open to inspection and copying by the Sheriff, or other County officials charged with enforcement of this chapter. These records may not be used by any massage practitioner or operator for any purpose other than as records of service provided and may not be provided to other parties by the massage practitioner or operator unless otherwise required by law. Such records shall be retained on the premises of the massage business for a period of two (2) years and be immediately available for inspection during business hours.

(f) Massage businesses shall at all times be equipped with an adequate supply of clean sanitary towels, coverings, and linens. Clean towels, coverings, and linens shall be stored in enclosed cabinets. Towels and linens shall not be used on more than one (1) client, unless they have first been laundered and disinfected. Disposable towels and coverings shall not be used on more than one (1) client. Soiled linens and paper towels shall be deposited in separate, approved receptacles.

(g) Wet and dry heat rooms, steam or vapor rooms or cabinets, toilet rooms, shower and bath rooms, tanning booths, whirlpool baths and pools shall be thoroughly cleaned and disinfected as needed, and at least once each day the premises are open, with a disinfectant approved by the Health Officer. Bathtubs shall be thoroughly cleaned after each use with a disinfectant approved by the Health Officer of the County of San Mateo. All walls, ceilings, floors, and other physical facilities for the business must be in good repair, and maintained in a clean and sanitary condition.

(h) Instruments utilized in performing massage shall not be used on more than one (1) client unless they

have been sterilized, using approved sterilization methods.

(i) All massage business operators and their employees, including massage practitioners, shall wear clean, non-transparent outer garments. Said garments shall not expose their genitals, pubic areas, buttocks, or chest, and shall not be worn in such manner as to expose the genitals, pubic areas, buttocks, or chest. For the purposes of this section, outer-garments means a garment worn over other garments and does not include garments like underwear, bras, lingerie or swimsuits.

(j) No person shall enter, be, or remain in any part of a massage business while in possession of an open container of alcohol, or consuming or using any alcoholic beverage or drugs except pursuant to a prescription for such drugs. The owner, operator, responsible managing employee, or manager shall not permit any such person to enter or remain upon such premises.

(k) No massage business shall operate as a school of massage, or use the same facilities as that of a school of massage.

(l) No massage business shall place, publish or distribute, or cause to be placed, published or distributed any advertising matter that depicts any portion of the human body that would reasonably suggest to prospective clients that any service is available other than those services listed as an available service pursuant to section 5.44.050(c), nor shall any massage business employ language in the text of such advertising that would reasonably suggest to a prospective client that any service is available other than those services as described in compliance with the provisions of this chapter.

(m) No massage shall be given unless the client's genitals are, at all times, fully covered. A practitioner shall not, in the course of administering any massage, make physical contact with the genitals or private parts of any other person regardless whether the contact is over or under the persons clothing.

(n) Where the business has staff available to assure security for clients and massage staff are behind closed doors, the entry to the reception area of the massage business shall remain unlocked during business hours when the business is open for business or when clients are present.

(o) No massage business located in a building or structure with exterior windows fronting a public street, highway, walkway, or parking area shall, during business hours, block visibility into the interior reception and waiting area through the use of curtains, closed blinds, tints, or any other material that obstructs, blurs, or unreasonably darkens the view into the premises. For the purpose of this subsection, there is an irrebuttable presumption that the visibility is impermissibly blocked if more than 10 percent of the interior reception and waiting area is not visible from the exterior window.

(p) All signs shall be in conformance with the current ordinances of the County of San Mateo.

(q) Minimum lighting consisting of at least one (1) artificial light of not less than forty (40) watts shall be provided and shall be operating in each room or enclosure where massage services are being performed on clients, and in all areas where clients are present.

(r) Ventilation shall be provided in accordance with applicable building codes and regulations.

(s) Hot and cold running water shall be provided at all times.

(t) Adequate dressing, locker and toilet facilities shall be provided for clients.

(u) A minimum of one (1) wash basin for employees shall be provided at all times. The basin shall be located within or as close as practicable to the area devoted to performing of massage services. Sanitary towels shall also be provided at each basin.

(v) Pads used on massage tables shall be covered with material acceptable to the Health Officer of the County of San Mateo.

(w) All massage businesses shall comply with all state and federal laws and regulations for handicapped

clients.

(x) A massage practitioner shall operate only under the name specified in his or her CAMTC certificate. A massage business shall operate only under the name specified in its County Registration Certificate.

(y) No massage business shall allow any person to reside within the massage business or in attached structures owned, leased or controlled by the massage business.

(z) Other than custodial or maintenance staff, no persons shall be permitted within the premises of a massage business between the hours of 11:00 p.m. and 6:00 a.m.

(Ord. No. 04601, § 3, 1-31-2012; Ord. No. 04688, § 2, 2-25-2014)

5.44.060 - Inspection by officials.

The investigating and enforcing officials of the County of San Mateo, including but not limited to the Sheriff, Health Officer, Director of Environmental Health, and Director of Building and Planning for the County of San Mateo, or their designees, shall have the right to enter the premises from time to time during regular business hours for the purpose of making reasonable inspections to observe and enforce compliance with building, fire, electrical, plumbing or health regulations, and to enforce compliance with applicable regulations, laws, and statutes, and with the provisions of this chapter. The Environmental Health Services Division may charge a fee for any health and safety inspections, as provided in Chapter 5.64 of the Ordinance Code.

(Ord. No. 04601, § 3, 1-31-2012)

5.44.070 - Notifications.

(a) A massage business shall notify the Director of Environmental Health, or his or her designee, of any changes described in section 5.44.040 pursuant to the timelines specified therein.

(b) A registrant shall report to the Director of Environmental Health any of the following within 96 hours of the occurrence:

(1) Arrests of any employees or owners of the registrant's massage business for an offense other than a misdemeanor traffic offense;

(2) Resignations, terminations, or transfers of practitioners employed by the registrant's massage business;

(3) Any event involving the registrant's massage business or the massage practitioners employed therein that constitutes a violation of this ordinance or state or federal law.

(c) This provision requires reporting to the Director of Environmental Health even if the massage business believes that the Director of Environmental Health has or will receive the information from another source.

(Ord. No. 04601, § 3, 1-31-2012; Ord. No. 04688, § 3, 2-25-2014)

5.44.080 - Exemptions.

(a) The provisions of this chapter shall not apply to the following classes of individuals or businesses while engaged in the performance of their duties:

(1) Physicians, surgeons, chiropractors, osteopaths, nurses or any physical therapists who are duly licensed to practice their respective professions in the State of California and persons working directly under the supervision of or at the direction of such licensed persons, working at the same location as the licensed person, and administering massage services subject to review or oversight by the licensed person.

(2) Barbers and beauticians who are duly licensed under the laws of the State of California while engaging in

practices within the scope of their licenses, except that this provision shall apply solely to the massaging of the neck, face and/or scalp, hands or feet of the clients.

(3) Hospitals, nursing homes, mental health facilities, or any other health facilities duly licensed by the State of California, and employees of these licensed institutions, while acting within the scope of their employment.

(4) Accredited high schools, junior colleges, and colleges or universities whose coaches and trainers are acting within the scope of their employment.

(5) Trainers of amateur, semi-professional or professional athletes or athletic teams while engaging in their training responsibilities for and with athletes; and trainers working in conjunction with a specific athletic event.

(6) Individuals administering massages or health treatment involving massage to persons participating in single-occurrence athletic, recreational or festival events, such as health fairs, road races, track meets, triathlons and other similar events; provided, that all of the following conditions are satisfied:

(A) The massage services are made equally available to all participants in the event;

(B) The event is open to participation by the general public or a significant segment of the public such as employees of sponsoring or participating corporations;

(C) The massage services are provided at the site of the event and either during, immediately preceding or immediately following the event;

(D) The sponsors of the event have been advised of and have approved the provisions of massage services;

(E) The persons providing the massage services are not the primary sponsors of the event.

(b) Massage Businesses operating on the premises of the San Francisco International Airport are exempt from the operating time limitations contained in Section 5.44.050(b). All other provisions of this chapter apply to such businesses.

(Ord. No. 04601, § 3, 1-31-2012; Ord. No. 04688, § 4, 2-25-2014)

5.44.090 - Unlawful business practices may be enjoined; remedies cumulative.

Any massage business operated, conducted, or maintained contrary to the provisions of this chapter shall constitute an unlawful business practice pursuant to Business and Professions Code Section 17200 et seq., and the County Counsel or District Attorney may, in the exercise of discretion, in addition to or in lieu of taking any other action permitted by this chapter, commence an action or actions, proceeding or proceedings in the Superior Court of San Mateo County, seeking an injunction prohibiting the unlawful business practice and/or any other remedy available at law, including but not limited to fines, attorneys' fees and costs. All remedies provided for in this chapter are cumulative.

(Ord. No. 04601, § 3, 1-31-2012)

5.44.100 - Administrative fines.

(a) Violations. Upon a finding by the Sheriff that a business has violated any provision of this chapter, the Sheriff may issue an administrative fine of up to five hundred dollars ($500).

(b) Separate Violations. Each violation of any provision of this chapter shall constitute a separate violation. Each client to whom massage is provided or offered in violation of this chapter shall also constitute a separate violation. Each day upon which a massage business remains open for business in violation of this chapter shall also constitute a separate violation.

(c) Fine Procedures. Notice of the fine shall be served by certified mail with the legal violation and supporting facts. The notice shall contain an advisement of the right to file an appeal with the Director of the Environmental Health Division or his or her designee contesting the imposition of the fine.

(d) Appeals. Appeals must be requested in writing, and shall provide facts disputing the violation and may be accompanied by declarations and exhibits. Appeals must be addressed to the Director of Environmental Health, and must be received within ten (10) days of the date appearing on the notice of the fine and a copy of the appeal and any supporting materials must be sent to the Sheriff's Office. The Sheriff's Office may respond to the appeal in writing within ten (10) days of receipt of the appeal and may provide additional evidence in support of the fine. The Director of Environmental Health may request, in writing, additional evidence from either the Appellant or the Sheriff's Office. The decision of the Director of Environmental Health shall be based solely on the materials submitted by the Appellant and the Sheriff's Office and be provided by certified mail. The Director of Environmental Health may sustain the fine, overrule the fine or decrease the amount of the fine. However the total fine shall not be reduced below $500. The decision will constitute a final administrative order with no additional administrative right of appeal.

(e) Failure to Pay Fine. If said fine is not paid within thirty (30) days from the date appearing on the notice of the fine or of the notice of determination from the Director of Environmental Health after the decision, the fine may be referred to a collection agency within or external to the County. In addition, any outstanding fines must be paid prior to the issuance or renewal of any registration.

(Ord. No. 04601, § 3, 1-31-2012; Ord. No. 04688, § 5, 2-25-2014)

5.44.110 - Suspension and revocation of County Registration Certificates.

(a) Reasons. Certificates of registration may be suspended or revoked upon any of the following grounds:

(1) A practitioner is no longer in possession of current and valid CAMTC-certification. This subsection shall apply to a sole proprietor or a person employed or used by a massage business to provide massage.

(2) An owner or sole proprietor: Is required to register under the provisions of California Penal Code section 290 (sex offender registration); is convicted of California Penal Code sections 266i (pandering), 315 (keeping or residing in a house of ill-fame), 316 (keeping disorderly house), 318 (prevailing upon person to visit a place for prostitution), 647(b) (engaging in or soliciting prostitution), 653.22 (loitering with intent to commit prostitution), 653.23 (supervision of prostitute); has a business permit or license denied, revoked, restricted, or suspended by any agency, board, city, county, territory, or state; is subject to an injunction for nuisance pursuant to California Penal Code sections 11225—11235 (red light abatement); is convicted of a felony offense involving the sale of a controlled substance; is convicted of any crime involving dishonesty, fraud, deceit, violence, or moral turpitude; or is convicted in any other state of an offense which, if committed in this state, would have been punishable as one or more referenced offenses in this subdivision.

(3) The county determines that a material misrepresentation was included on the application for a certificate of registration or renewal.

(4) Violations of any of the following occurred on the premises of a massage business or were committed by a practitioner: California Business and Professions Code section 4600 et seq.; any local, state, or federal law; or the provisions of this chapter.

(b) Procedures. Written notice of the suspension or revocation shall be served on the sole proprietor or owners by certified mail with the legal violation and supporting facts. The notice shall contain an advisement of the right to request an appeal hearing before the License Board.

(c) Time Period of Suspension of Permit. The Sheriff may suspend a registration for a period between five (5) days ar of the license term, at his or her discretion.

(d) Effective Date of Suspension or Revocation. Suspension or revocation issued pursuant to subsection (b) will be effective ten (10) days from the date appearing on the order, unless a timely appeal is filed in accordance with subsection (e).

(e) Appeal.

(1) The decision of the Sheriff is appealable to the License Board.

(2) An appeal must be in writing, and be hand-delivered or mailed to the License Board.

(3) An appeal must be received by the License Board on or before the effective date of suspension or revocation provided by subsection (d).

(4) The filing of a timely appeal will stay a suspension or revocation pending a decision on the appeal by the License Board.

(5) A hearing shall be scheduled before the License Board within thirty (30) days. Either the Appellant or the Sheriff's Office may request, in writing directed to the Chair of the License Board, a continuance of the hearing. Such requests must be supported by good cause. The decision whether to grant a continuance is at the discretion of the Chair of the License Board, who shall consider whether granting the continuance poses a threat to public health or safety in light of the severity of the violations alleged.

(6) The decision of the License Board shall be a final administrative order, with no further administrative right of appeal or reconsideration. The License Board may sustain a suspension or revocation, overrule a suspension or revocation, reduce a revocation to a suspension and/or reduce the length of a suspension. However no revocation or suspension shall be reduced to a length of less than a five-day suspension. Further the License Board may stay the effective date of any suspension for a reasonable time following a hearing.

(f) Reapplication. No reapplication will be accepted within one (1) year after a certificate is revoked.

(g) Evidence. The following rules shall apply to any hearing required by this section. All parties involved shall have the right to offer testimonial, documentary, and tangible evidence bearing on the issues, to be represented by counsel, and to confront and cross-examine witnesses. Any relevant evidence may be admitted if it is the sort of evidence upon which reasonable persons are accustomed to rely in the conduct of serious affairs. Formal rules of evidence and discovery do not apply to proceedings governed by this chapter. Unless otherwise specifically prohibited by law, the burden of proof is on the registrant in any hearing or other matter under this chapter.

(Ord. No. 04601, § 3, 1-31-2012; Ord. No. 04688, § 6, 2-25-2014)

5.44.120 - Public nuisance.

It shall be unlawful and a public nuisance for a massage business to be operated, conducted, or maintained contrary to the provisions of this chapter. The county may exercise its discretion, in addition to or in lieu of prosecuting a criminal action, to commence proceedings for the abatement, removal, and enjoinment of that business in any manner provided by law.

(Ord. No. 04601, § 3, 1-31-2012)

COUNTY OF SAN MATEO
Inter-Departmental Correspondence
SHERIFF

DATE: January 9, 2012
BOARD MEETING DATE: January 24, 2012
SPECIAL NOTICE/HEARING: None
VOTE REQUIRED: Majority

TO: Honorable Board of Supervisors

FROM: Greg Munks, Sheriff
Jean S. Fraser, Chief, Health System

SUBJECT: Ordinance repealing and replacing Chapter 5.44 of the San Mateo County Ordinance Code, relating to massage businesses and amending Chapter 5.64 relating to inspection fees

RECOMMENDATION:
Adopt an ordinance repealing and replacing Chapter 5.44 (Massage Establishments) of Title 5 (Business Regulations) of the San Mateo County Ordinance Code, relating to the Regulation of massage businesses and amending Chapter 5.64 (Fees for Inspection of State Public Health Laws) relating to inspection fees.

BACKGROUND:
The current massage ordinance was adopted in 1973, with minor revisions adopted in 1987 and 1991. Although massage is a viable professional field offering the public valuable health and therapeutic services, massage businesses can create opportunities for prostitution, drug dealing, human trafficking and other harmful secondary effects upon the public health and safety. The unincorporated areas of San Mateo County contain at least twenty-two massage establishments, for which the Sheriff's Department received approximately seven complaints in 2011 and arrested four individuals for charges of possessing controlled substances and keeping or residing in a house of ill-fame for the purpose of prostitution.

The Governor signed SB 731 on September 27, 2008, and AB 619 on August 4, 2011, which respectively adopted and amended Section 4600 *et seq.* of the California Business and Professions Code. Such legislation was intended to protect individuals who receive massage, protect communities from prostitution and illicit activity, and also facilitate legitimate massage by creating centralized regulation of education, background, and permitting. Pursuant to the legislation, massage providers may voluntarily apply for and receive a certificate from the state's California Massage Therapy Council (CAMTC). Once an individual obtains a CAMTC certificate, he or she is able to practice in any city or county without being required to obtain a local license or permit. Similarly, a massage business that uses only CAMTC-certified massage

practitioners is not required to obtain a separate local license or permit. The County retains the ability to require health and safety regulations, however, and to require that practitioners and businesses register with the County. The County also retains the ability to require zoning restrictions, building regulations, and business licensing, as long as those regulations also affect other "professional or personal service businesses" (defined to include dentistry, medicine, chiropractors, dietitians, optometrists, acupuncture, accounting, architecture, attorneys, engineers, geologists, funeral directors, land surveyors, real estate brokers, etc.).

DISCUSSION:

Local governments throughout California are adopting massage ordinances with the intent of regulating the practice of massage and protecting the public health and safety in accordance with the above-referenced revisions to state law. The proposed ordinance was presented to the Board's Housing, Health and Human Services Standing Committee (the "HHH Committee") on November 14, 2011. Since that time, the Sheriff's Office, Environmental Health Division, and the County Counsel's office have revised the proposed ordinance based on the HHH Committee's comments as well as comments from representatives of the massage industry.

The proposed ordinance effectively allows the County to maintain the ability to regulate, inspect, and monitor the practice of massage while shifting much of the administrative work and background checks to the state CAMTC. Key provisions of the proposed ordinance include CAMTC certification, County registration, and requirements that businesses must comply with a variety of health and safety regulations, including: posting of a list of available services; keeping linens clean; requiring practitioner to work under the name certified with the CAMTC; and limiting the hours of operation.

There will be no fee for County registration, however the Environmental Health Division will collect fees for inspections of businesses, and the County will also collect fees for background checks of business owners who are not certified by the CAMTC. Pursuant to state law, the County's administrative fine amounts per violation may not exceed the punitive fine for an injunction or misdemeanor, which amount is $500 in San Mateo County. The proposed ordinance provides, however, that the administrative fine shall be $500 for each violation as well as for as each day that a business remains open in violation of the ordinance. County registration may be revoked or suspended for material misrepresentations or a conviction of certain crimes. The registration and operating requirements will be effective commencing July 1, 2012. This provides several months for practitioners and businesses to become certified, register with the County, and ensure the massage facilities comply with the ordinance.

Adoption of this ordinance will contribute to the Shared Vision 2025 outcome of a Collaborative Community by conforming the county's regulations with the applicable state statutes.

County Counsel has reviewed and approved the proposed Ordinance.

FISCAL IMPACT:

Some staff time and resources will be required for the Environmental Health Division to issue County registration certificates, as well as for the Sheriff to undertake monitoring and enforcement efforts. The Environmental Health Division will collect cost recovery fees for inspections of businesses, and fees will be collected for background checks of business owners who are not certified by the CAMTC. There should be no impact on the County's General Fund.

ORDINANCE NO. _____

BOARD OF SUPERVISORS, COUNTY OF SAN MATEO, STATE OF CALIFORNIA

* * * * * * * *

AN ORDINANCE REPEALING AND REPLACING CHAPTER 5.44 (MASSAGE ESTABLISHMENTS) OF TITLE 5 (BUSINESS REGULATIONS) OF THE SAN MATEO COUNTY ORDINANCE CODE, RELATING TO THE REGULATION OF MASSAGE BUSINESSES AND AMENDING CHAPTER 5.64 (FEES FOR INSPECTION OF STATE PUBLIC HEALTH LAWS) RELATING TO INSPECTION FEES

The Board of Supervisors of the County of San Mateo, State of California, ORDAINS as follows:

SECTION 1. FINDINGS. In enacting these regulations the Board of Supervisors recognizes that massage is a viable professional field offering the public valuable health and therapeutic services. The Board of Supervisors finds and declares as follows:

(a) The registration and health and safety requirements imposed by this chapter are reasonably necessary to protect the health, safety and welfare of the citizens of the County.

(b) Massage businesses have been found to present opportunities for acts of prostitution and other unlawful activity, and, in fact, officers have made arrests for prostitution in massage businesses located within the unincorporated areas of the County. Municipalities within the County have also reported instances where acts of prostitution have occurred in massage businesses.

(c) The California legislature and the courts have long

recognized the necessity of imposing reasonable regulations and standards for the operation of massage businesses, including but not limited to minimum educational and experience requirements, passage of a practical examination of competence, sanitary conditions, hours of operation, and other operational regulations designed to minimize opportunities for illegal activities and to ensure the protection of the health, safety and welfare of citizens.

(d) There is a significant risk of injury to clients of massage businesses by improperly trained or poorly educated massage practitioners.

(e) The presence of businesses known or reputed to be places of prostitution or other illegal activity can have an adverse impact on surrounding properties and result in blight, foster further illegal activities, and generally become a public nuisance.

SECTION 2. Chapter 5.44 (Massage Establishments) of Title 5 (Business Regulations) of the San Mateo County Ordinance Code, as presently written, is hereby repealed.

SECTION 3. New Chapter 5.44 (Massage Businesses) of Title 5 (Business Regulations) of the San Mateo County Ordinance Code is adopted, to read as follows: “Chapter 5.44 MASSAGE BUSINESSES

5.44.010 PURPOSE AND INTENT.

(a) In enacting this chapter, the Board of Supervisors recognizes that commercial massage therapy is a professional pursuit which can offer the public valuable health and therapeutic services. The Board of Supervisors further recognizes that, unless properly regulated, the practice of massage therapy and

the operation of massage businesses may be associated with unlawful activity and pose a threat to the quality of life in the local community. Accordingly, it is the purpose and intent of this chapter to protect the public health, safety, and welfare by providing for the orderly regulation of businesses providing massage therapy services, discouraging prostitution and related illegal activities carried on under the guise of massage therapy, and establishing certain sanitation, health, and operational standards for massage businesses.

(b) Furthermore, it is the purpose and intent of this chapter to address the negative impacts identified in the Board of Supervisor's findings to reduce or prevent neighborhood blight and to protect and preserve the quality of the County neighborhoods and commercial districts; and to enhance enforcement of criminal statutes relating to the conduct of operators and employees of massage businesses.

(c) It is the Board's further purpose and intent to rely upon the uniform statewide regulations applicable to massage practitioners and establishments that were enacted by the State Legislature in 2008 as Business and Professions Code sections 4600 *et seq.* by Senate Bill 731, and amended in 2011 by Assembly Bill 619, to restrict the commercial practice of massage in the unincorporated areas of San Mateo County to those persons duly certified to practice by the California Massage Therapy Council, and to provide for the registration and regulation of massage businesses for health and safety purposes to the extent allowed by law.

5.44.020 DEFINITIONS.

For the purposes of this chapter, unless the particular provision or the context otherwise clearly requires, the definitions in this section shall govern the construction, meaning, and application of words and phrases used in this chapter:

(a) “Business” includes, but not by way of limitation, everything about which a person can be employed, and means that which occupies the time, attention, and labor of men and women for the purpose of producing a livelihood or profit, and connotes the efforts of men and women by varied and diverse methods of dealing with each other, to improve their individual economic conditions, and for the purposes of this chapter shall include, without limitation, the advertising and soliciting of massages. The term “business” includes, but is not limited to, a massage practitioner who is the sole owner, operator and employee of a massage business operating as a sole proprietorship, as well as a massage establishment which employs massage practitioners.

(b) “California Massage Therapy Council” or “CAMTC” means the Massage Therapy Organization formed pursuant to Business and Professions Code section 4600.5.

(c) “Certified Massage Practitioner” means any individual certified by the California Massage Therapy Council as a Certified Massage Therapist or as a Certified Massage Practitioner pursuant to California Business and Professions Code sections 4600 *et seq*.

(d) “Client” means the customer or patron who pays for or receives massage services.

(e) “Compensation” means the payment, loan, advance, donation, contribution, deposit, exchange, or gift of money or anything of value.

(f) “County Registration Certificate” means a registration certificate issued by the Director of Environmental Health upon submission of satisfactory evidence that a massage business employs or uses only certified massage practitioners pursuant to this Chapter.

(g) “Director of Environmental Health” means the Director of Environmental Health of San Mateo County and his or her authorized representatives or designees.

(h) “Employee” means any person employed by a massage business who may render any service to the business, and who receives any form of compensation from the business.

(i) “Health Officer” means the person appointed by the San Mateo County Board of Supervisors pursuant to the California Health and Safety Code or his or her authorized representatives or designees.

(j) “License Board” means the License Board of the County of San Mateo as it is defined and constituted in Chapter 5.04 of the San Mateo County Code.

(k) “Massage” or “massage therapy,” means and refers to any method of treating the external parts of the body for remedial, health, or hygienic purposes for any form of compensation by means of pressure on or friction against, or stroking, kneading, rubbing, tapping, pounding, or stimulating the external parts of the body, with or without the aid of any mechanical or electrical

apparatus or appliances; or with or without supplementary aids, such as rubbing alcohol, liniments, antiseptics, oils, powders, creams, lotions, ointments, or other similar preparations commonly used in this practice; or by baths, including but not limited to Turkish, Russian, Swedish, Japanese, vapor, shower, electric tub, sponge, mineral, fomentation, or any other type of bath.

(l) "Massage business" means any business that offers massage therapy in exchange for compensation, whether at a fixed place of business or at a location designated by the customer or client through outcall massage services. Any business that offers any combination of massage therapy and bath facilities – including, but not limited to, showers, baths, wet and dry heat rooms, pools and hot tubs – shall be deemed a massage business under this chapter. The term "massage business" includes a certified massage practitioner who is the sole owner, operator and employee of a massage business operating as a sole proprietorship.

(m) "Operator" or "massage business operator" means any and all owners of a massage business.

(n) "Outcall massage" means the engaging in or carrying on of massage therapy for compensation in a location other than the business operations address set forth in the massage business's county registration certificate.

(o) "Owner" or "Massage business owner" means any of the following persons:

(1) Any person who is a general partner of a general or limited

partnership that owns a massage business.

(2) Any person who has a five percent (5%) or greater ownership interest in a corporation that owns a massage business.

(3) Any person who is a member of a limited liability company that owns a massage business.

(4) Any person who has a five percent (5%) or greater ownership interest in any other type of business association that owns a massage business.

(p) “Person” means any individual, firm, association, partnership, corporation, joint venture, limited liability company, or combination of individuals.

(q) “Practitioner” or “Massage Practitioner” shall be used interchangeably and mean any person who administers massage to another person, for any form of consideration (whether for the massage, as part of other services or a product, or otherwise).

(r) “Reception and waiting area” means an area immediately inside the front door of the massage business dedicated to the reception and waiting of patrons of the massage business and visitors, and which is not a massage therapy room or otherwise used for the provision of massage therapy services.

(s) “Registration” means the registration required by this Chapter to operate a massage business.

(t) “School of massage” means any school or institution of learning that is recognized as an approved school pursuant to Business and Professions Code Division 2, Chapter 10.5, as currently drafted or as may be amended.

(u) “Sheriff” means the Sheriff of San Mateo County and his or her authorized representatives or designees.

(v) “Sole proprietorship” means and includes any legal form of business organization where the business owner (sometimes referred to as the “sole proprietor”) is the only person employed by that business to provide massage services.

(w) “Solicit” means to request, ask, demand or otherwise arrange for the provision of services.

5.44.030 CAMTC CERTIFICATION AND LOCAL REGISTRATION REQUIRED

(a) Individuals. On and after July 1, 2012, it shall be unlawful for any individual to practice massage therapy for compensation as a sole proprietorship or employee of a massage business or in any other capacity within the unincorporated areas of San Mateo County unless that individual is a certified massage practitioner.

(b) Businesses. On and after July 1, 2012, it shall be unlawful for any business to provide massage for compensation within the unincorporated areas of San Mateo County unless all individuals employed by the massage business to perform massage, whether as an employee, independent contractor, or sole proprietorship, are certified massage practitioners and said business has obtained a valid county registration certificate as provided in this Chapter.

5.44.040 MASSAGE BUSINESS REGISTRATION

(a) Application. The registration application for a County Registration Certificate shall include all of the following:

(1) Legal name of the massage business.

(2) Address and telephone number of the massage business.

(3) Legal names of all owners of the massage business.

(4) A list of all of the massage business's employees and independent contractors who are performing massage and their CAMTC certification.

(5) Residence address and telephone number of all owners of the massage business.

(6) Business address and telephone number of all owners of the massage business.

(7) The form of business under which the massage business will be operating (*i.e.*, corporation, general or limited partnership, limited liability company, or other form).

(8) Each owner or operator of the massage business who is not a CAMTC-certified massage practitioner shall submit an application for a background check, including the following: the individual's business, occupation, and employment history for the five (5) years preceding the date of the application; the inclusive dates of such employment history; the name and address of any massage business or similar business owned or operated by the individual whether inside or outside the County.

(9) For all owners, a valid and current driver's license and/or identification issued by a state or federal governmental agency or other photographic identification bearing a bona fide seal by a foreign government.

(10) For all owners, a signed statement that all of the information contained in the application is true and correct; that all owners shall be responsible for the conduct of the business's employees or independent contractors providing massage services; and acknowledging that failure to comply with the California Business and Professions Code section 4600 *et seq*., any local, state, or federal law, or the provisions of this Chapter may result in revocation of the business's County registration certificate.

(b) Issuance. Upon provision by the massage business of the foregoing documentation, the Director of Environmental Health shall issue the massage business a County Registration Certificate, which shall be valid for two (2) years from the date of issuance. No reapplication will be accepted within one (1) year after an application or renewal is denied or a certificate is revoked.

(c) Amendment. A massage business shall apply to the county to amend its county registration certificate within thirty (30) days after any change in the registration information, including, but not limited to, the hiring or termination of certified massage practitioners or the change of the business's address.

(d) Renewal. A massage business shall apply to the County to renew its County registration certificate at least thirty (30) days prior to the expiration of said County registration certificate. If an application for renewal of a County registration certificate and all required information is not timely received and the certificate expires, no right or privilege to provide massage shall exist.

(e) Fees. There shall be no fee for the registration application or certificate, or any amendment or renewal thereof. The provisions of this section

shall not prevent the County from establishing fees for health and safety inspections as may be conducted from time to time by the Director of Environmental Health, and for the background checks, fingerprinting, and subsequent arrest notification for owners of a massage businesses who are not CAMTC-certified and who are subject to such background checks pursuant to this Chapter.

(f) Transfer. A County Registration Certificate shall not be transferred except with the prior written approval of the Director of Environmental Health. A written request for such transfer shall contain the same information for the new ownership as is required for applications for registration pursuant to this section. In the event of denial, notification of the denial and reasons therefore shall be provided in writing and shall be provided to the applicant by personal delivery or by registered or certified mail.

5.44.050 OPERATING REQUIREMENTS.

On or after July 1, 2012, no person shall engage in, conduct, carry on, or permit any massage within the unincorporated areas of the County of San Mateo unless all of the following requirements are met:

(a) CAMTC-certification shall be worn by and clearly visible on the massage practitioner's person during working hours and at all times when the massage practitioner is inside a massage business or providing outcall massage.

(b) Massage shall be provided or given only between the hours of 7:00 a.m. and 9:00 p.m. No massage business shall be open and no massage shall be provided between 9:00 p.m. and 7:00 a.m. A massage commenced prior to

9:00 p.m. shall nevertheless terminate at 9:00 p.m., and, in the case of a massage business, all clients shall exit the premises at that time. It is the obligation of the massage business, to inform clients of the requirement that services must cease at 9:00 p.m.

(c) A list of the services available and the cost of such services shall be posted in the reception area within the massage premises, and shall be described in readily understandable language. Outcall service providers shall provide such a list to clients in advance of performing any service. No owner, manager, operator, or responsible managing employee shall permit, and no massage practitioner shall offer or perform, any service other than those posted or listed as required herein, nor shall an operator or a massage practitioner request or charge a fee for service other than that on the list of services.

(d) A copy of the CAMTC certificate of each and every massage practitioner employed in the business shall be displayed in the reception area or similar open public place on the premises.

(e) For each massage service provided, every massage business shall keep a complete and legible written record of the following information: the date and hour that service was provided; the service received; the name or initials of the employee entering the information; and the name of the massage practitioner administering the service. Such records shall be open to inspection and copying by the Sheriff, or other County officials charged with enforcement of this chapter. These records may not be used by any massage practitioner or operator for any purpose other than as records of service provided and may not be provided to

other parties by the massage practitioner or operator unless otherwise required by law. Such records shall be retained on the premises of the massage business for a period of two (2) years.

(f) Massage businesses shall at all times be equipped with an adequate supply of clean sanitary towels, coverings, and linens. Clean towels, coverings, and linens shall be stored in enclosed cabinets. Towels and linens shall not be used on more than one (1) client, unless they have first been laundered and disinfected. Disposable towels and coverings shall not be used on more than one (1) client. Soiled linens and paper towels shall be deposited in separate, approved receptacles.

(g) Wet and dry heat rooms, steam or vapor rooms or cabinets, toilet rooms, shower and bath rooms, tanning booths, whirlpool baths and pools shall be thoroughly cleaned and disinfected as needed, and at least once each day the premises are open, with a disinfectant approved by the Health Officer. Bathtubs shall be thoroughly cleaned after each use with a disinfectant approved by the Health Officer of the County of San Mateo. All walls, ceilings, floors, and other physical facilities for the business must be in good repair, and maintained in a clean and sanitary condition.

(h) Instruments utilized in performing massage shall not be used on more than one (1) client unless they have been sterilized, using approved sterilization methods.

(i) All massage business operators and their employees, including massage practitioners, shall wear clean, non-transparent outer garments. Said

garments shall not expose their genitals, pubic areas, buttocks, or chest, and shall not be worn in such manner as to expose the genitals, pubic areas, buttocks, or chest.

(j) No person shall enter, be, or remain in any part of a massage business while in possession of an open container of alcohol, or consuming or using any alcoholic beverage or drugs except pursuant to a prescription for such drugs. The owner, operator, responsible managing employee, or manager shall not permit any such person to enter or remain upon such premises.

(k) No massage business shall operate as a school of massage, or use the same facilities as that of a school of massage.

(l) No massage business shall place, publish or distribute, or cause to be placed, published or distributed any advertising matter that depicts any portion of the human body that would reasonably suggest to prospective clients that any service is available other than those services listed as an available service pursuant to section 5.44.050(c), nor shall any massage business employ language in the text of such advertising that would reasonably suggest to a prospective client that any service is available other than those services as described in compliance with the provisions of this chapter.

(m) No massage shall be given unless the client's genitals are, at all times, fully covered. A practitioner shall not, in the course of administering any massage, make physical contact with the genitals or private parts of any other person.

(n) Where the business has staff available to assure security for clients

and massage staff behind closed doors, the entry to the reception area of the massage business shall remain unlocked during business hours when the business is open for business or when clients are present.

(o) No massage business located in a building or structure with exterior windows fronting a public street, highway, walkway, or parking area shall block visibility into the interior reception and waiting area through the use of curtains, closed blinds, tints, or any other material that obstructs, blurs, or unreasonably darkens the view into the premises.

(p) All signs shall be in conformance with the current ordinances of the County of San Mateo.

(q) Minimum lighting consisting of at least one (1) artificial light of not less than forty (40) watts shall be provided and shall be operating in each room or enclosure where massage services are being performed on clients, and in all areas where clients are present.

(r) Ventilation shall be provided in accordance with applicable building codes and regulations.

(s) Hot and cold running water shall be provided at all times.

(t) Adequate dressing, locker and toilet facilities shall be provided for clients.

(u) A minimum of one (1) wash basin for employees shall be provided at all times. The basin shall be located within or as close as practicable to the area devoted to performing of massage services. Sanitary towels shall also be provided at each basin.

(v) Pads used on massage tables shall be covered with material acceptable to the Health Officer of the County of San Mateo.

(w) All massage businesses shall comply with all state and federal laws and regulations for handicapped clients.

(x) A massage practitioner shall operate only under the name specified in his or her CAMTC certificate. A massage business shall operate only under the name specified in its county registration certificate.

5.44.060 INSPECTION BY OFFICIALS.

The investigating and enforcing officials of the County of San Mateo, including but not limited to the Sheriff, Health Officer, Director of Environmental Health, and Director of Building and Planning for the County of San Mateo, or their designees, shall have the right to enter the premises from time to time during regular business hours for the purpose of making reasonable inspections to observe and enforce compliance with building, fire, electrical, plumbing or health regulations, and to enforce compliance with applicable regulations, laws, and statutes, and with the provisions of this chapter. The Environmental Health Services Division may charge a fee for any health and safety inspections, as provided in Chapter 5.64 of the Ordinance Code.

5.44.070 NOTIFICATIONS.

(a) A massage business shall notify the Director of Environmental Health, or his or her designee, of any changes described in Section 5.44.040 pursuant to the timelines specified therein.

(b) A registrant shall immediately report to the Director of

Environmental Health any of the following:

(1) arrests of any employees or owners of the registrant's massage business for an offense other than a misdemeanor traffic offense;

(2) resignations, terminations, or transfers of practitioners employed by the registrant's massage business;

(3) the occurrence of any event involving the registrant's massage business or the massage practitioners employed therein that constitutes a violation of this ordinance or state or federal law.

5.44.080 EXEMPTIONS.

The provisions of this chapter shall not apply to the following classes of individuals or businesses while engaged in the performance of their duties:

(a) Physicians, surgeons, chiropractors, osteopaths, nurses or any physical therapists who are duly licensed to practice their respective professions in the State of California and persons working directly under the supervision of or at the direction of such licensed persons, working at the same location as the licensed person, and administering massage services subject to review or oversight by the licensed person.

(b) Barbers and beauticians who are duly licensed under the laws of the State of California while engaging in practices within the scope of their licenses, except that this provision shall apply solely to the massaging of the neck, face and/or scalp, hands or feet of the clients.

(c) Hospitals, nursing homes, mental health facilities, or any other health facilities duly licensed by the State of California, and employees of these

licensed institutions, while acting within the scope of their employment.

(d) Accredited high schools, junior colleges, and colleges or universities whose coaches and trainers are acting within the scope of their employment.

(e) Trainers of amateur, semi-professional or professional athletes or athletic teams while engaging in their training responsibilities for and with athletes; and trainers working in conjunction with a specific athletic event.

(f) Individuals administering massages or health treatment involving massage to persons participating in single-occurrence athletic, recreational or festival events, such as health fairs, road races, track meets, triathlons and other similar events; provided, that all of the following conditions are satisfied:

(1) The massage services are made equally available to all participants in the event;

(2) The event is open to participation by the general public or a significant segment of the public such as employees of sponsoring or participating corporations;

(3) The massage services are provided at the site of the event and either during, immediately preceding or immediately following the event;

(4) The sponsors of the event have been advised of and have approved the provisions of massage services;

(5) The persons providing the massage services are not the primary sponsors of the event.

5.44.090 UNLAWFUL BUSINESS PRACTICES MAY BE ENJOINED; REMEDIES CUMULATIVE.

Any massage business operated, conducted, or maintained contrary to the provisions of this chapter shall constitute an unlawful business practice pursuant to Business & Professions Code Section 17200 *et seq*., and the County Counsel or District Attorney may, in the exercise of discretion, in addition to or in lieu of taking any other action permitted by this chapter, commence an action or actions, proceeding or proceedings in the Superior Court of San Mateo County, seeking an injunction prohibiting the unlawful business practice and/or any other remedy available at law, including but not limited to fines, attorneys' fees and costs. All remedies provided for in this chapter are cumulative.

5.44.100 ADMINISTRATIVE FINES.

(a) Violations. Upon a finding by the Sheriff that a business has violated any provision of this chapter, the Sheriff may issue an administrative fine of up to five hundred dollars ($500).

(b) Separate Violations. Each client to whom massage is provided or offered in violation of this chapter shall constitute a separate violation. Each day upon which a massage business remains open for business in violation of this chapter shall also constitute a separate violation.

(c) Fine Procedures. Notice of the fine shall be served by certified mail with the legal violation and supporting facts. The notice shall contain an advisement of the right to request a hearing before the Director of the Environmental Health Division or his or her designee contesting the imposition of the fine.

(d) Appeals. Appeals must be requested in writing, and shall provide

facts disputing the violation. Appeals must be addressed to the Director of Environmental Health, and must be received within ten (10) days of the date appearing on the notice of the fine. The decision of the Director of Environmental Health shall be provided by certified mail. The decision will constitute a final administrative order with no additional administrative right of appeal.

(e) Failure to Pay Fine. If said fine is not paid within thirty (30) days from the date appearing on the notice of the fine or of the notice of determination from the Director of Environmental Health after the appeal hearing, the fine may be referred to a collection agency within or external to the County. In addition, any outstanding fines must be paid prior to the issuance or renewal of any registration.

5.44.110 SUSPENSION AND REVOCATION OF COUNTY REGISTRATION CERTIFICATES

(a) Reasons. Certificates of registration may be suspended or revoked upon any of the following grounds:

(1) A practitioner is no longer in possession of current and valid CAMTC-certification. This subsection shall apply to a sole proprietor or a person employed or used by a massage business to provide massage.

(2) An owner or sole proprietor: is required to register under the provisions of California Penal Code section 290 (sex offender registration); is convicted of California Penal Code section 266i (pandering), 315 (keeping or residing in a house of ill-fame), 316 (keeping disorderly house), 318 (prevailing upon person to visit a place for prostitution), 647(b) (engaging in or soliciting prostitution), 653.22 (loitering with intent to commit prostitution), 653.23

(supervision of prostitute); has a business permit or license denied, revoked, restricted, or suspended by any agency, board, city, county, territory, or state; is subject to an injunction for nuisance pursuant to California Penal Code sections 11225-11235 (red light abatement); is convicted of a felony offense involving the sale of a controlled substance; is convicted of any crime involving dishonesty, fraud, deceit, violence, or moral turpitude; or is convicted in any other state of an offense which, if committed in this state, would have been punishable as one or more referenced offenses in this subdivision.

(3) The county determines that a material misrepresentation was included on the application for a certificate of registration or renewal.

(4) Violations of any of the following occurred on the premises of a massage business or were committed by a practitioner: California Business and Professions Code section 4600 *et seq*.; any local, state, or federal law; or the provisions of this chapter.

(b) Procedures. Written notice of the suspension or revocation shall be served on the sole proprietor or owners by certified mail with the legal violation and supporting facts. The notice shall contain an advisement of the right to request an appeal hearing before the License Board.

(c) Time Period of Suspension of Permit. The Sheriff may suspend a registration for a period between five (5) days and the end of the license term, at his or her discretion.

(d) Effective Date of Suspension or Revocation. Suspension or revocation issued pursuant to subsection (b) will be effective ten (10) days from

the date appearing on the order, unless a timely appeal is filed in accordance with subsection (e).

(e) Appeal.

(1) The decision of the Sheriff is appealable to the License Board.

(2) An appeal must be in writing, and be hand-delivered or mailed to the License Board.

(3) An appeal must be received by the License Board on or before the effective date of suspension or revocation provided by subsection (d).

(4) The filing of a timely appeal will stay a suspension or revocation pending a decision on the appeal by the License Board.

(5) A hearing shall be scheduled within thirty (30) days unless an extension is authorized by the appellant.

(6) The decision of the License Board shall be a final administrative order, with no further administrative right of appeal.

(f) Reapplication. No reapplication will be accepted within one (1) year after a certificate is revoked.

(g) Evidence. The following rules shall apply to any hearing required by this chapter. All parties involved shall have the right to offer testimonial, documentary, and tangible evidence bearing on the issues, to be represented by counsel, and to confront and cross-examine witnesses. Any relevant evidence may be admitted if it is the sort of evidence upon which reasonable persons are accustomed to rely in the conduct of serious affairs. Formal rules of discovery do not apply to proceedings governed by this chapter. Unless otherwise specifically

prohibited by law, the burden of proof is on the registrant in any hearing or other matter under this chapter.

5.44.120 PUBLIC NUISANCE

It shall be unlawful and a public nuisance for a massage business to be operated, conducted, or maintained contrary to the provisions of this chapter. The county may exercise its discretion, in addition to or in lieu of prosecuting a criminal action, to commence proceedings for the abatement, removal, and enjoinment of that business in any manner provided by law.

SECTION 4. Sections 5.64.050 of Chapter 5.64 (Fees for Enforcement of State Public Health Laws) of Title 5 (Business Regulations) of the San Mateo County Ordinance Code is hereby amended to add the following definition: "The term 'massage business' shall include the businesses defined in Section 5.44.020."

SECTION 5. Sections 5.64.070 of Chapter 5.64 (Fees for Enforcement of State Public Health Laws) of Title 5 (Business Regulations) of the San Mateo County Ordinance Code is hereby amended by adding the following line item fee under the heading "Solid/Medical Waste Programs": "Massage Business $420"

SECTION 6. SEVERABILITY. If any provision(s) of this ordinance is declared invalid by a court of competent jurisdiction, it is the intent of the Board of Supervisors that such invalid provision(s) be severed from the remaining provisions of the ordinance so that regulation and control of massage may remain in place.

SECTION 7. This ordinance shall be effective thirty (30) days from the date of passage thereof.

* * * * * * * *

COUNTY OF SAN MATEO
Inter-Departmental Correspondence
Health System

Date: January 6, 2014
Board Meeting Date: February 25, 2014
Special Notice / Hearing: None
Vote Required: Majority

To: Honorable Board of Supervisors

From: Greg Munks, Sheriff
Jean S. Fraser, Chief, Health System

Subject: Massage Businesses Ordinance

RECOMMENDATION:
Adoption of an ordinance amending Sections 5.44.040, 5.44.050, 5.44.070, 5.44.080, 5.44.100 and 5.44.110 of Chapter 5.44 (Massage Businesses) of Title 5 (Business Regulations) of the San Mateo County Ordinance Code, relating to the regulation of massage businesses, previously introduced on February 11, 2014 and waiver of reading the ordinance in its entirety.

BACKGROUND:
The Governor signed SB 731 on September 27, 2008, and AB 619 on August 4, 2011, which respectively adopted and amended Section 4600 et seq. of the California Business and Professions Code. The legislation was intended to protect individuals who receive massages, protect communities from prostitution and illicit activities, and facilitate legitimate massage by centralizing regulation and permitting.

Pursuant to the legislation, massage providers may voluntarily apply for and receive a certificate from the State's California Massage Therapy Council (CAMTC). Once an individual obtains a CAMTC certificate, he or she is able to practice in any city or county without being required to obtain a local license or permit. Similarly, a massage business that uses only CAMTC-certified massage practitioners is not required to obtain a separate local license or permit.

The County retains oversight of health and safety regulations by requiring registration by practitioners and businesses with the County. The County also retains the ability to require zoning restrictions, building regulations, and business licensing, as long as those regulations also affect other "professional or personal service businesses" (defined to include dentistry, medicine, chiropractors, dietitians, optometrists,

acupuncture, accounting, architecture, attorneys, engineers, geologists, funeral directors, land surveyors, real estate brokers, etc.).

In 2012 your Board adopted an amendment to the San Mateo County Massage Businesses Ordinance, which was established in response to this new legislation. The intent of this 2012 amendment was to maintain oversight over massage businesses to protect communities from prostitution and illicit activities while facilitating legitimate massage.

Having enforced the Ordinance for the past 18 months, the Sheriff's Office, the Planning and Building Department and the Health System's Environmental Health Services division have identified areas where an additional amendment to the Ordinance would further your Board's original intentions.

These revisions are not intended to address consideration of zoning changes that would possibly restrict where massage businesses can be located within the unincorporated area of the County. Staff is currently looking at the zoning issue, separate from this ordinance.

DISCUSSION:

The proposed amendment to the existing Massage Businesses Ordinance achieves the following:

- Mandates the availability of complete written service records for inspection during regular business hours.
- Clarifies the type of outer garments that must be worn.
- Clarifies lobby visibility requirements.
- Clarifies the rules governing continuances of hearings and the License Board's authority to reduce suspensions and revocations.
- Clarifies the duty to report violations of the Ordinance to the Environmental Health Director.
- Requires that appeals of fines may be resolved in writing without adversarial hearing.
- Requires that massage businesses serving or appealing a suspension, revocation and/or a fine are prevented from selling or transferring their business without first serving the suspension or revocation and/or paying the fine.
- Prohibits individuals from residing in a massage business or being unnecessarily present in the business outside of business hours.
- Exempts the San Francisco International Airport (Airport) from the Ordinance's operating time limitations, in recognition of the Airport's 24/7 operation and its minimal risk of prostitution and other related activity.

The Ordinance has been reviewed and approved by County Counsel as to form.

Adoption of this Ordinance amendment will contribute to the Shared Vision 2025 outcome of an Environmentally Conscious Community by aligning the County's

regulations with applicable State's statutes, in order to contribute to safer neighborhoods and businesses providing beneficial services to all residents. It is anticipated that the percent of massage businesses providing full access to complete written service records for inspection will increase to 100%.

PERFORMANCE MEASURE(S):

Measure	FY 2012-13 Actual	FY 2013-14 Projected
Percent of massage businesses providing full access to complete written service records for inspection	75%	100%

FISCAL IMPACT:

There is no Net County Cost associated with this Ordinance.

Labor and Employment Litigation Update

Thursday, September 13, 2018 General Session; 4:15 – 5:30 p.m.

Stacey N. Sheston, Partner, Best Best & Krieger

Notes:

BEST BEST & KRIEGER LLP
ATTORNEYS AT LAW

www.BBKlaw.com

Labor and Employment Law Update

League of California Cities

Long Beach, CA

September 13, 2018

INDIAN WELLS
IRVINE
LOS ANGELES
MANHATTAN BEACH
ONTARIO
RIVERSIDE
SACRAMENTO
SAN DIEGO
WALNUT CREEK
WASHINGTON, D.C.

Stacey Sheston
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WAGE AND HOUR

PUBLIC AGENCIES JOINTLY EMPLOYING WORKERS TOGETHER WITH PRIVATE EMPLOYERS ARE NOT SUBJECT TO CALIFORNIA OVERTIME REQUIREMENTS

Morales v. 22nd Dist. Agricultural Ass'n, 1 Cal.App.5th 504 (2018)

Defendant 22nd District Agricultural Association of the State of California (the DAA) is a California public agency that owns and manages the Del Mar Fairgrounds and the Del Mar Horsepark. Plaintiff Jose Luis Morales and a group of other seasonal employees of the DAA filed a putative class action alleging that the DAA failed to pay plaintiffs overtime compensation required by state law under Labor Code section 510 and federal law under the Fair Labor Standards Act of 1938 (29 U.S.C. § 201 et seq.) (FLSA). The trial court sustained, without leave to amend, the DAA's demurrer to plaintiffs' section 510 cause of action. After the trial court conditionally certified the case as a collective action, the DAA asserted an affirmative defense to plaintiffs' FLSA claim. Specifically, the DAA alleged that the employees were exempt from the FLSA overtime compensation requirements pursuant to a statutory exemption (29 U.S.C. § 213(a)(3)) commonly referred to as the "amusement exemption." The trial court held a jury trial on the DAA's affirmative defense to plaintiffs' FLSA claim. The jury rendered a verdict in favor of the DAA and the trial court entered a judgment in favor of the DAA. Plaintiffs timely appealed, alleging error by the trial court in sustaining DAA's demurrer to the overtime claims.

The appellate court affirmed. First, the court acknowledged that public agencies in California are not subject to the state overtime provisions in the Labor Code and Industrial Welfare Commission Wage Orders. Therefore, the court held that a public agency cannot become liable under these state law provisions simply by virtue of entering into a joint employer relationship with a private entity that is itself subject to state law.

CALIFORNIA WAGE ORDER DEFINITIONS OF "EMPLOYEE" APPLY TO DETERMINATION OF EMPLOYEE VERSUS INDEPENDENT CONTRACTOR STATUS

Dynamex Operations West, Inc. v. Superior Court, 4 Cal.5th 903 (2018)

Dynamex is a nationwide same-day courier and delivery service that offers on-demand pickup and delivery services to businesses and the public. It previously classified its California drivers as employees, but as a cost savings measure, converted its drivers to independent contractors prior to the dispute. One of those drivers filed a class action lawsuit alleging various wage and hour claims, including claims under the Industrial Welfare Commission's wage orders. If the drivers were "employees," Dynamex would be subject to various wage order obligations regarding minimum wages, maximum hours, and a number of very basic working conditions (such as meal and rest breaks). The trial court certified a class action embodying a class of Dynamex drivers deemed to have

relevant common legal and factual issues relating to their classification as employees or as independent contractors. Dynamex unsuccessfully moved to decertify the class, and then filed a writ proceeding in the court of appeal, maintaining that two of the alternative wage order definitions of "employ" relied upon by the trial court do not apply to the employee or independent contractor issue. Dynamex contended, instead, that those wage order definitions are relevant only to the distinct joint employer issue. The court of appeal rejected Dynamex's contention, and concluded that the wage order definitions applied by the trial court were applicable to the employee or independent contractor question with respect to obligations arising out of the wage order. Dynamex sought review by the California Supreme Court as to the court of appeal's conclusion that the wage order definitions of "employ" and "employer" applied to the determination employee versus independent contractor status.

The California Supreme Court unanimously affirmed, rejecting a long-standing test for determining whether workers should be classified as employees or independent contractors, in favor of a new standard that heavily favors workers being classified as employees under the California Wage Orders. The Court adopted a broad "ABC Test" that starts with the assumption that a worker is an employee, placing the burden on the employer to establish that the worker is an independent contractor by satisfying all parts of the following three part test:

A. That the worker is free from the control and direction of the hirer in connection with the performance of the work, both under the contract for the performance of such work and in fact;

B. That the worker performs work that is outside the usual course of the hiring entity's business; and

C. That the worker is customarily engaged in an independently established trade, occupation or business of the same nature as the work performed for the hiring entity.

Thus, according to the Court, a seamstress hired by a clothing manufacturer to make dresses from cloth and pattern supplied by the company is an employee, as is a decorator contracted to regularly design cakes for a bakery. On the other hand, an outside plumber hired to fix a leak in a bathroom on a one-time basis is still an independent contractor. This new test only applies to classification as an employee for purposes of the Wage Orders. Based on the Court's decision, there is no indication that it changed the tests to determine employee status under other employment statutes related to taxes, unemployment, entitlement to benefits, including workers' compensation insurance, or other state and federal laws relating to wages, hours and working conditions.

DISCRIMINATION/HARASSMENT/RETALIATION

ADMINISTRATIVE PROCEEDINGS OF THE REQUISITE JUDICIAL CHARACTER CAN RESULT IN AN ADMINISTRATIVE DECISION THAT IS BINDING IN A LATER CIVIL ACTION BROUGHT IN SUPERIOR COURT

Wassman v. South Orange County Comm. College Dist., 24 Cal.App.5th 825 (2018)

Carol E. Wassmann was terminated for cause from her employment as a tenured librarian with the South Orange County Community College District ("District") in April 2011. A five-day administrative hearing was conducted in accordance with Education Code section 87660 et seq., which governs "the evaluation of, the dismissal of, and the imposition of penalties on, community college faculty." After hearing testimony, receiving documentary evidence, and reviewing written arguments, the administrative law judge issued a 20-page decision in August 2012, upholding the District's decision and determining there was cause for dismissing Wassmann. In October 2012, Wassmann filed a petition for writ of mandate, alleging that the ALJ's findings were not supported by the weight of evidence. (Notably, she did not raise any issues regarding race discrimination, age discrimination or harassment.) The trial court denied the petition in August 2013, finding the record to be "replete with instances of repeated violations of rules, multiple conflicts with supervisors and numerous failures to perform assignments."

In December 2013, Wassmann filed a charge of race and age discrimination, as well as harassment, with the California Department of Fair Employment and Housing (DFEH). The charge named several of her former supervisors as respondents, and while it did not name the District, she later amended the charge to add two coworkers in her employee association who had represented her in her performance management and disciplinary proceedings. She requested a right-to-sue letter, and subsequently sued the District and the individuals named in the charge, alleging, among other things, claims for racial discrimination, age discrimination, and harassment in violation of the California Fair Employment and Housing Act (FEHA) (Gov. Code, § 12900 et seq.), and for intentional infliction of emotional distress. The trial court granted motions for summary judgment on the ground the FEHA claims were barred by res judicata, collateral estoppel, or failure to exhaust administrative remedies, and the intentional infliction of emotional distress cause of action was barred by res judicata, collateral estoppel, or the statute of limitations. Wassmann appealed.

The court of appeal affirmed. The process required under the Education Code affords an employee a robust platform of due process from which to challenge adverse employment actions, concluding with an evidentiary hearing before an administrative law judge. The ALJ's determination is then subject to judicial review via petition for writ of mandate, where the trial court exercises independent judgment on the evidence. Where these sorts of administrative proceedings possess the requisite judicial character, the resulting administrative decision is binding in a later civil action brought in superior court. *See, e.g., Runyon v. Board of Trustees*, 48 Cal.4th 760 (2010); *Johnson v. City of Loma Linda*, 24 Cal.4th 61 (76). The appellate court here determined that Wassermann's unsuccessful challenge to the ALJ's decision had preclusive effect under principles of res judicata and

collateral estoppel. Wassmann could have challenged the District's action "on any ground" (both from the outset and in her writ petition), but failed to raise concerns about discrimination or harassment, and thus she failed to exhaust her administrative remedy. The appellate court also found her claims time-barred, given that the latest date of any potential discriminatory or harassing conduct would have been her termination date in April 2011. Neither her one-year DFEH deadline, nor the two-year statute of limitations on her IIED claim, were tolled during her pursuit of administrative remedies with the District. Thus her subsequent DFEH charge and lawsuit in December 2013 were untimely.

THE 90-DAY PERIOD FOR FILING A CIVIL ACTION BEGINS WHEN A CLAIMANT IS GIVEN NOTICE OF THE RIGHT TO SUE BY THE EQUAL EMPLOYMENT OPPORTUNITY COMMISSION

Scott v. Gino Morena Enters., 888 F3d 1101 (9th Cir. 2018)

Scott began working for Gino Morena Enterprises ("GME") in April 2011 at a barbershop located on the United States Marine Corps Base Camp Pendleton. There she was responsible for providing customers with haircuts and selling hair products. She alleged that two female GME managers sexually harassed and retaliated against her by treating her poorly for declining their advances. On November 13, 2013, while still employed by GME, Scott filed a charge with the California Department of Fair Employment and Housing ("DFEH"). Six days later, the DFEH transferred the duty to investigate Scott's charge to the EEOC (pursuant to a work sharing agreement between the DFEH and the EEOC) and issued her a right-to-sue letter on November 25, 2013. The DFEH letter explained that: (1) a civil action under California's Fair Employment and Housing Act (the "FEHA") "must be filed within one year from the date of this letter"; (2) Scott's DFEH charge "is dual filed with the [EEOC]" and Scott "ha[s] a right to request EEOC to perform a substantial weight review of [DFEH's] findings . . . within fifteen (15) days of . . . receipt of this notice"; (3) "[a]lthough DFEH has concluded that the evidence and information did not support a finding that a violation occurred, the allegations and conduct at issue may be in violation of other laws"; and (4) Scott "should consult an attorney as soon as possible regarding any other options and/or recourse [she] may have regarding the underlying acts or conduct."

Scott alleged that on December 22, 2013, after being issued a warning letter by one of the managers, she decided to quit. On October 15, 2014, Scott spoke with someone at the EEOC, who confirmed that Scott's complaint was being processed and gave her a claim number. She filed a second charge with the DFEH on November 17, 2014. The second charge recounted the allegations leading to her first DFEH charge, and then additionally stated that she had been constructively discharged due to the intolerable harassment by her managers. Scott received a second DFEH right-to-sue letter on the same date she filed the second charge. The letter stated that Scott's case was being closed because an immediate right-to-sue notice was requested and that the DFEH would take no further action on the charge. The letter also stated: "To obtain a federal Right to Sue notice, you must visit the U.S. Equal Employment Opportunity Commission (EEOC) to file a

complaint within 30 days of receipt of this DFEH Notice of Case Closure or within 300 days of the alleged discriminatory act, whichever is earlier."

On November 20, 2014, Scott filed a complaint in the Orange County Superior Court asserting FEHA claims, and GME moved the case to federal court. In mid-2015, Scott requested, and obtained, a right-to-sue notice from the EEOC (associated with her first administrative charge). That notice, which was issued on June 3, 2015, stated that "[m]ore than 180 days have passed since the filing of this charge" and "[t]he EEOC is terminating its processing of this charge." Id. The notice also stated that Scott's "lawsuit under Title VII . . . must be filed in a federal or state court WITHIN 90 DAYS of . . . receipt of this notice; or [the] right to sue based on this charge will be lost." Scott then amended her complaint to assert only federal Title VII-based discrimination and harassment claims. After the parties subsequently engaged in discovery on the issue of equitable tolling, GME filed a motion for summary judgment. The district court granted the motion, ruling that all of Scott's claims were time-barred and equitable tolling did not apply. Scott timely appealed.

The Ninth Circuit Court affirmed in part and reversed in part. Claims based on Scott's second charge were deemed untimely, as she had not obtained a federal right-to-sue letter by the earlier of 30 days of the DFEH's closure letter or 300 days of the alleged discriminatory act. As to claims based on her first charge, the dispute turned on whether the 90-day period to file a civil action begins when the plaintiff receives a right-to-sue notice from the EEOC or 180 days after the charge is filed with the EEOC, regardless of when the EEOC issues a right-to-sue notice. The panel held that, under 42 U.S.C. § 2000e-5(f)(1), the 90-day period for filing a civil action, following exhaustion of administrative remedies, begins when the aggrieved person is given notice of the right to sue by the Equal Employment Opportunity Commission, rather than when the person becomes eligible to receive a right-to-sue notice from the EEOC. Accordingly, Scott's claims based on her first administrative charge were timely. The panel further held that she could base her Title VII claims on the defendant's alleged acts occurring after she filed her first administrative charge to the extent she could show such acts were part of a single hostile work environment claim (i.e. a continuing violation).

VIABLE RETALIATION CLAIM UNDER FEHA REQUIRES DEMONSTRATION OF EMPLOYMENT ACTION REASONABLY LIKELY TO ADVERSELY AND MATERIALLY AFFECT AN EMPLOYEE'S JOB PERFORMANCE OR OPPORTUNITY FOR CAREER ADVANCEMENT

Meeks v. AutoZone, Inc., 24 Cal.App.5th 855 (2018)

Meeks was hired at AutoZone as a customer sales representative in March 2006, and she later received a number of promotions, eventually becoming a store manager. From early in her employment, she had regular encounters with a co-worker (Fajardo) who had similarly worked his way up from service representative to store manager. Meeks claimed Fajardo regularly subjected her to sexual harassment in various forms, both while she was a customer sales representative and after she was promoted into management. Meeks alleged that: he would comment on her body and clothes; he would

ask her to go out with him, or more directly suggest that they have sex; he would send her text messages with sexual content, including images and video, and he forcibly attempted to kiss her three times, succeeding once in pressing his lips to hers. She claimed he also suggested that he could facilitate her advancement and promotion within AutoZone, through his position as one of the "favorites" of the district manager (and their supervisor in common), Ledesma. He also told Meeks that he would get her fired if she reported his conduct.

Meeks first reported Fajardo's conduct to AutoZone in October 2009. According to Meeks, Ledesma told her that when she talked to Fajardo about it, he had "just kind of laughed it off and said, 'Oh, it was all a misunderstanding. It's a joke. It's no big deal.'" Meeks testified that Ledesma told her that she (Meeks) should "just squash it," because Ledesma did not want to "lose three managers" (referring to Meeks, Meeks' husband, who was also an AutoZone employee, and Fajardo). She instructed Meeks to tell the investigator from the human resources department that "everything had been taken care of." Meeks further testified that Ledesma threatened to fire Meeks and her husband if Meeks took her complaints higher. Meeks sued AutoZone and Fajardo, alleging sexual harassment, failure to prevent sexual harassment, and retaliation. The trial court granted summary adjudication in favor of AutoZone on the retaliation claim. The jury returned defense verdicts on the remaining claims, and Meeks appealed, arguing (a) that certain evidentiary rulings at trial constitute prejudicial error, requiring reversal, and (b) that the summary adjudication on her retaliation claim was erroneous.

The appellate court reversed on the evidentiary claims (exclusion of various types of evidence deemed prejudicial) and remanded for a new trial. However, the court upheld summary adjudication of the retaliation claim because there was no evidence of adverse action following her complaint. The term "adverse employment acts" encompasses not only 'ultimate' employment actions, such as hiring, firing, demotion or failure to promote," but also "the entire spectrum of employment actions that are reasonably likely to adversely and materially affect an employee's job performance or opportunity for career advancement." (*Jones v. Department of Corrections & Rehabilitation* 152 Cal. App. 4th 1367, 1380-1381 (2007). On the other hand, minor or relatively trivial adverse actions or conduct by employers or fellow employees that, from an objective perspective, are reasonably likely to do no more than anger or upset an employee and cannot properly be viewed as materially affecting the terms, conditions, or privileges of employment and are not actionable. Meeks continued to be employed at AutoZone, experienced no loss or reduction in her classification, position, salary, benefits and work hours; and her employment was not terminated. She did not contend she suffered working conditions so intolerable or aggravated as to constitute constructive discharge, that her performance evaluations suffered, or that she was ever denied any promotion or assignment that might have led to promotion. Meeks testified that Ledesma threatened her with an adverse employment action – to fire her and her husband, if she did not "squash" her complaint about Fajardo – but there is no evidence that the threat was carried out.

MISLEADING AN APPLICANT TO BELIEVE THAT NO EMPLOYMENT OPENING EXISTS CAN BE SUFFICIENT EVIDENCE OF INTENTIONAL PREGNANCY DISCRIMINATION TO DEFEAT SUMMARY JUDGMENT ON A FEHA CLAIM

Abed v. Western Dental Servs., Inc., 23 Cal. App. 5th 726 (2018)

Western Dental operates dental offices and clinics throughout California, including one in Napa. The company accepts student externs from schools that have dental assistant programs. Western Dental had a practice of posting job openings for a dental assistant on its website, both to solicit applications for current openings and to create a pool of candidates for positions to be filled in the future. In March 2015, an open requisition for a dental assistant in the Napa office was approved, and a solicitation for applications was publicly posted. Abed obtained an externship in Western Dental's office in Napa, the city where she wanted to live, and she began on May 18, 2015. At the time, she was pregnant, which she did not disclose to anyone at Western Dental. The managing dentist, Dr. Andrew Rivamonte, told her to treat the externship as "a four-to six-week working interview" and try to learn as much as possible because historically such externs were ultimately hired on full-time.

At some point during her externship, Abed hung her purse in the employee break room. The purse was partially open and it contained a bottle of prenatal vitamins. Abed's supervisor, Strickling, saw them and asked whose they were, and another coworker indicated the purse was Abed's. Strickling later told another dental assistant (DeHaro) she thought Abed may be pregnant, and DeHaro said something to the effect that "if [Abed] were pregnant, it would not be convenient for the office." Abed later testified that she overheard a conversation about her pregnancy between Strickling and DeHaro. According to Abed, Strickling said, "[W]ell, if she's pregnant, I don't want to hire her." Strickling testified that approximately two weeks after the discovery of Abed's pregnancy, her supervisor asked Strickling to tell Abed there were no open positions for a dental assistant in Napa, but that there was one in Vacaville. Abed did not apply for a position in the Napa office because Strickling had told her there were no openings there. But before her externship was over, Abed learned that an opening in the Napa office was posted on Western Dental's website.

Abed completed her externship June 20, 2015. Less than a week later, a recruiter emailed Western a form for an extern candidate who could start July 6, and in late July, Western Dental extend her an offer to become a dental assistant in the Napa office. Shortly afterward, that candidate was hired for the position created by the open requisition approved the previous March. Abed filed an action in September 2015, bringing claims for pregnancy discrimination under the FEHA and invasion of privacy. Western Dental successfully moved for summary judgment, arguing that Abed's failure to apply for a position was dispositive.

On appeal, the court reversed. In most cases alleging a failure to hire for discriminatory reasons, the prima facie case includes a showing that the plaintiff applied for the job. However, Abed was not required to show that she submitted an application because

Western Dental falsely telling her no position was available (and thereby causing her not to apply for one) was sufficient evidence of intentional pregnancy discrimination.

PUBLIC AGENCY

NON-CONSENTING PUBLIC EMPLOYEES CANNOT BE REQUIRED TO PAY AGENCY FEES TO UNION REPRESENTING THEIR BARGAINING UNIT

Janus v. American Federation of State, County and Muni. Employees, 585 U.S. ___ , 138 S.Ct. 2448 (2018)

Janus, a public sector employee in Illinois, challenged on First Amendment grounds an Illinois statute that required employees who choose not to join the union to still pay an "agency fee" (here, 78% of full membership fees) that covers the union's cost of representing employees during negotiations and other related matters. Janus claimed that the distinction between an agency fee designed to cover the costs of negotiations and additional amounts designed to cover political and ideological projects was irrelevant because the issues the union advanced in negotiations were also political and ideological. The trial court granted the union's motion to dismiss, and the Seventh Circuit Court of appeal affirmed based on *Abood* v. *Detroit Bd. of Ed.*, 431 U. S. 209 (1977). *Abood* had held that a permissible agency fee may cover union expenditures attributable to those activities "germane" to the union's collective – bargaining activities (chargeable expenditures), but may not cover the union's political and ideological projects (nonchargeable expenditures).

The Supreme Court agreed with Mr. Janus. In a 5-4 decision, the Court found that forcing employees to endorse ideas and positions they believed to be objectionable violated their First Amendment right to free speech. In that regard, positions advanced by a union in negotiations often dealt with import issues of public concern, like the public agency's budget, taxes, the level of services provided and how to prioritize competing issues of public concern. The Court also determined that the union's justifications for agency fees, that they promote labor peace and avoid the "free rider" risk where employees can enjoy the benefits of collective bargaining without having to pay their fair share of the costs, were insufficient to justify the intrusion those fees imposed on the employees' free speech rights.

Accordingly, the Court ruled that public sector employers and their unions could no longer require non-consenting employees to pay an agency fee. Specifically, "neither an agency fee nor any other payment to the union may be deducted from a nonmember's wages, nor may any other attempt be made to collect such a payment, unless the employee affirmatively consents to pay." In California, the adoption of SB 866 nearly simultaneously with the Court's ruling further impacts how agency employers may communicate with their employees about the *Janus* impacts.

UNIONIZED PUBLIC AGENCY EMPLOYEES HAVE RIGHT TO USE EMPLOYER EMAIL SYSTEMS FOR COMMUNICATIONS REGARDING WORKING CONDITIONS

Napa Valley Comm. Coll. Dist., PERB Dec. No. 2563-E (May 25, 2018)

On September 9, 2015, the Napa Valley College Faculty Association (Association) President sent an e-mail to all full-time and part-time faculty reminding them of an Association meeting scheduled for the following day. A part-time faculty member replied to all stating that adjunct instructors should get paid on the same salary scale as full-time instructors and arguing that an increase in adjunct faculty pay would not require more money from taxpayers, but a more equal distribution between full-time and adjunct faculty. Part-time adjunct instructor Eric Moberg later responded to all faculty, suggesting: "How about we take some money from the bloated Pentagon budget that funds death and destruction instead of education and enlightenment."

Another faculty member (Shea) responded directly to Moberg that, as the mother of a soldier killed in Iraq, she was disturbed by Moberg's e-mail. Shea also sent her message to Department Chair, the Dean of Human Resources, and the Vice President of Instruction. Subsequent emails from administration said that issues of compensation and working conditions should be brought to the leadership of the Faculty Association since that body is the official representative of the faculty. The Association President replied soon after, cancelling the Association meeting and stating that the chain of emails using the employer's system was not sanctioned by the Faculty Association and would not be considered the work of the Association. Moberg filed a grievance, which was rejected. Later his offer to teach in the following spring term was revoked on grounds that he had misrepresented information on his application for employment.

Moberg filed an unfair labor practice charge with PERB alleging that his offer had been revoked in retaliation for the protected organizing activity he had engaged in using the college's email system. The Office of General Counsel dismissed the charge, finding that the use of the email system had not constituted protected activity that could support a retaliation charge.

The Board disagreed and adopted the stance of the National Labor Relations Board's *Purple Communications* decision from 2014. In that case, the NLRB had ruled that, because e-mail "has effectively become a 'natural gathering place,' pervasively used for employee-to-employee conversations," private sector unionized employees must be permitted to use employer e-mail systems to engage in organizing activities during non-working hours PERB actually extended *Purple Communications*, finding that California's labor relations statutes provide even greater protections for public employees. PERB held that "employees who have rightful access to their employer's e-mail system in the course of their work have a right to use the e-mail system to engage in EERA protected communications on nonworking time." An employer may only rebut this presumption by demonstrating "special circumstances" to justify restricting its employees' rights. The same rule would apply under similar California labor statutes including the Meyers-Milias-Brown Act.

THE CALPERS BOARD MUST ADJUDICATE ADMINISTRATIVE APPEALS OF THE CALPERS EXECUTIVE OFFICE'S INTERPRETATIONS OF PEPRA BEFORE JUDICIAL REVIEW CAN BE SOUGHT

Public Employees' Retirement System v. Santa Clara Valley Transp. Auth., 23 Cal. App. 5th 1040 (2018)

When the California Legislature enacted the California Public Employees' Pension Reform Act of 2013 (PEPRA) (Gov't Code § 7522 et seq.), the federal government disputed the application of the PEPRA to transit workers as an interference with federal law, and sought to withhold transportation grants. In response, the Legislature enacted section 7522.02(a)(3) as an urgency measure in October 2013, exempting transit workers from the PEPRA until January 1, 2015, or until there was a federal district court ruling that the PEPRA did not interfere with federal law, whichever came first. The State of California also sued the federal Department of Labor in a federal district court, obtaining summary judgment in its behalf. Soon thereafter, the CalPERS executive office announced in a circular letter that the exemption in section 7522.02(a)(3) had expired by its own terms. Under the circular letter, the CalPERS executive office would treat all transit workers hired between January 1, 2013, and December 29, 2014, as accruing benefits under the old system during that period, and thereafter accruing the new limited PEPRA pension benefits starting on December 30, 2014 (along with those hired on or after Dec. 30).

Over 400 of transit employees filed administrative appeals challenging the administrative action and interpretation of PEPRA. Several employee associations raised the same challenges on behalf of their members, and the Santa Clara Valley Transit Authority (Santa Clara VTA) also filed an administrative appeal on behalf of its employees. The CalPERS Board did not conduct administrative hearings, but instead, the CalPERS executive office simply sought a judicial declaration that its interpretation of the effect of the statutory temporary exemption was correct. Santa Clara VTA demurred on the basis of CalPERS' failure to exhaust the administrative remedy to which it was entitled under the CalPERS regulations, and the trial court agreed. It concluded the CalPERS executive office could not disregard the CalPERS regulations giving an entitlement to an appeal to the CalPERS board, and that the CalPERS executive office had failed to establish that the CalPERS board would adhere to the executive office's statutory interpretation.

On appeal, the court affirmed, holding that the CalPERS executive office has a prescribed administrative route for enforcing its interpretation of section 7522.02(a)(3) against transit workers hired in 2013 and 2014. That route is through an appeal to the CalPERS Board to adjudicate a precedential administrative opinion either upholding or rejecting it, after a review by an independent hearing officer from the Office of Administrative Hearings (§ 11502). Then that ruling can be applied in the remainder of the pending appeals. But until the CalPERS executive office completes that process, the appellate court held that the "doors of the courthouse are closed to it" because there is no jurisdiction in the trial court to award declaratory relief regardless of which party prematurely sought it.

STATE LAW RESTRICTIONS PRECLUDE USE OF WIRETAP RECORDINGS IN ADMINISTRATIVE PROCEEDINGS ABSENT COURT ORDER

County of Los Angeles v. Los Angeles County Civil Serv., 22 Cal. App. 5th 473 (2018)

Arellano was hired by the Sheriff's Department in 1989. He later joined the Narcotics Unit. In March 2009, the high intensity drug trafficking area (HIDTA) task force began investigating Arellano to determine if he was engaged in any criminal activity. In April 2009, HIDTA obtained several court-ordered state wiretaps, and among the intercepted calls were 26 calls discussing illegal narcotics activity. Two of the calls were believed to involve Arellano. On June 25, 2009, the Sheriff's Department Internal Criminal Investigations Bureau (ICIB) opened a criminal investigation into Arellano. On November 30, 2009, while the ICIB investigation proceeded, the District Attorney moved the court for an order releasing wiretap recordings, and transcripts of those recordings, to the Sheriff's Department for use against Arellano. The application further stated that the "evidence derived therefrom [the intercepted recordings] are relevant to an internal investigation by the Los Angeles County Sheriff Department." The judge signed an order authorizing the disclosure of those records pursuant to the application for use in the investigation. After the ICIB closed its investigation without filing criminal charges, the matter was referred to the Sheriff's Department Internal Affairs Bureau (IAB) based on Arellano's alleged violations of multiple departmental policies. The IAB began its investigation in August 2010 and ended it a year later. As part of the IAB investigation, the Sheriff's Department had access to the wiretapped calls. In August 2011, the Sheriff's Department issued its notice of intent to discharge Arellano from his position of Deputy Sheriff, and a final notice of termination followed. During a subsequent appeal hearing before the civil service commission, Arellano moved to suppress the wiretapped calls. The hearing officer granted the motion after finding that the court order permitting the wiretap evidence to be released did not expressly provide that the evidence could be used for administrative purposes. He ultimately recommended that Arellano only receive a five day suspension without pay, and the civil service commission adopted the recommendation. The County then filed a petition for writ of administrative mandamus in superior court, which the trial court denied.

The appellate court affirmed. The court order did not authorize disclosure or use of the wiretap evidence in an administrative proceeding. Instead, the order cited Penal Code sections 629.82, subdivision (b), and 629.78, neither of which provides for disclosure or use of such evidence in an administrative proceeding. In other words, although the order permitted release of the intercepted calls to the Sheriff's Department, its cited statutory parameters limited disclosure of and testimony about the calls to a criminal court or grand jury proceeding pursuant to section 629.78. Therefore, the order did not authorize disclosure or use of the wiretap evidence in any other kind of proceeding, including an administrative hearing before the civil service commission, which could involve more public disclosure than an internal departmental investigation.

POBR STATUTE OF LIMITATIONS RUNS FROM TIME A PERSON AUTHORIZED TO INITIATE AN INVESTIGATION OF THE ALLEGATION OF MISCONDUCT LEARNS OF THE POTENTIAL MISCONDUCT.

Ochoa v. County of Kern, 22 Cal.App.5th 235 (2018)

On March 22, 2013, Deputy Chaidez heard from a complainant who accused Deputy Ochoa of having harassed her, and Chaidez submitted an interoffice memorandum documenting the allegation to Sergeant Bittle, Ochoa's superior. On March 25, 2013, Bittle received Chaidez's memorandum and "started an investigation" "to determine what the nature of the complaint was." After a few weeks of unsuccessful attempts at contact, Bittle spoke to the complainant and her brother who further explained the allegations. Bittle detailed the conversation in an April 8, 2013, interoffice memorandum to a superior. On April 9, 2013, a criminal investigation of Ochoa was initiated "for assault under color of authority and annoying/molesting a child under the age of 18 years old." On May 6, 2013, Chief Deputy Zimmerman signed a "Personnel Complaint" authorizing internal affairs to investigate the harassment claim against Ochoa. Over the next several months, the Department made requests of, and worked with, the District Attorney's office regarding investigation issues with potential criminal ramifications. Ultimately, the District Attorney decided not to prosecute Ochoa, the latest determination being made July 7, 2014. On August 11, 2014, the Department served Ochoa with a Notice of Proposed Termination. Following a *Skelly* hearing, Ochoa was terminated effective October 7, 2014.

Ochoa petitioned for a peremptory writ of mandate and other extraordinary relief pursuant to Code of Civil Procedure section 1085 and Government Code section 3309.5, respectively. Ochoa claimed the Department violated Government section 3304(d) by failing to complete an administrative investigation of his alleged misconduct and notify him of the proposed disciplinary action within one year of the public agency's discovery by a person authorized to initiate said investigation. The superior court denied the petition.

On appeal, the court affirmed. In the published portion of its opinion, the court concluded section 3304, subdivision (d)(1), requires the investigation to be completed within one year of the public agency's discovery by a person authorized to initiate an investigation of the allegation of misconduct. Although the sergeant could not initiate an internal affairs investigation, he was "a person authorized to initiate an investigation" of the allegation within the meaning of that statute. Therefore, the one-year limitations period commenced March 25, 2013. In the unpublished portion of the opinion, however, the court found the termination was timely because the first criminal investigation had sufficiently tolled the limitations period.

POBR STATUTE OF LIMITATIONS RUNS FROM DISCOVERY OF INFORMATION BY THOSE AUTHORIZED TO INVESTIGATE AND IS TOLLED BY PENDING CRIMINAL PROCEEDINGS

Daugherty v. City and County of San Francisco, 24 Cal.App.5th 928 (2018)

A criminal corruption investigation of officers in the San Francisco Police Department (SFPD) began in 2011 led by the United States Attorney's Office (USAO), with the assistance of select members of the criminal unit of SFPD's Internal Affairs Division (IAD-Crim). During the course of the investigation, search warrants of the cellphone records of former SFPD Sergeant Ian Furminger – the central figure in the corruption scheme – led to the discovery in about December 2012 of racist, sexist, homophobic, and anti-Semitic text messages between Furminger and nine SFPD officers. The criminal case resulted in convictions of Furminger and a codefendant for conspiracy to commit theft, conspiracy against civil rights and wire fraud. Three days after the verdict, on December 8, 2014, the text messages were released by the USAO to the administrative unit of SFPD's Internal Affairs Division (IAD-Admin). After IAD-Admin completed its investigation of the text messages, the chief of police issued disciplinary charges against respondents in April 2015.

While the disciplinary proceedings were pending, Officer Rain O. Daugherty filed a petition for writ of mandate and complaint for extraordinary relief, seeking to rescind the disciplinary charges on the grounds that they were untimely. The trial court granted the writ petition and complaint, finding the one-year statute of limitations began to accrue in December 2012 when the misconduct was discovered, and thus, the investigation of respondents' misconduct was not completed in a timely manner.

The appellate court reversed, concluding that the one-year statute of limitations did not begin to run until the text messages were released by the USAO to IAD-Admin. Before then, the alleged misconduct was not and could not be discovered by the "person[s] authorized to initiate an investigation" for purposes of Government Code section 3304, subdivision (d)(1). The court also concluded that the one-year statute of limitations would have been tolled until the verdict in the criminal corruption case because the text messages were the "subject" of the criminal investigation within the meaning of section 3304, subdivision (d)(2)(A). Thus, the April 2015 notices of discipline were timely.

GRIEVANCE CHALLENGING EMPLOYER'S LANGUAGE IN JOB POSTING THAT HAD NEVER BEEN APPLIED TO UNION APPLICANT WAS NOT RIPE FOR DETERMINATION

Metropolitan Water Dist. v. Winograd, 24 Cal.App.5th 881(2018)

AFSCME and the Metropolitan Water District ("District") were parties to two labor agreements pertaining to District employees. Some of these agreements related to recruitment and selection processes, including a defined "Employment Testing" process. In addition, the District maintained its own recruitment and selection procedures for job vacancies, under which internal applicants who met minimum requirements would be

interviewed first for any position that is part of a bargaining unit." The District's 2012 recruitment procedure publication added a procedure referred to as "comparative analysis." Pursuant to this procedure, the Hiring Manager reviews resumes and codes each candidate as: "Recommend to proceed - Invited to interview," "Possible Candidate - Hold for now (no action taken at this point)," and "Recommend Not to Proceed - (no action taken at this point)."

AFSCME filed a grievance challenging the District's use (in postings and processing) of the comparative analysis to determine who would be invited to test for vacancies. The District denied the grievance, taking the position that the term "comparative analysis" is simply another term for a "review of records," and that a review of records is a permitted "test" as set forth in the MOU. The union elevated the grievance through Levels II and III to review by a hearing officer's (Winograd). For hearing, the District and AFSCME stipulated: (1) that the grievance procedures had been followed to that point, (2) that the comparative analysis test was not applied to any union candidate, and (3) that the issue was whether the District violated the negotiated agreements by including the following language in a specific job posting: "Based on a comparative analysis, only those candidates demonstrating the strongest backgrounds will be invited to participate in a written test and oral panel interview." In its post-hearing brief, the District argued (in addition to its contract interpretation theory) that the matter was not ripe for decision, as AFSCME had not presented any evidence of harm. However, in sustaining the grievance, the hearing officer stated that the District had confirmed its intent to use a 'comparative analysis' in the future, and that, in effect, AFSCME was seeking declaratory relief.

The District successfully sought a petition for writ of administrative mandate seeking to set aside the hearing officer's decision. The trial court granted the petition on grounds that the hearing officer: (1) had granted relief on an issue that was not ripe; and (2) had exceeded the scope of the issue before him. The court of appeal agreed that the matter was not ripe and affirmed.

Ripeness typically has a two-step analysis: first, whether the issue is appropriate for immediate judicial resolution; and second, whether the complaining party will suffer a hardship from a refusal to entertain its legal challenge. Under the first test, courts will decline to adjudicate a dispute if "the abstract posture of the proceeding makes it difficult to evaluate the issues, if the court is asked to speculate on the resolution of hypothetical situations, or if the case presents a "contrived inquiry." Under the second test, courts generally will not consider issues based on speculative future harm. Applying that analysis to this case, the court found the grievance issue was framed as a question of whether the District violated the MOU in a particular job posting that had never been applied to a union applicant. Thus, under the first prong of the ripeness test, there was no actual controversy, and the hearing officer was asked to speculate on the resolution of the hypothetical situation where a union applicant, meeting minimum requirements for the position, would be subjected to the comparative analysis procedure. That the District said it would continue to apply comparative analysis in the future was deemed not to render the effect of doing so any less speculative. Further, the court noted that AFSCME would suffer no actual hardship, and that if one of its members was screened out under the

comparative analysis in the future, the union could file a grievance at that time. Finally, the court also found the hearing officer had exceeded his authority because the MOU limited his role to hearing the specified grievance. The parties had narrowed the issue to the District using the disputed language in a single job posting, but the hearing officer directed the District to cease using all forms of comparative analysis prior to an interview in future job recruitments.

INTERVIEWS WITH PEACE OFFICERS FORMERLY EMPLOYED AT FACILITY SUBJECT TO OVERSIGHT REVIEW BY THE INSPECTOR GENERAL WERE NOT "INTERROGATIONS" TRIGGERING A RIGHT OF REPRESENTATION UNDER THE POBR

Blue v. California Office of the Inspector General, 23 Cal.App.5th 138 (2018)

As a part of its typical oversight function, the Office of the Inspector General (OIG) conducted interviews with five correctional officers who previously worked at High Desert State Prison as part of an investigation into that institution's practices regarding excessive use of force against inmates and the internal reviews of such incidents. The OIG understood the Senate Rules Committee's request for an investigation as calling for a broad inquiry into policies and practices in place at High Desert State Prison and overall staff culture and attitudes at the prison. The OIG decided, in addition to reviewing facility rules and policies, to interview former High Desert State Prison staff. Current employees were seen as potentially reluctant to speak openly with OIG staff out of fear that they would be subjected to retaliation for cooperating with the review. In addition, the OIG wanted to steer clear of witnesses in parallel internal affairs investigations being conducted by the California Department of Corrections (CDCR). The OIG's process involved monitoring approximately 19 parallel IA investigations and reviewing various CDCR policies and High Desert State Prison policies, incident reports and other records. The OIG also conducted interviews with former inmates at the prison and former staff members who had transferred to another CDCR prison or were no longer state employees. In advance of such staff interviews, the OIG communicated that the former High Desert State Prison employees to be interviewed were not considered "subjects of an investigation" and would not be asked questions about ongoing investigations. At the conclusion of its review, the OIG issued a report summarizing its review of High Desert State Prison and making policy recommendations for additional training and support services and steps designed to prevent staff from serving in high stress assignments for extended periods of time. The report contained no statements indicating any of the staff interviewed had engaged in or were suspected of engaging in misconduct, nor did it even identify any names of persons interviewed.

The California Correctional Peace Officers Association (CCPOA) and several of the former High Desert staff who had been interviewed sued the OIG alleging, among other things, a violation of the officers' rights under the Peace Officers Procedural Bill of Rights. Specifically, they alleged that refusing to allow them representation at their OIG interviews violated their interrogation rights under Government Code section 3303. OIG filed an anti-SLAPP motion to strike, arguing plaintiffs' claims arose from protected activity (i.e. they challenged defendants' communicative conduct, i.e., denial of plaintiffs'

requests for representation, "made in connection with an issue under consideration or review by a legislative, executive, or judicial body, or any other official proceeding authorized by law). The trial court denied the motion, finding that although defendants carried their threshold burden of demonstrating the causes of action arose from protected activity, the plaintiffs had established a probability of prevailing on the merits of these claims.

The court of appeal reversed in part. The court agreed that defendants had carried the burden of showing the claims arose from protected activity. However, the court ruled the plaintiffs could not show a likely success on the merits of their POBR claim. None of the individual correctional officer plaintiffs who were interviewed in connection with the OIG's review of High Desert State Prison were "under investigation" for anything, let alone something "that could lead to punitive action." (Gov. Code, § 3303.) Thus even assuming their interviews could reasonably be considered "interrogation" at all, the court found they were was not the sort of interrogations focusing on matters that are likely to result in punitive action" against the officers being interviewed. The OIG was not investigating specific allegations of employee misconduct, nor would the OIG have had statutory authority to conduct such an investigation. The court reversed the portion of the trial court's order denying the anti-SLAPP motion with respect to the first and second causes of action and remanded the matter to the trial court with directions to enter a new order granting the motion in its entirety and dismissing the complaint.

Facebook vs. The First Amendment

Thursday, September 13, 2018 General Session; 4:15 – 5:30 p.m.

Traci I. Park, Partner, Burke, Williams & Sorensen, LLP
Kelly A. Trainer, Partner, Burke, Williams & Sorensen, LLP

Notes:

League of
California Cities
Annual Conference
Long Beach, California
September 13, 2018

Facebook vs. The First Amendment

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INTRODUCTION

As social media continues to permeate every aspect of culture, politics, and the workplace, the law struggles to keep up. For public agencies, social media opened up new venues for engagement with the public. While this has allowed for increased civic engagement, and a relatively low-cost way to communicate with the public, it has also provided a platform for critics and trolls. Public agencies, and public officials, at all levels of government, have struggled to moderate that on-line public engagement, which frequently includes posts, comments, or replies by members of the public that may be offensive, obnoxious, off-topic, or just plain annoying.

At times, this has led to public agencies or officials removing content posted by members of the public, or limiting their ability to engage by banning/blocking/muting individuals from their social media pages or feeds. These efforts to regulate public online speech have led to allegations of First Amendment violations, a rapidly developing area of the law. Because these issues are highly fact-sensitive, this paper will examine two recent high-profile cases addressing the application of the First Amendment to the metaphysical world of government social media.[1]

Although the cases discussed in this paper stem from the historically conservative Eastern District of Virginia and the notoriously liberal Southern District of New York, they reached similar results and set precedent from which a California federal district court or the Ninth Circuit Court of Appeals would likely draw. Both cases discussed in this paper involved efforts by public officials to regulate public speech and engagement on their social media pages by banning or blocking users, an emerging issue plaguing public entities and local officials across the nation. Similar issues have come up in the Southern District California and the Federal District of Hawaii (both of which fall within the jurisdiction of the Ninth Circuit), but did not result in judicial decisions on the merits.[2] However, it is only a matter of time until a court in

[1] Please note that this paper will not examine the complicated area of public employee free speech on social media.

[2] In *Hawaii Defense Foundation v. City & County of Honolulu* (D. Hi. 2014), the Honolulu Police Department was sued for First Amendment retaliation after it deleted comments critical of the Honolulu Police Department and banned two users from further posting on its Facebook page. The case settled while cross motions for summary judgment were pending, but the Honolulu Police Department was ordered to pay $31,000 in attorney's fees to the plaintiffs. In *Karras v. Gore* (S.D. Cal. 2014), the San Diego County Sheriff's Department deleted hundreds of critical comments from its Facebook page, resulting in a lawsuit by impacted users who sought an injunction against the Department ordering it to (1) restore the deleted posts; (2) lift the ban on the plaintiffs' ability to post and comment; and (3) prohibit the Department from removing posts from its page. Instead of fight the litigation, the Department permanently closed its Facebook page, rendering the plaintiffs' request for injunctive relief moot.

California will inevitably be called upon to address the competing interests of public speech under the First Amendment and a public official's ability to regulate public engagement on his or her social media platforms.

SUMMARY OF FIRST AMENDMENT FORUM ANALYSIS

There are three generally recognized types of fora – a traditional public forum, a designated or "limited" public forum, and a non-public forum. The type of First Amendment analysis that applies to a given statement or expression depends on the forum where the speech takes place.

Traditional Public Forum. "[T]raditional public fora are "places which by long tradition or by government fiat have been devoted to assembly and debate."[3] In a traditional public forum, "regulation of speech on government property that has traditionally been available for public expression is subject to the highest scrutiny. Such regulations survive only if they are narrowly drawn to achieve a compelling state interest." [4]

Designated and/or Limited Public Forum. "In addition to traditional public fora, a public forum may be created by government designation of a place or channel of communication for use by the public at large for assembly and speech, for use by certain speakers, or for the discussion of certain subjects."[5] There is some confusion over whether a limited public forum and a designated public forum are the same. Indeed, in many cases, the terms are used interchangeably. However, the Ninth Circuit is very clear that a limited public forum is a subcategory of designated public forum:

> The designated public forum has been the source of much confusion. As this court has put it, with considerable understatement, "The contours of the terms 'designated public forum' and 'limited public forum' have not always been clear. Some courts and commentators refer to a "designated public forum" as a "limited public forum" and use the terms interchangeably. But they are not the same, at least not in this circuit. Rather, a limited public forum is a sub-category of a designated public forum that "refer[s] to a type of nonpublic forum that the government has intentionally opened to certain groups or to certain topics. In a limited public forum, restrictions that are viewpoint neutral and reasonable in light of the purpose served by the forum are permissible.

[3] *Perry Education Ass'n v. Perry Local Educators' Ass'n,* (1983) 460 U.S. 37, 45.
[4] *Int'l Soc. for Krishna Consciousness, Inc. v. Lee* (1992) 505 U.S. 672, 678.
[5] *Cornelius v. NAACP Legal Def. & Educ. Fund, Inc.* (1985) 473 U.S. 788, 802.

> In other words, the fact that the government has opened a nonpublic forum to expressive activity does not determine whether we must apply strict scrutiny or the lower reasonableness standard. Rather, we must examine the terms on which the forum operates to determine whether it is a designated public forum or a limited public forum. If a forum is a "designated public forum," we apply strict scrutiny. But if it is merely a "limited public forum," then we apply the reasonableness test.[6]

The impact of the distinction between designated and limited public fora in the Ninth Circuit is the level of scrutiny applied. "In traditional and designated public forums, content-based restrictions on speech are prohibited, unless they satisfy strict scrutiny. In limited public forums, content-based restrictions are permissible, as long as they are reasonable and viewpoint neutral."[7]

In determining whether a forum is designated or limited, "[w]e look first to the terms of any policy the government has adopted to govern access to the forum."[8] If a policy has been adopted, then the court also looks to "how that policy has been implemented in practice."[9]

With respect to a public agency's or official's social media page or feed, if the agency or official has no policy, no posting guidelines, and permits the public to freely engage, that social media page or feed will likely be treated as a public forum, where regulation of speech would likely require strict scrutiny. If, however, the public agency or official has a policy, posting guidelines, and a clear designation as a limited public forum, it is more likely that a reviewing court will apply the reasonableness and view-point neutral standard.

Nonpublic Forum. Finally, all remaining public space that is not a public forum or a designated/limited public forum is generally classified as a nonpublic forum. In a nonpublic forum, "[t]he challenged regulation need only be reasonable, as long as the regulation is not an effort to suppress the speaker's activity due to disagreement with the speaker's view."[10]

DEVELOPING LEGAL PRECEDENT

The question of how the First Amendment applies to the use of social media by a public agency or public official is making its way through courts across the country.

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[6] *Hopper v. City of Pasco* (9th Cir. 2001) 241 F.3d 1067, 1074-75 (*internal citations omitted*).
[7] *Seattle Mideast Awareness Campaign v. King County* (9th Cir. 2015) 781 F.3d 489, 496.
[8] *Id*. at 497.
[9] *Ibid.*
[10] *Int'l Soc. for Krishna Consciousness, Inc. v. Lee* (1992) 505 U.S. 672, 679.

Summarized below are two instructive cases, both of which are currently on appeal to a circuit court, that address the issue of officials blocking users on social media accounts.

Davison v. Loudoun County Board of Supervisors, et al., 267 F.Supp.3d 702 (E.D. Va. 2017), appeal docketed, No. 17-2002 (4th Cir. 2017), cross appeal docketed, No. 17-2003 (4th Cir. 2017).

Phyllis Randall is the Chair of the Loudoun County Board of Supervisors in Loudoun County, Virginia. While running for office, she established a Facebook page titled "Friends of Phyllis Randall" that she used to communicate with the electorate. When elected, she established a new Facebook page titled, "Chair Phyllis J. Randall," and invited the followers of "Friends of Phyllis Randall" to "visit [her] County Facebook Page[,] Chair Phyllis J. Randall."

Her "Chair" page was established with the assistance of Jeanine Arnett, her Chief of Staff. As Chief of Staff, Ms. Arnett was paid through a discretionary budget provided to Ms. Randall by the County. In addition to having a professional relationship, Ms. Randall and Ms. Arnett had a personal friendship that predated their professional relationship. Both Ms. Randall and Ms. Arnett had administrator rights to the "Chair" page. The page was categorized as "Government Official," and it provided Ms. Randall's County telephone number and email address, as well as a link to the County's official website.

Ms. Randall used the "Chair" page to address County residents and constituents and to share information of interest. The page was purposefully created outside of normal County channels "so as to not be constrained by the policies applicable to County social media websites." Neither Ms. Randall nor Ms. Arnett used County equipment in managing the "Chair" page.

There were no terms of use posted on the "Chair" page, but in one post, Ms. Randall shared the following:

> Everyone, could you do me a favor. I really want to hear from ANY Loudoun citizen on ANY issues, request, criticism, compliment, or just your thoughts. However, I really try to keep back and forth conversations (as opposed to one time information items such as road closures) on my county Facebook page (Chair Phyllis J. Randall) or County email (Phllis.randall@loudon.gov [*sic*]). Having back and forth constituent conversations are Foiable (FOIA) so if you could reach out to me on these mediums that would be appreciated. Thanks much, Phyllis.

The majority of the posts on the page were related to her role as the Chair of the Board of Supervisors. They included items such as soliciting participation in the "Commission on Women and Girls," an initiative she created in her Chair capacity; information about Board of Supervisors' meetings; conferences she attended as the Chair; promoting events she would attend in her capacity as Chair; invitations to her "State of the County" address; and press conferences. She sometimes used the comment section of her posts to engage directly with constituents.

Her office regularly released an official "Chair Phyllis J. Randall" newsletter, which was primarily written by her executive assistant. It was also on the County website and distributed through its mailing list. The bottom of each newsletter included the words, "STAY CONNECTED" with an image of a Facebook icon, which linked to her "Chair" Facebook page.

Her "Chair" page also included some more personal matters, such as personal congratulations, an afternoon shopping trip, and proclaiming her affection for the German language.

Ms. Randall also maintained a personal Facebook page (for purely personal and family-related content), and the "Friends of Phyllis Randall" page, which she used to discuss politics.

The plaintiff in the case, Brian Davison, was active in local politics, and had a particular interest in what he believed to be "corruption" by the Loudoun County School Board. He attended a joint town hall meeting between the School Board and the Board of Supervisors. He anonymously submitted two questions to the town hall, and one was selected. His question concerned Ms. Randall's campaign proposal that public servants take an ethics pledge and whether School Board members should be required to take such a pledge. Ms. Randall answered the question, but stated that she did not "appreciate" the "set-up question," and that her proposed ethics pledge was not intended as a "tool to accuse somebody or hit somebody over the head."

Mr. Davison found her response to be inadequate, and took to Twitter to post a message directed at Ms. Randall: "@ChairRandall 'set up question'? you might want to strictly follow FOIA and the COIA as well."

Ms. Randall posted about the town hall on her "Chair" Facebook page that night. Mr. Davison then commented on her post. He could not recall the exact content of his comment, but Ms. Randall recalled that it alleged corruption on the part of School Board Members and conflicts of interest between Board Members and their families. Ms. Randall took issue with his comment, and decided that she would delete her original post, which included Mr. Davison's comment, because it was "probably not something [she] want[ed] to leave" on her Facebook page.

Ms. Randall also banned Mr. Davison from her Facebook page because she did not want someone commenting on her site that "would make comments about people's family members." Although he was banned, Mr. Davison could still read and share content posted on the page, but he could not comment or send private messages.

The next morning, she reconsidered her actions and unbanned him. As a result, Mr. Davison was banned from the page for no more than 12 hours.

Mr. Davison brought a section 1983 claim against Ms. Randall in her official and personal capacity, alleging that she violated his First Amendment and due process rights by blocking him. He sought injunctive and declaratory relief. The District Court held a one-day bench trial, and issued the following holdings:

1. Ms. Randall acted under color of state law in maintaining the "Chair" page and in banning Mr. Davison from that page.
2. Ms. Randall engaged in viewpoint discrimination and banning Mr. Davison from the page in violation of the First Amendment.
3. The Board of Supervisors was not subject by section 1983 *Monell* liability for Ms. Randall's actions.
4. Ms. Randall did not violate Mr. Davison's due process rights.
5. An injunction was unwarranted, but declaratory judgment was warranted.

Acting Under Color of State Law

The court found that Ms. Randall's actions "arose out of public, not personal, circumstances," and that her "Chair" page was "born out of, and is inextricably linked to, the fact of [her] public office." As such, she acted under color of state law. The court found that, when considered under the totality of the circumstances, the following facts supported its conclusion:

- She used it as a tool of governance and to engage in discussions with her constituents. For example, she facilitated disaster relief efforts after a storm, promoted events that were related to her work as the Chair, and used the page to keep her constituents advised of her activities and important events in local government.
- She used County resources to support the page. Her Chief of Staff helped create and maintain the page, and she was a salaried employee of the County. Official County newsletters included links promoting her Chair page, which were drafted by a County employee, hosted on the County's website, and disseminated through a mailing list provided to Ms. Randall by the County.
- Ms. Randall made efforts to swathe the "Chair" page in the "trappings of her office." The title of the page included her title; the page was categorized as a

government official; it included her County email address and telephone number; it included the County's website; most of the posts were addressed to "Loudoun" (her constituents); she asked her constituents to use the page for "back and forth constituent conversations"; and the content posted related to her office.

- Her decision to remove content and ban Mr. Davison was based on his criticism of her colleagues in County government, and as such, she "acted out of 'censorial motivation' to suppress criticism of county officials related to the 'conduct of the official duties.'"

As to the First Amendment claims, the court noted that because Mr. Davison brought suit against Ms. Randall in both her official and individual capacities, that the County would only be liable under *Monell v. Department of Social Services of City of New York* (1978) 436 U.S. 658, if the County was a "moving force behind the deprivation" and its "policy or custom must have played a part in the violation of federal law." The court held that, under these standards, Ms. Randall was not liable in her official capacity, but was liable in her individual capacity.

Was the Speech Entitled to First Amendment Protection?

While neither party could recall the exact substance of Mr. Davison's deleted comment, the court found that it raised "ethical questions" about the conduct of School Board members, and that this kind of "criticism of official conduct is not just protected speech, but lies at the very heart of the First Amendment." Accordingly, the court determined the deleted post was speech entitled to First Amendment protection.

Appropriate Forum and Viewpoint Discrimination

Next, explaining that Ms. Randall deliberately permitted public comment and "virtually unfettered discussion" on the "Chair" page, the court found that Ms. Randall had opened a forum for speech, or "a digital space for the exchange of ideas and information" when she established the page.[11] Of particular relevance to the court was that she actively encouraged comments, including criticisms, from her constituents.

[11] The Court noted that in *Page v. Lexington County School District One* (4th Cir. 2008) 531 F.3d 275, the "Fourth Circuit has suggested that the government may open a forum for speech by creating a website that includes a chat room or bulletin board in which private viewers could express opinions or post information, or that otherwise invites or allows private persons to publish information or their positions."

The court then noted that, at this point in the analysis, the question would normally be to determine the nature of the forum – traditional, limited, or non-public. However, the Court found that this analysis was unnecessary because the record demonstrated that Ms. Randall engaged in viewpoint discrimination when she banned Mr. Davison from her page.[12] Viewpoint discrimination is prohibited in all forums. According to the court:

> If the Supreme Court's First Amendment jurisprudence makes anything clear, it is that speech may not be disfavored by the government simply because it offends. Here…Defendant acted in her governmental capacity. Defendant's offense at Plaintiff's views was therefore an illegitimate basis for her actions – particularly given that Plaintiff earned Defendant's ire by criticizing the County government. Indeed, the suppression of critical commentary regarding elected officials is the quintessential form of viewpoint discrimination against which the First Amendment guards. By prohibiting Plaintiff from participating in her online forum because she took offense at his claim that her colleagues in the County government had acted unethically, Defendant committed a cardinal sin under the First Amendment.

The Court also noted that while the consequences of Mr. Davison's temporary ban were "fairly minor," it would not withhold First Amendment protection for that reason.

Finally, the court noted that there are circumstances under which public officials can exercise control over their social media sites:

> All of this isn't to say that public officials are forbidden to moderate comments on their social media websites, or that it will always violate the First Amendment to ban or block commenters from such websites. Indeed, a degree of moderation is necessary to preserve social media websites as useful forums for the exchange of ideas. Neutral, comprehensive social media policies like that maintained by Loudoun County – and eschewed by Defendant here – may provide vital guidance for public officials and commenters alike in navigating the First

[12] While not engaging in a forum analysis, the Court did note that Ms. Randall had posted no policy for the "Chair" page that limited the types of comments that were posted, and the closest she did come to posting such a policy was to actively encourage constituents to comment on "ANY issue…"

Amendment pitfalls of this protean and revolutionary forum for speech.[13]

Appeal

Both Ms. Randall and Mr. Davison have appealed the decision to the Fourth Circuit.[14] Ms. Randall argues that declaratory judgment was improper, that she did not act under color of state law, that her "Chair" page was not a public forum, that she did not engage in viewpoint discrimination, and that the "relatively inconsequential" impact on Mr. Davison was not actionable. She also asserts that the District Court did not pay sufficient attention to Ms. Randall's own First Amendment rights, and that the District Court erred in "accepting the notion that Plaintiff has a First Amendment right to post comments on Facebook using any particular screen name."[15]

Mr. Davison argues that the District Court erred in denying his claims for due process violations and his claims against Ms. Randall in her official capacity. He further argues that his motion for leave to amend his complaint to add an additional First Amendment claim should have been granted.

Key Takeaways

Among other things, to reduce the likelihood of a public forum finding, public officials should be wary of using any public resources, whether it be staff time or electronic resources provided by the public agency, to create, administer, or maintain a social media page. In addition, identifying oneself as a public official and providing official email, phone, or other contact information, or links to other agency-controlled websites or publications, are factors that may weigh towards a public forum. Even if the page includes a mix of personal and public interest posts, the use of social media to engage with residents and constituents on public issues will likely factor toward a public forum.

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[13] The County maintained a policy declaring that its purpose was to "present matters of public interest in Loudon County," but advised users that "the County reserves the right to delete submissions" that violated enumerated rules, such as "vulgar language" and "spam." According to the court, the County's policy "evinces the County's purposeful choice to open its social media websites to those wishing to post questions, comments and concerns, within certain limits."

[14] Mr. Davison appeared pro se at the District Court, but is now represented by counsel on appeal (including by the Knight First Amendment Institute at Columbia University, who is a named plaintiff in the second case discussed in this paper).

[15] Mr. Davison had multiple Facebook accounts – one in his own name, and another – the one used to post on Ms. Randall's "Chair" page that was named "Virginia SGP." He explained that the Virginia SGP could be turned over to another activist.

For public officials who intend to use social media to engage with the public, establishing a set of user posting guidelines may provide at least some limited ability to remove content or block users, so long as the guidelines are actually viewpoint neutral, not directed at core political speech, and are applied accordingly.

Knight First Amendment Inst. at Columbia Univ. v. Trump, et al., 302 F. Supp. 3d 541 (S.D.N.Y. 2018), appeal docketed, No. 18-1691 (2nd Cir. 2018).

On May 23, 2018, the United States District Court for the Southern District of New York issued the most publicized decision to-date on an official's use of social media.[16]

Donald Trump established the @realDonaldTrump account in March 2009, well before he sought public office. Before his inauguration, he used the account to tweet about a variety of topics, including pop culture and politics. Since his inauguration in January 2017, he has continued to use the @realDonaldTrump "as a channel for communicating with the public about his administration."

The @realDonaldTrump page is registered to "Donald J. Trump, 45th President of the United States of America, Washington, D.C." The page is generally accessible to the public at large, and any individual can view his tweets without being signed into Twitter. Twitter users engage frequently with the President's tweets, often resulting in hundreds or thousands of replies and retweets. President Trump has not issued any rule or statement purporting to limit the speech of those who reply to his tweets. The National Archives and Records Administration has advised the White House that the tweets from @realDonaldTrump are official records that must be preserved under the Presidential Records Act.

Daniel Scavino, White House Social Media Director and Assistant to the President, has assisted in the operation of the @realDonaldTrump page. Together, Mr. Scavino and President Trump have used the @realDonaldTrump page to:

- Announce, describe, and defend his policies;
- Promote his Administration's legislative agenda;
- Announce official decisions, at times before the matter is announced through official channels (such as the nomination of Christopher Wray for FBI Director);
- Remove appointees from office;

[16] The Knight Institute has uploaded all the legal documents from the case, as well as some media coverage of the case, and it is available at https://knightcolumbia.org/content/knight-institute-v-trump-lawsuit-challenging-president-trumps-blocking-critics-twitter (last checked by the authors of this paper on August 21, 2018).

- Engage with foreign political leaders;
- Publicize state visits;
- Challenge media organizations whose coverage of his Administration he believes to be unfair; and
- Criticize opponents, critics, and organizations who oppose his policies and legislative agendas.

Various individuals have been blocked by the @realDonaldTrump account, including the seven individual plaintiffs who ultimately brought suit in this case. Each of them had their access to the President's Twitter feed blocked after tweeting a message critical of the President or his policies in response to tweets from @realDonaldTrump. As a result of being blocked, the plaintiffs could not view the @realDonaldTrump tweets, directly reply to them, or use the @realDonaldTrump page to view the comment threads while they were logged into their verified Twitter accounts. However, they could still see @realDonaldTrump tweets when not logged into their Twitter own accounts. In addition, even when blocked, the plaintiffs could still view replies to the @realDonaldTrump tweets and could post replies to those replies – even from their own blocked accounts. Because they could only view the replies to the tweet and not the original tweet, it could make the context of the reply tweets difficult to understand.

The Knight Institute and the individual plaintiffs brought suit against President Trump, Hope Hicks, Sarah Huckabee Sanders, and Daniel Scavino, seeking declaratory judgment and injunctive relief. The parties entered a stipulation of facts and cross-moved for summary judgment on the basis of that stipulation. The court granted summary judgment in favor of Sarah Huckabee Sanders due to a lack of standing because the plaintiffs' injuries were not attributable to her.[17] The court found that there was standing against Daniel Scavino and Donald Trump, and granted summary judgment in favor of the plaintiffs.

The court then turned to the "First Amendment's application to the distinctly twenty-first century medium of Twitter." It first found that the speech the plaintiffs sought to engage in was protected by the First Amendment because it was political speech, which is at the core of First Amendment protection.

Applicability of Forum Analysis

The defendants asserted that Twitter is not owned or controlled by the government, and therefore, not susceptible to forum analysis. In considering this argument, the

[17] Defendant Hope Hicks was later dismissed given her resignation from the position of White House Communications Director.

court made clear that the correct inquiry is to focus on the "access sought by the speaker." For example, in *Perry Education Association v. Perry Local Educators Association*, where the plaintiff sought access to the school's internal mail system, the mail system, rather than the entire school was the space, was in question.[18] As such, the court clarified that it was not the entire @realDonaldTrump account that was the forum to be analyzed. Rather, the plaintiffs only sought access to specific parts of the account: "the content of the tweets sent, the timeline comprised of those tweets, the comment threads initiated by each of those tweets, and the interactive space associated with each tweet in which other users may directly interact with the content of the tweet by, for example, replying to, retweeting, or liking the tweet."

The court also concluded that the forum analysis applied to spaces that are "owned or controlled" by the government or government official, so that legal ownership of the platform generally is not a requirement. While Twitter is a private company that is not government-owned, Mr. Scavino and President Trump exercise control over many aspects of the @realDonaldTrump account, including those the plaintiffs wished to access. The court also found that the control that Mr. Scavino and President Trump exercise is "governmental" because of the following factors, which are executive functions:

- The @realDonaldTrump account is presented as being registered to Donald J. Trump, "45th President of the United States of America, Washington, D.C.";
- The tweets are official records and must be preserved under the Presidential Records Act;
- The account has been used in the course of the appointment of officers, the removal of officers, and the conduct of foreign policy.

The court then turned to the concept of government speech, as a category of speech that falls outside the forum analysis, because the First Amendment restricts government regulation of private speech, but does not regulate government speech. In determining whether speech qualifies as government speech, the court looked at three factors identified by the Supreme Court:

1. Whether the government has historically used the speech in question to convey state messages;
2. Whether the speech is often closely identified in the public mind with the government; and
3. The extent to which the government maintains direct control over the messages conveyed.

[18] *Perry Education Association, supra*, at 46-47.

The court first held that the President's tweets themselves are government speech, and therefore not subject to a forum analysis. However, the court also found that the "interactive space" for the replies and retweets that occur after each initial tweet by the President is not government speech. Rather, those replies "remain the private speech of the replying user." The court found that the association between the President's tweet and the replies to that tweet (that they exist on the comment thread) was insufficient to make the reply government speech.

Forum Classification

Finally, having determined that the forum analysis was appropriate for the interactive space associated with a tweet, the court then determined the proper classification: traditional public forum, designated public forum, or a nonpublic forum. The court concluded that there was strong support for finding that the interactive space on the @realDonaldTrump Twitter account was a designated public forum, which it defined as follows:

> A second category consists of public property which the state has opened for the use by the pubic as a place for expressive activity. To create a forum of this type, the government must intend to make the property generally available to a class of speakers. The government does not create a public forum by inaction or by permitting limited discourse, but only by intentionally opening a nontraditional forum for public discourse, and we look to the policy and practice of the government to ascertain whether it intended to designate a place not traditionally open to assembly and debate as a public forum.

In looking at the intent of the government, the court noted that intent is inferred from objective factors: "the government's policy and past practice, as well as the nature of the property and its compatibility with expressive activity." The court noted that the @realDonaldTrump account is generally available to the public, without any limiting criteria. Any person can follow the account on Twitter, unless that person has been blocked. Any (unblocked) person can participate by replying to and retweeting the President's tweets. Twitter is certainly compatible with expressive activity, and, as the court reasoned, the "interactivity of Twitter is one of its defining characteristics, and indeed, the interactive space of the President's tweets accommodates a substantial body of expressive activity."

Viewpoint Discrimination

In a designated public forum, restrictions on speech "are permissible only if they are narrowly drawn to achieve a compelling state interest." However, regardless of the "specific nature of the forum…viewpoint discrimination is presumed impermissible

when directed against speech otherwise within the forum's limitations." Here, the court found that the individual plaintiffs were "indisputably blocked as a result of viewpoint discrimination" when they were critical of the President or his policies.[19]

The defendants argued that blocking the individual plaintiffs was permissible:

> [They argue that] the President retains a First Amendment interest in choosing the people with whom he associates and retains the right not to engage with (i.e., the right to ignore) the individual plaintiffs. Further, they argue, the individual plaintiffs have no right to be heard by a government audience and no right to have their views amplified by the government. While those propositions are accurate as statements of law, they nonetheless do not render the blocking of the individual plaintiffs constitutionally permissible.

The Court recognized that "a public official does not lose his First Amendment rights upon taking office." Further, the Court recognized that the First Amendment does not require that public officials "listen to or respond to" the speaker. "Nonetheless, when the government goes beyond merely amplifying certain speakers' voices and not engaging with others, and actively restricts the right of an individual to speak freely and to advocate ideas, it treads into territory proscribed by the First Amendment."

The court also examined the "muting" and "blocking" features on Twitter, which is how the platform allows users to limit interaction with other users:

> Muting is a feature that allows a user to remove an account's Tweets from the user's timeline without unfollowing or blocking that account. For muted accounts that the muting account does not follow on Twitter, replies and mentions will not appear in the muting account's notifications, nor will mentions by the muted account. That is, muting allows a user to ignore an account with which the user does not wish to engage. The muted account may still attempt to engage with the muting account, among other capabilities – but the muting account generally will not see those replies. Critically, however, the muted account may still reply directly to the muting account, even if that reply is ultimately ignored.

[19] The court noted this finding would be the same even in a nonpublic forum: "Control over access to a nonpublic forum can be based on subject matter and speaker identity so long as the distinctions drawn are reasonable in light of the purpose served by the forum and are viewpoint neutral. The blocking of the individual plaintiffs, which resulted from their tweets that criticized the President or his policies, is not viewpoint-neutral, and is therefore impermissible regardless of how the property is categorized under forum doctrine."

> Blocking, by contrast, goes further. The blocking user will not see any tweets posted by the blocked user just as a muting user would not see tweets posted by a muted user, but whereas muting preserves the muted account's ability to reply to a tweet sent by the muting account, blocking precludes the blocked user from seeing or replying to the blocking user's tweets entirely. The elimination of the blocked user's ability to reply directly is more than the blocking user merely ignoring the blocked user; it is the blocking user limiting the blocked user's right to speak in a discrete, measurable way. Muting equally vindicates the President's right to ignore certain speakers and to selectively amplify the voices of certain others but – unlike blocking – does so without restricting the right of the ignored to speak.

The court rejected the contention by defendants that muting and blocking are the same, noting that, in particular, that the reply or retweet is not directed solely at the user who posted the original tweet. Rather, the reply is visible to others and may be replied to by other users. As such, blocking a user limits that user's ability to speak to that audience, a restriction which is impermissible under the First Amendment. The court found this violation, even while being mindful of the President's First Amendment rights:

> While we must recognize, and are sensitive to, the President's personal First Amendment rights, he cannot exercise those rights in a way that infringes the corresponding First Amendment rights of those who have criticized him.

Finally, the court found that the minimal infringement on the individual plaintiffs' First Amendment rights was not relevant because "the First Amendment recognizes, and protects against, even de minimis harms."

Appeal

President Trump and Mr. Scavino appealed the ruling to the Second Circuit, and their brief was submitted on August 7, 2018. They argue that the @realDonaldTrump account has remained President Trump's personal account and he does not use any government authority when blocking users. They further argue that it is not a "forum" for public expression, but rather that

> Donald Trump uses it not to provide a platform for public discussion, but to disseminate his own views to the world. When he blocks a particular user from reading or replying to his tweets, he is exercising his right to choose with whom he will engage in speech. Nothing in the First Amendment divests him of that prerogative or compels him to

> receive messages that he does not wish to hear. Blocked users remain free to express their views to other Twitter users through their own Twitter accounts; the First Amendment does not entitle them to piggyback on Donald Trump's speech to amplify their own.

Key Takeaways

If upheld, the Trump Twitter case confirms that when a public official uses social media to post about public interest issues or to communicate and engage with the public, the regulation of comments and replies by the public will be reviewed under a forum analysis. Notably lacking in this case were any user guidelines, and the President's efforts to block users were directed specifically at those who were critical of him, his policies, his agenda, or his conduct in general, all of which constitute core political speech.

Although President Trump was not the first to argue that because Twitter is a private company, the First Amendment should not apply, the Southern District of New York made clear that the interactive space where users may reply and retweet and engage with each other and directly with the President himself was a forum "owned or controlled" by the government or a government official.

Whenever a local public official uses social media to post about government business or issues of public importance, due to the interactive nature of social media, they are inviting public engagement and must be mindful of First Amendment limitations on regulating comments and replies by the public. Public officials may not block or ban users merely because they disagree with the comment or reply, or because the comments or replies are critical of the official, the government, or actions taken by either.

CONCLUSION

Social media technology continues to develop and change at a pace far more rapid than the courts and Legislature can keep up with. The facts and circumstances of each case are different, and bright line rules do not yet exist, so it remains difficult to predict how a court will rule on any given issue. Thus, it is incumbent upon cities and other public agencies to be mindful of their practices and policies, ensure they have clear posting guidelines, designate and operate their social media pages as limited forums, and consult with legal counsel as questions arise. As a best practice, cities and other public entities should consider adopting policies and procedures for social media use, and training elected and appointed officials on their personal use of social media.

Land Use and CEQA Litigation Update

Friday, September 14, 2018 General Session; 8:00 – 10:00 a.m.

Whitman F. Manley, Senior Partner, Remy Moose Manley

Notes:

CEQA AND LAND-USE UPDATE
April – September 2018

Whit Manley
Remy Moose Manley LLP
Sacramento, California

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Statutory Exemptions; Scope of Project

County of Ventura v. City of Moorpark (2018) 24 Cal.App.5th 377

The Second District Court of Appeal held that the statutory CEQA exemption applicable to a beach restoration project also encompassed the agency's approval of a settlement agreement specifying particular haul routes that trucks had to use to and from the site. The court also held that, in certain portions of the agreement, the agency improperly contracted away its police powers, but this defect did not require invalidating the entire agreement.

The State formed the Broad Beach Geologic Hazard Abatement District ("BBGHAD") to restore a 46-acre stretch of beach in Malibu. The project involved placing five "deposits" of sand on the beach at five year intervals. Each 300,000-cubic-yard deposit would generate 44,000 one-way truck trips over the course of three to five months. The City of Moorpark was concerned that the haul trucks would harm the city's residents. Moorpark and BBGHAD entered into a settlement agreement to resolve these concerns. The settlement agreement restricted the haul routes that BBGHAD could use for the project.

The County of Ventura sued. First, Ventura argued that the city/BBGHAD settlement agreement was distinct from the beach restoration project, and was therefore not exempt from CEQA. The court disagreed, finding that the settlement agreement was part of the whole of the action because it was one piece of a single, coordinated endeavor to address erosion. Applying the test for "separate projects" under *Banning Ranch Conservancy v. City of Newport Beach* (2012) 211 Cal.App.4th 1209, the court found: (i) both respondents were proponents of the settlement agreement; (ii) the agreement and beach restoration served a single purpose: to abate a geologic hazard; and (iii) even if the beach restoration could be completed without the settlement agreement, the two became inextricably linked when the Coastal Commission incorporated the agreement into the project's coastal development permit. Thus, the court found, the agreement was not a separate project under *Banning Ranch*. The restoration project was exempt from CEQA as an "improvement" (Pub. Resources Code, § 26505) undertaken by a geologic hazard abatement district "necessary to prevent or mitigate an emergency." (Pub. Resources Code, § 26601; see Pub. Resources Code, § 21080, subd. (b)(4).) Because settlement agreement was part of that project, it too was exempt.

Second, Ventura argued the settlement agreement was void because Vehicle Code section 21 preempted Moorpark's ability to control project traffic. Again, the court disagreed. Vehicle Code section 21, subdivision (a), preempts local traffic control ordinances and resolutions. The settlement agreement was a contract, not an ordinance or resolution. As such, section 21 did not apply.

Third, Ventura argued the settlement agreement was an unlawful attempt by Moorpark to exercise its regulatory powers outside of its city limits. But the prohibition against extraterritorial regulation did not apply to Moorpark's contracting power. In addition, the court said, a city has authority to enter into contracts to enable it to carry out its necessary functions. Trucks' use of roads can create a public nuisance, and Moorpark appropriately entered into the settlement agreement in an attempt to abate that nuisance.

Fourth, Ventura argued BBGHAD relinquished its police power when it granted Moorpark the power to dictate sand hauling routes that BBGHAD's contractors had to use, rendering the entire agreement void.

The court held that BBGHAD was allowed under state law to exercise a portion of the state's police power, but it could not contract away its right to exercise its police power in the future. The determination of haul routes was a police power, and therefore the portions of the settlement agreement that surrendered BBGHAD's discretion to alter those routes in the future were void. The settlement agreement had at least two purposes: (i) to determine permissible and prohibited sand hauling routes, and (ii) to describe the duration of and limited discretion to modify the route restrictions. Only the second purpose was unlawful. Because the unlawful portions was severable, the remainder of the agreement could remain in force. Thus, the court declined to find the agreement void in its entirety.

Statutory Exemptions: Ministerial versus Discretionary Permits

California Water Impact Network v. County of San Luis Obispo (2018) 25 Cal.App.5th 666

The Second District Court of Appeal held that well construction permits issued by San Luis Obispo County were ministerial, and therefore did not trigger CEQA.

The county issued permits to four companies to install irrigation wells, mostly for vineyards. The petitioner sued. The county and real parties in interest demurred. The trial court agreed that the permits were ministerial, sustained the demurrer, and entered judgment denying the petition. The petitioner appealed. The Court of Appeal affirmed.

The county's permitting authority over irrigation well construction was based on County Code Chapter 8.40. Under this ordinance, the county "shall" issue a permit if the well complies with county and state standards. The standards incorporated by reference consist of bulletins issued by the Department of Water Resources. The standards address such matters as well seal depths, the licensing of the firm installing the well, the distance from potential sources of contamination, and the like. The Court analogized these standards to building permits, which are presumed to be ministerial. "So long as technical standards and objective measurements are met, [the] County must issue a well permit to licensed contractors." (Slip op. at p. 9.) The code and DWR bulletins focused on objective standards designed to protect groundwater *quality*. Nothing in the code or bulletins addressed the regulation of groundwater quantity. The county could not, for example, adopt a condition limiting the amount of water pumped as a means of preserving groundwater resources. "The purpose of Chapter 8.40 is to prevent contamination or pollution of groundwater during well construction, repair, modification or destruction. Only an impermissible rewriting of the ordinance would allow us to infer a legislative intent to condition well permits on pump limits or subsidence monitoring, which have nothing to do with groundwater pollution. The County has no discretion to impose water usage conditions on permits issued under Chapter 8.40." (*Id*. at pp. 10-11.)

In 2014, the State Legislature adopted the Sustainable Groundwater Management Act (SGMA). (Wat. Code, § 10720 et seq.) The SGMA empowers local agencies local agencies to adopt groundwater management plans aimed at, among other things, protecting groundwater resources from over-pumping. Although the county had begun implementing the SGMA, County Code Chapter 8.40 – the ordinance at issue here – did not address the issue. "Appellant's concerns about groundwater sustainability do not empower the courts to rewrite County Code Chapter 8.40 to hasten appellant's legislative goals. Those goals must be addressed to County's elected officials as they implement SGMA." (*Id*. at p. 12.)

Categorical Exemptions

World Business Academy v. California State Lands Commission (2018) 24 Cal.App.5th 476

The Second District Court of Appeal upheld the State Lands Commission's reliance on CEQA's "existing facilities" categorical exemption to approve extensions of two leases to Pacific Gas and Electric (PG&E) for public land used by the Diablo Canyon nuclear power plant for cooling water facilities.

PG&E operates the Diablo Canyon nuclear power plant. The plant circulates sea water to cool the nuclear units. Facilities used to circulate the sea water – an intake cove, breakwaters, intake structure, and discharge channel – are located on state-owned tidal and submerged lands. In 1969 and 1970, the State Lands Commission issued PG&E long-term leases for the state-owned lands. The leases were scheduled to expire in 2018 and 2019. In 2015, PG&E applied to the Commission to extend the leases by five years, so that the leases would expire at the same time as the permits issued by the federal Nuclear Regulatory Commission. The State Lands Commission approved the lease extensions. In doing so, the Commission found that no CEQA review was required under the Class 1 "existing facilities" categorical exemption. In the lawsuit that followed, petitioners argued that the lease replacement did not qualify for the "existing facilities" exemption, and even if it did, the "unusual circumstances" exception applied. The trial court denied the petition. Petitioners appealed.

At the outset, the court criticized both parties for failing to ensure that a complete copy of the record was transmitted to the Court of Appeal. Instead, the parties transmitted only excerpts of the record as part of the appellant's appendix. Appellant belatedly transmitted the entire administrative record, however, and the court exercised its discretion to consider it.

The court held that the Commission properly relied on the "existing facility" categorical exemption. This exemption covers "the operation, repair, maintenance, permitting, leasing, licensing, or minor alteration of existing public or private structures, facilities, mechanical equipment, or topographical features, involving negligible or no expansion of use beyond that existing at the time of the lead agency's determination." (CEQA Guidelines, § 15301.) The lease replacement plainly fit within these terms because the nuclear power plant was an existing facility. Appellant argued that the exemption necessarily did not apply to nuclear power plants, citing the legislative and regulatory history underlying the Class 1 exemption. This history, however, had never been presented to the Commission. "Hence, to the extent they rely on legislative and administrative history that was not before the Commission, arguments regarding the scope of the existing facilities exemption may not be raised." (24 Cal.App.5th at p. 494.) In any event, section 15301 included, as an example of an "existing facility," "investor and publicly-owned utilities used to provide electric power" (CEQA Guidelines, § 15301, subd. (b)), and the Diablo Canyon plant plainly fell within this language. The "key consideration" under Class 1 is "whether the project involves negligible or no expansion of an existing use," and nothing in the record suggested that the lease replacement would expand the plant's current operational capacity.

The court also rejected appellant's contention that the "unusual circumstances" exception precluded the Commission's reliance on the exemption. That exception applies "where there is a reasonable possibility that the activity will have a significant effect on the environment due to unusual circumstances." (CEQA Guidelines, § 15300.2, subd. (c).) Under *Berkeley Hillside Preservation v. City of Berkeley* (2015) 60 Cal.4th 1086, the party challenging the exemption based on the "unusual

circumstances" exception must show: (1) that the project has some feature that distinguishes it from others in the exempt class, such as its size or location, and (2) that there is a reasonable possibility of a significant effect on the environment due to that unusual circumstance. The court found it unnecessary to determine whether the lease replacement presented unusual circumstances (the first part of the test) because, even assuming the existence of "unusual circumstances," appellant failed to establish that there was a fair argument that any environmental impacts may occur. In making this determination, the court emphasized that the project was simply a lease replacement, and the environmental impacts alleged by appellant were not a change from conditions as they had previously existed under the current leases. Appellant argued that the Commission applied the wrong "baseline" to its analysis by failing to consider the impacts of seven additional years of operations, and new evidence concerning seismic risks, increased cancer rates, worsening marine conditions, the deteriorating condition of the plant and related safety impacts, and other impacts. But "all of the purported environmental effects to which appellant points are incident to and part of the plant's current baseline operations." (24 Cal.App.5th at p. 501.) "These preexisting effects are part of the baseline, and appellant has not pointed to any substantial evidence indicating that they will become worse due to the lease replacement." (*Id*. at p. 504.)

Finally, the court held that the Commission did not abuse its discretion in finding that the lease extensions were consistent with the public trust. The Commission's conclusion was backed up by a staff report discussing public trust issues. "The Commission considered the facts before it, citing record evidence while balancing the public trust rights to navigation, fisheries, and environmental protection against the public need for efficient electrical production. This review was not arbitrary, capricious, or procedurally irregular." (*Id*. at pp. 509-510.)

Negative Declarations

Jensen v. City of Santa Rosa (2018) 23 Cal.App.5th 877

The First District Court of Appeal upheld the City of Santa Rosa's adoption of a negative declaration for a youth treatment center, finding that noise analysis offered by non-expert attorneys was not substantial evidence in support of a fair argument of a potentially significant noise impact from outdoor recreation activities and the parking lot at the center.

In 2014, Santa Rosa approved plans to convert the shuttered Warrack Hospital to the SAY Organization's new Dream Center. SAY is a non-profit organization that provides housing, counseling, and job services to youth and families in Sonoma County. The facility would offer temporary housing, job skills training, health services, and enrichment activities. The property is in a developed area, surrounded by residential housing, offices, and a hospital. SAY applied for a conditional use permit, rezoning, and design review to implement the project. The city's initial study/negative declaration concluded there would be no significant impacts. The city approved the project. Two neighbors sued. The trial court denied the petition. The neighbors appealed.

The First District evaluated whether substantial evidence supported a fair argument that noise impacts from the project's parking lot and outdoor recreation area could be significant, thus requiring an EIR. The neighbors urged the court to reject the city's noise study, and rely instead on their independently calculated findings purporting to show the project's noise levels would be significant. The neighbors' attorneys extrapolated their own analysis from a previous study conducted by noise experts for the city, for another project, at a different site. The neighbors also argued that the city's noise ordinance set the

maximum allowable noise levels, and any noise that would exceed those thresholds was a significant impact.

The court rejected all of petitioners' arguments. First, the court rejected petitioners' interpretation of the city's noise ordinance, finding that its "base" noise values set the standard or normally acceptable levels, not maximum allowable levels, and thus, were not significance thresholds for CEQA's purposes. Furthermore, the ordinance was not as inflexible and quantitative as petitioners alleged, but rather, allowed for experts to consider factors such as the noises' level, intensity, nature, and duration when determining if impacts would be significant. Under this analysis, petitioners failed to identify any evidence in the record that noise impacts would exceed the allowable threshold.

Second, the court rejected petitioners' contention that their noise calculations based on another study for a different project were substantial evidence that this project could result in noise impacts. According to the court, a project opponent cannot simply import the values of one study onto those of another, particularly in the absence of qualified expert opinion. Petitioners' convoluted methodology and ultimate conclusions were based on speculation, rested on supposition and hypothesis, and were not confirmed by experts. The analysis also ignored key facts, such as limitations on parking lot use and hours of operation.

The court also noted that petitioners' conclusions, which they drew from the noise study prepared for the other project, were not presented to the city during the approval process, and did not appear in any part of the administrative record; rather, the other study was simply attached to the opponents' comments submitted to the city council as part of an administrative appeal. Only during appellate briefing did petitioners present the calculations they extrapolated from the other study. For that reason alone, the court stated it was justified in rejecting petitioners' calculations.

Given the court's conclusion that the offered evidence lacked the requisite foundation and credibility, petitioners failed to demonstrate, even under the comparatively low fair-argument standard, that further environmental review was required.

* * *

Protect Niles v. City of Fremont (2018) – Cal.App.5th – [2018 WL 3769850]

The First District Court of Appeal held that the record contained a "fair argument" that a mixed-use project in an historic district might have significant aesthetic impacts on the historic character of the community due to the project's size and scale. The court also cited residents' concerns regarding traffic hazards and congestion, and concluded that the city erred in adopting a mitigated negative declaration, and had to prepare an EIR.

The City of Fremont adopted a zoning overlay district to protect the historic character of the community of Niles, a small commercial strip dating to the 19th century. A developer proposed a mixed-use project with 98 residential units on a vacant six-acre property at the gateway to this district. Neighbors complained that the buildings were too tall, and the project was too dense, so that it was incompatible with the area and would increase traffic congestion. The city's architectural review board recommended denying the project. The planning commission recommended approval, and the city council adopted a mitigated negative declaration and approved the project. Neighbors sued. The trial court found that the

record contained a "fair argument" on aesthetics and traffic, and granted the writ. The developer appealed.

In May 2018, the city published a draft EIR for the project. The neighbors moved to dismiss the appeal as moot because the city had decided to comply with the trial court's writ. The appellate court declined to dismiss the appeal. The city was not a party to the appeal. The developer's submittal of a revised application did not mean the original project was abandoned. Moreover, the appeal was not moot; "[w]ere [the developer] to prevail in this appeal, the [c]ity's 2015 Project approval would be restored regardless of the status of the revised application and EIR." (Footnote omitted.)

Turning to the merits, the court concluded that the project's visual impact on its setting – in this case, an historic commercial "main street" recognized as sensitive by the city – was a proper subject of review, over and above the analysis of the project's impact on historic resources. According to the court, the record "clearly" contained a fair argument that the project would have a significant aesthetic impact on the historic district. The city's initial study found that the project was aesthetically compatible with the district because it reflected the architectural style of the industrial buildings that previously occupied the site, and the city's design guidelines recognized that architecture within the district was varied. Members of the architecture review board and of the public, however, stated that the project was too tall and dense, and inconsistent with Niles' village-like character. These complaints continued even after the developer modified the project. "In short, opinion differed sharply as to the [p]roject's aesthetic compatibility with the historic district." The court recognized "that aesthetic judgments are inherently subjective." In this case, however, "the comments about incompatibility were not solely based on vague notions of beauty or personal preference, but were grounded in inconsistencies with the prevailing building heights and architectural styles of the Niles [district] neighborhood and commercial core." Commenters included members of the city's historic architectural review board, who recommended denial. Although the project evolved, the essential elements of its design, massing and density did not.

The court rejected the developer's various arguments that the project's aesthetic impact was not significant. First, although the site was currently vacant and scruffy, that did not automatically mean that development of the site would be an upgrade. Second, the site, though on the edge of the historic district, was nevertheless located at a recognized gateway to Niles, and was within the district's boundaries. Third, the architectural review board's recommendation to deny the project was not a bare conclusion, but was supported by record evidence of the board members' underlying aesthetic judgments about the effect of the project. Thus, the board's "collective opinions about the compatibility of the [p]roject with the Niles [district] are substantial evidence in this record of the [p]roject's potentially significant aesthetic impacts. [Footnote omitted.]"

The court also found that the record contained a fair argument concerning traffic safety. The project's traffic study concluded a left-turn pocket lane was warranted at the project entrance. Staff did not recommend the pocket, however, because left-turn pocket lanes generally were not located elsewhere along the street, and because omitting a pocket would make vehicles slow down. Testimony from residents, however, stated that drivers did not adhere to the posted speed limit, and site lines might not be adequate if multiple drivers queued up to turn left into the project site. "These *fact-based* comments" (original italics) were substantial evidence supporting a fair argument that a newly constructed intersection at the project entrance would create traffic hazards.

The record also contained a fair argument that the project would contribute to existing traffic congestion. Residents testified that traffic at the nearby Niles Boulevard / Mission Boulevard

intersection was already terrible, and that during the morning commute traffic already backed up from this intersection to the project site. The city's own traffic study found that traffic at this intersection was Level of Service ("LOS") E – an unacceptable level of congestion – and that project-related traffic would cause congestion there to worsen to LOS F. The developer argued that, under the city's thresholds of significance, a shift from LOS E to LOS F was not a significant impact. The court held, however, that the city's significance threshold could not be applied to foreclose consideration of substantial evidence that the impact might be significant. "The fact-based comments of residents and city staff and officials supported a fair argument that unusual circumstances in Niles might render the thresholds inadequate to capture the impacts of congestion on Niles Boulevard extending from the Niles/Mission intersection well into the Niles [historic overlay district] commercial core. Residents aptly described Niles as 'geographically cut off from the rest of Fremont,' which might cause congestion effects atypical of the [c]ity. Also, Niles Boulevard serves as the main street of the commercial core of the Niles [district], such that congestion arguably adversely affects the character of the historical district, another unusual impact."

Environmental Impact Reports

Rodeo Citizens Assn. v. County of Contra Costa (2018) 22 Cal.App.5th 214

The First District Court of Appeal rejected a challenge to an EIR prepared for a project to add gas recovery facilities to an existing oil refinery. The court, applying the "substantial evidence" test, found that the EIR's description of the project was not misleading, and concluded that the EIR did not need to speculate about the impacts from downstream use of recovered gas on greenhouse gas ("GHG") emissions, and contained sufficient information on the hazards of transporting the gas by rail.

Phillips 66 Company ("Phillips") owns two refineries, one near Santa Maria, the other near Rodeo. The Santa Maria refinery processes heavy crude oil. The semi-refined crude is then sent via pipeline to the Rodeo facility, where it is further refined into finished petroleum products. The Rodeo facility also refines crude oil from both domestic and foreign sources delivered by ship to an adjacent marine terminal. The Rodeo refinery is able to process both heavy and light crude oil. The final products are shipped by rail from the refinery to Phillips' customers.

In June 2012, Phillips applied to Contra Costa County for a permit to modify the existing Rodeo facility to enable Phillips to recover butane and propane and ship it by rail for sale. In June 2013, the county released a Draft EIR for the project. A Final EIR was released in November 2013. Based on comments from the Bay Area Air Quality Management District, the county prepared a Recirculated EIR (REIR) addressing air and health issues. In early 2015, the county published a Final REIR and approved the project. Rodeo Citizens Association ("Citizens") and two other groups sued. The trial court found certain deficiencies in the air quality section of the EIR, and issued a writ of mandate requiring the county to reconsider that section, but rejected the remainder of petitioners' arguments. Citizens appealed.

Citizens argued the EIR's project description incorrectly defined the project to include only the recovery and sale of propane and butane from refinery fuel gas. According to Citizens, the real purpose of the project was to allow Phillips to process increased amounts of non-traditional crudes, including imported tar sands and Bakken crudes; these non-traditional crudes contain higher levels of dangerous chemicals and emit more harmful air pollution during the refining process. Citizens contended the EIR's project description violated CEQA for not disclosing the true scope of the project, which, in turn, caused the EIR to understate the project's impacts. The court found, however, that substantial evidence supported the

REIR's project description. In particular, the Final EIR included a master response directly addressing the "project description." This response presented substantial evidence that the project was designed to extract propane and butane from its existing fuel gas stream, and did not depend on securing new sources of crude oil feedstock. Citizens "only weakly" contested the accuracy of the master response and failed to demonstrate the county lacked substantial evidence for the project description.

Turning to the EIR's GHG analysis, Citizens claimed that the analysis violated CEQA because it failed to consider GHG emissions resulting from the combustion of propane and butane by downstream users. The EIR addressed the issue of downstream users, but concluded that due to the lack of data and changing market conditions, there was no way to determine how the propane and butane would be used. In many instances, a switch to propane actually reduces GHG emissions as compared with gasoline and diesel. Indeed, California has adopted a program to encourage companies to switch from gasoline/diesel to propane. Ultimately, the EIR concluded that it would be too speculative to reach a conclusion regarding the significance of the project's GHG impacts resulting from downstream users. The court held that substantial evidence, including comments from the air district, supported this conclusion.

Regarding the project's public and environmental health hazards impacts, Citizens argued that the EIR failed to assess the impacts of the project on a child care center located approximately 500 feet from the rail lines on which the propane and butane would be transported from the refinery. This argument was "arguably barred" by the exhaustion doctrine, because Citizens failed to raise it prior to the county's approval of the project. In any event, although the EIR did not specifically address how the transport of the project's hazardous materials might impact the child care center, the EIR disclosed that the risk zone for rail transport under the project was 262 feet from the tracks. At around 500 feet away, the child care center was safely beyond this distance.

Finally, Citizens contended the EIR's cumulative hazards analysis was inadequate because it failed to consider the cumulative risk of rail accidents. The Final EIR's response to comments on this issue explained that most of the projects cited by the commenters were located a substantial distance from the refinery and did not involve the transport of liquid propane gas by rail. Citizens argued this response was inadequate. The court found, however, that the county's explanation for why a cumulative analysis for transportation hazards was not included was not unreasonable, which is all that CEQA requires.

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San Franciscans for Livable Neighborhoods v. City and County of San Francisco (2018) – Cal.App.5th – [2018 WL 4024685]

The First District Court of Appeal rejected a broad challenge to an EIR prepared for the City and County of San Francisco's Housing Element. The court ruled that the EIR used an appropriate baseline, provided sufficient support for the city's conclusions regarding various impacts, and analyzed a reasonable range of alternatives.

In 2011, the City and County of San Francisco certified an EIR and approved a combined 2004 and 2009 Housing Element. The document covered both 2004 and 2009 because the city's earlier 2004 Housing Element had been set aside on CEQA grounds, and by the time an EIR was prepared, the next Housing Element cycle was underway. A coalition of neighborhood groups ("Neighbors") sued, lost, and appealed.

Neighbors argued the EIR used a phony baseline against which to measure the impacts of the Housing Element. The court acknowledged that, as a general matter, the baseline consists of physical conditions at the time the agency commences the environmental review process. In this case, Neighbors argued the city violated CEQA by assessing traffic and water impacts measured against conditions expected to exist in the year 2025 based on population projections from the Association of Bay Area Governments. As the court noted, the EIR contained information on existing traffic levels and water use, as well as 2025 projections. The Housing Element did not approve any additional units; instead, it established a policy framework that would likely result in greater density. The city acted within its discretion in adopting a baseline calculation that forecast traffic and water impacts in 2025, rather than comparing the existing conditions with and without the Housing Element. The Housing Element was not designed to induce growth that would not otherwise occur, but was instead designed to establish policies that would guide growth that would occur with or without the Housing Element. Neighbors argued that the Housing Element would lead to increased growth. That was an argument, not about baseline conditions, but about causation, premised on the notion that policies to increase density would operate in isolation from the causes of population growth. In fact, the Housing Element was designed not to produce growth, but to accommodate it.

Neighbors argued that the city did not provide sufficient justification for its decision to use a "future baseline," rather than current conditions. The Supreme Court's decision in *Neighbors for Smart Rail v. Exposition Metro Line Construction Authority* (2013) 57 Cal.4th 439 suggests that, while a future baseline may be permissible, the EIR should explain why a current-conditions baseline analysis would be misleading. In this case, there was sufficient justification for using a 2025 baseline to measure the Housing Element's impacts. As the court stated, "[i]t would be absurd to ask the City to hypothesize the impacts of a long-term housing plan taking hold immediately. When an amendment to a general plan takes a long view of city planning, the analysis of the amendment's impacts should do so as well. [Citation.]" (Slip op. at p. 17.) Elsewhere, the EIR analyzed the visual and land-use impacts – consisting of the potential for greater density in various city neighborhoods – against the existing character of those neighborhoods. This baseline was not hypothetical, but was based on observation of existing conditions.

Neighbors challenged the EIR's analysis of particular impacts. The court rejected those challenges. To wit:

- With respect to land use and aesthetics, the EIR acknowledged that the denser development could be out of scale or otherwise incompatible with existing neighborhoods. Various policies, however, required compliance with zoning standards, design guidelines, and other policies promoting consistency with the prevailing character of a neighborhood. The Housing Element did not change or trump those requirements.

- At the time the EIR was prepared, three major projects – Treasure Island, Parcmerced and Hunters Point – were undergoing review. Neighbors argued the Housing Element EIR ignored the traffic from these projects. In fact, the EIR's 2025 analysis of cumulative conditions included projected traffic from those projects.

- Neighbors argued the EIR failed to disclose uncertainty regarding the sufficiency of the city's long-term water supplies. The court held, however, that the Housing Element would not increase the demand for water. "The Housing Element serves as the policy basis for approving project with increased residential density as a growth-accommodating rather than growth-

inducing measure." (Slip op. at p. 26.) Denser development would, on the whole, demand less water on a per-capita basis, and new development would have to comply with various requirements designed to reduce this demand. City plans were in place to develop additional sources of supply. The EIR's reliance on the city's water supply assessment, which used a horizon year of 2030, was reasonable. The EIR acknowledged that, after 2030, supplies might not be sufficient, but cited plans to further reduce demand via rationing or conservation if necessary.

- Neighbors argued a memorandum from the city's public utility commission ("PUC") triggered the duty to recirculate the EIR. The PUC memorandum, issued after publication of the final EIR, disclosed that short-term shortfalls in water could arise due to decreased availability of certain supplies relied upon by the city. Elsewhere, however, the PUC stated that demand was also lower than projected, and that if shortfalls developed, modest rationing could plug any gaps without ill effects.

- The EIR concluded that the Housing Element, by encouraging greater density along transit corridors, was consistent with regional policies aimed at directing development to these areas. Neighbors' disagreement with this analysis did not mean the EIR was inadequate.

Neighbors argued the EIR failed to adequately consider a reasonable range of alternatives. Those alternatives included (A) continued reliance on the city's Housing Element policies dating to 1990 (no project), (B) Housing Element policies adopted in 2004 that were not stricken in response to the earlier CEQA lawsuit (another variant on no project), and (C) the "2009 Housing Element Intensified." Each alternative was compared to both the 2004 and 2009 Housing Elements. Neighbors argued the only authentic alternative was the "2009 Housing Element Intensified" alternative, which did not really reduce impacts. According to the court, however, Neighbors did not carry its burden to show that the selected alternatives did not amount to a reasonable range, or that the city improperly excluded an alternative despite its environmental benefits. The only significant impact identified by the EIR concerned the city's transit capacity. The EIR analyzed whether the various alternatives would avoid this impact, or create other impacts. That is exactly what an alternatives analysis is supposed to do. The Final EIR addressed alternatives proposed by the Neighbors – a "RHNA-Focused Reduced Density" alternative focusing solely on meeting the City's obligations to provide affordable housing, and a "No Additional Rezoning" alternative – and explained why they did not add meaningfully to the analysis, did not reduce impacts, or were infeasible. The RHNA-Focused Reduced Density alternative addressed affordable housing, which the city consistently treated as a social issue, rather than an environmental one. And the "No Additional Rezoning" alternative was infeasible because the city had to rezone somewhere in order to accommodate anticipated growth. Impacts on transit were inevitable given the growth that was expected to occur.

Finally, Neighbors argued the city failed to consider additional mitigation measures to address transit impacts – to wit, reducing density along transit corridors or imposing transit impact fees. The city responded to these proposals by noting that the first proposal was already encompassed by Alternative A, and the city already imposed an impact fee, and further funding for transit expansion was uncertain.

Supplemental Review

Citizens Coalition Los Angeles v. City of Los Angeles (2018) – Cal.App.5th – [2018 WL 4026019]

The Second District Court of Appeal upheld the City of Los Angles' reliance on an addendum to a previously certified EIR for a Target superstore. The court rejected claims that the city had to consider the impacts of other potential superstores that might be proposed based on the same zoning district established to accommodate the Target. The court also held that, although the city's decision constituted "spot zoning," such zoning was not impermissible.

Target applied to the City of Los Angeles for entitlements to build a "superstore" Target retail store. The city certified an EIR and approved the entitlements, which included eight variances. In the lawsuits that followed, a trial court upheld the EIR, but found that substantial evidence did not support the city's findings as to six of the variances. Both sides appealed. Meanwhile, the city amended its "Station Neighborhood Area Plan" ("SNAP") to accommodate the Target. The Court of Appeal then dismissed the pending appeal as moot. (*La Mirada Avenue Neighborhood Assn. of Hollywood v. City of Los Angeles* (2016) 2 Cal.App.5th 586.)

To support its approval of the SNAP, the city prepared an addendum to its original EIR, concluding that the Target would result in no greater impacts than those that had previously been disclosed. Citizens' Coalition etc. ("Coalition") sued again, accusing the city of violating CEQA and adopting impermissible spot zoning. The trial court granted the writ on CEQA grounds, and did not rule on the spot zoning claim. The city and Target appealed.

The CEQA dispute focused on whether the city erred in performing supplemental review under Public Resources Code section 21166. In the Coalition's view, by amending the SNAP, the city created a new, floating sub-zone congenial to superstores, separate and apart from the proposed Target superstore; as such, the city had to study the amendments as a stand-alone project. The city and Target, by contrast, argued that the SNAP amendments were designed solely to enable the Target superstore to go forward; in this view, because they involved a project for which the city had already certified an EIR, supplemental review was appropriate. "Accordingly, we approach the CEQA question by asking three questions: (1) what does the Ordinance do?; (2) which provisions of CEQA apply to the Ordinance—the provisions governing 'projects' for which there is no prior CEQA analysis or the provision (namely, section 21166) that applies when there has already been a prior CEQA analysis?; and (3) did the City Council comply with the applicable provision(s)?" (Slip op. at p. 10.)

First, the ordinance created a new "sub-area F" within the SNAP, and placed the parcel where the superstore was located into that subarea. The ordinance also identified the criteria that would have to be met (parcel size, proximity to transit, etc.) that any parcel would have to meet in order to be placed into subarea F. Only the Target superstore parcel met these criteria. Two other parcels potentially qualified, but the other parcels did not meet the requirement that the parcel contain at least 100,000 square feet of commercial space. For this reason, the ordinance did not create a free-floating zone that could be applied anywhere within the SNAP.

Second, the city had already certified an EIR for the Target superstore. The challenged action, however, consisted not of approval of the superstore, but of amending the SNAP to create a new subzone, and then placing the superstore parcel in that subzone. The projects – superstore and SNAP amendment – were clearly related to one another, but operated at different levels of generality; the superstore (for

which the city certified an EIR) was a specific development proposal, and the SNAP amendment represented a shift in land-use policy. According to the court, this shift in "level of generality" did not mean that section 21166 was inapplicable. The issue instead was whether the information in the prior environmental document for the superstore remained relevant to the agency's decision to amend the SNAP. In proposing to amend the SNAP, the issue for the city was to understand the impacts that would occur by placing a large superstore in subarea F. That is what the superstore EIR focused upon. The superstore EIR therefore retained relevance to the city's analysis. Although the Coalition argued the superstore EIR was flawed, that did not mean the EIR lacked relevance. Moreover, the trial court had found the superstore EIR to be adequate, and by the time the city prepared the addendum and approved the SNAP amendment, the trial court's decision was final. For these reasons, the city did not violate CEQA in deciding to proceed under section 21166.

Third, the court considered whether the city's addendum complied with section 21166. "[The] inquiry into whether a prior CEQA review of a project is sufficient in scope vis-à-vis subsequent changes to that project is … functionally indistinguishable from the question whether a current CEQA review of a project is sufficient in scope vis-à-vis possible future actions flowing from that project. In both instances, the fundamental question is the same: Does the existing CEQA document encapsulate all of the environmentally significant impacts of the project? In the latter instance, further CEQA analysis is required only (1) if the 'future expansion or other action ... is a reasonably foreseeable consequence of the initial project,' and (2) if that 'future expansion or action will be significant in that it will likely change the scope or nature of the initial project or its environmental effects.' (*Laurel Heights Improvement Assn. v. Regents of University of California* (1988) 47 Cal.3d 376, 396 ([*Laurel Heights I*]).) We hold that the same test should be applied in both instances, including under section 21166." (Slip op. at pp. 22-23.)

With respect to the first prong of the *Laurel Heights I* test, the court offered the following categories for when the courts have found a future action or consequence to be "reasonably foreseeable": (1) when the agency has already committed to take the other action; (2) when the project under review presupposes the occurrence of the other action; (3) when the other action is itself under concurrent environmental review [note – this category appears to borrow on case law concerning the scope of projects included in cumulative impact analysis]; (4) when "the agency subjectively 'intends' or 'anticipates' the consequence, and the project under review is meant to be the 'first step' towards the consequence" (slip op. at p. 27, citations omitted); and (5) when "the project under review creates an incentive that is all but certain to result in the consequence" (*ibid*., citations omitted). A future action or consequence must be considered if it falls into any of these categories and "is sufficiently certain to come to pass." (*Id*. at p. 28.)

"Conversely, a consequence is not reasonably foreseeable when it is entirely independent of the project under consideration. [Citations.] [¶] A consequence is not reasonably foreseeable simply because the project under consideration makes that consequence a *possibility*—even when the public agency is subjectively aware of that possibility (that is, even when it is 'a gleam in [the] planner's eye'). [Citations.]" (Slip op. at pp. 28-29.) Showing that the consequence is possible, or even probable, is not enough to make it reasonably foreseeable. Under these circumstances, the agency can delay its review "until the consequence is sufficiently certain. [Citation.]" (Slip op. at p. 31.)

In this light, the issue was whether substantial evidence supported the city's finding that no large-scale commercial developments beyond the Target superstore were a reasonably foreseeable consequence of the SNAP amendment's creation of subarea F. According to the court, substantial evidence supported

the city's finding that the construction of the Target superstore was the sole reasonably foreseeable consequence of creating subarea F. Two other parcels in the SNAP met the size and proximity-to-transit criteria. No one had proposed a superstore on either of them. Nothing suggested that such development was anticipated. The code amendment did not create an incentive to make such further large-scale development inevitable. The SNAP amendment constituted a changed circumstance, in that it altered the mechanism for allowing the superstore to go forward, but this change did not require major revisions in the certified EIR.

The Coalition argued that the city had to anticipate and analyze the impacts of further superstore development authorized by the SNAP amendment on the theory that, "if you zone it, they will build." The court disagreed because substantial evidence supported the city's conclusion that any incentives created by subarea F would not make such development "all but certain." (Slip op. at p. 35.)

The court also rejected the Coalition's "spot zoning" claim. In this case, the city's action placed the superstore parcel, but not other parcels, into the less restrictively zoned SNAP subarea F. The creation of a "spot zone" is "invalid only when it is not in the public interest — that is, when it is 'arbitrary,' 'irrational,' and 'unreasonable.' [Citations.]" (Slip op. at p. 36.) Here, the Coalition did not carry its burden to show that the city's decision was irrational. The subarea F zoning was actually a "mixed bag," in that it allowed greater building heights, but also imposed numerous restrictions. Moreover, the city council had a rational basis for establishing such a district. Staff provided a comprehensive inventory of the ways in which the retail complex would benefit the neighborhood. In approving the rezone, the city council was not required to make an express finding that the ordinance was in the public interest; rather, the council merely had to have an evidentiary basis supporting such a conclusion. As to the Coalition's other claims:

- The city council's alleged motive in approving the rezone – characterized by the Coalition as a nefarious scheme to allow Target to proceed with construction while litigation was pending – was irrelevant.

- The city's approval of the zoning for Target did not commit the city to approve other large-scale commercial projects. The council retained the ability to assess whether other future large-scale commercial developments were in the public interest, and nothing in the SNAP amendment diminished that discretion.

- The Coalition argued that the ordinance was incompatible with the SNAP because the ordinance amended the plan. "The plain import of this argument is that a SNAP may never be amended. That is clearly not the law. [Citations.]" (Slip op. at p. 40.)

OTHER LAND-USE CASES

<u>Planning and Zoning Law; Initiatives and Referenda</u>

City of Morgan Hill v. Bushey (2018) – Cal.5th – [slip op. dated August 23, 2018]

The California Supreme Court held that the referendum power can be used to disapprove a rezone, even where that rezone was designed to make the zoning ordinance consistent with a General Plan amendment, at least where the municipality has other options for ensuring consistency.

In 2014, the City of Morgan Hill amended its General Plan to change the land-use designation for a vacant lot from "industrial" to "commercial." The zoning district – "light industrial" – remained the same. In 2015, the city council amended the zoning ordinance to change the lot's zoning to "general commercial." Both the General Plan amendment and the rezone were designed to facilitate a proposed project centered on a hotel. A referendum petition challenging this rezone qualified for the ballot. The city council placed the referendum on the ballot, and filed a lawsuit against election officials seeking an order directing the officials to remove it. The trial court ordered the referendum removed from the ballot. The Court of Appeal reversed. The Supreme Court granted review "to determine whether the people can bring a referendum to challenge an amendment to a property's zoning where a prior general plan amendment rendered the property's zoning inconsistent with the general plan and the challenged zoning amendment seeks to make the property's zoning consistent with the amended general plan."

Voters may amend a city's or a county's general plan or zoning ordinance by initiative. (*DeVita v. County of Napa* (1995) 9 Cal.4th 763.) Under Government Code section 65860, subdivision (a), a local agency cannot enact a zoning ordinance that is inconsistent with the agency's general plan. In *Lesher Communications, Inc. v. City of Walnut Creek* (1990) 52 Cal.3d 531, the Supreme Court held that this same prohibition applies to voters enacting zoning by initiative. Nevertheless, under Government Code section 65860, subdivision (c), if a zoning ordinance becomes inconsistent with the General Plan as a result of a plan amendment, the zoning – if valid when enacted – need not be amended right away; rather, the local agency can amend the zoning ordinance to achieve consistency "within a reasonable time so that it is consistent with the general plan as amended."

Here, the filing of a sufficient number of signatures on the referendum, and the subsequent failure of the measure at the polls, suspended and then annulled the new zoning, so that it never took effect. The former "light industrial" zoning therefore remained in place. That was permissible, even though the former zoning was inconsistent with the General Plan as amended. Thus, the court held, the voters may "challenge by referendum a zoning ordinance amendment that changes a property's zoning designation to comply with a general plan amendment, at least where other consistent zoning options are available, or the local municipality has the power to make the zoning change and general plan consistent through other means." (Slip op. at p. 9.) Although the referendum has the potential to invalidate the municipality's first attempt to rezone, the municipality may have other options – such as adopting another zoning district that is also consistent with the amended General Plan – and the Planning and Zoning Law does not impose an express time limit on how soon after amending its General Plan the municipality must adopt conforming zoning. Thus, according to the court, the Legislature did not intend the Planning and Zoning Law's General Plan consistency requirement to usurp the voters' reserve power of referendum.

The city argued that a successful referendum was tantamount to adopting the former zoning, which could not be squared with the requirement that the zoning be consistent with the General Plan. The court disagreed, noting that if a referendum qualifies for the ballot, then the amendment to the zoning code never takes effect, and the former zoning remains in place unless and until the voters approve the new zoning. Nothing in the statute suggested that the Legislature assigned the obligation to amend the zoning ordinance solely to the municipality's elected officials.

The city argued the voters should have challenged the council's 2014 approval of the General Plan amendment. The court was unmoved. A General Plan is, by definition, general, and the voters may have reason to challenge the particulars of development authorized under the rezone, even if the voters do

not challenge the General Plan amendment. The court therefore overruled the Court of Appeal's earlier decision in *deBottari v. City of Norco* (1985) 171 Cal.App.3d 1204.

The city argued that giving effect to the referendum would present "awkward questions about what constitutes a 'reasonable time' for a zoning ordinance to remain out of compliance with a general plan." The court acknowledged this uncertainty, but held that such uncertainty did not mean that the general plan consistency requirement trumped the reserved right of referendum. The appropriate time frame might vary from one context to another, but in this particular case it had not been exceeded.

The city claimed that this particular referendum posed insurmountable problems because no other zoning designation was available that was consistent with the amended General Plan; all such districts allowed hotels, and opposition to a hotel was what animated the referendum's sponsors. The court concluded, however, that the record was incomplete on this issue, and remanded the matter to the trial court for further proceedings.

Comment: According to the Supreme Court, the city could address the inconsistency problem by adopting a different zoning district, by amending the General Plan or zoning ordinance, or by other means. Given these options, a municipality may be hard pressed to show that the defeat of a rezone by referendum would necessarily result in an irreconcilable inconsistency with the municipality's General Plan. In such a situation, a municipality would appear to always have options for achieving consistency.

* * *

Center for Community Action and Environmental Justice v. City of Moreno Valley (2018) – Cal.App.5th – [2018 WL 4025516]

The Fourth District Court of Appeal has held that, although a municipality's approval of a development agreement is subject to referendum, such an agreement cannot be adopted by initiative.

A developer proposed a project dubbed the "World Logistics Center" ("WLC"). In 2015, the City of Moreno Valley certified an EIR and approved a development agreement for the project. The city's decision was greeted with a hailstorm of CEQA lawsuits. A coalition filed an initiative petition that would repeal the city-approved development agreement, and adopt a new one. The initiative received sufficient signatures to qualify for the ballot. The city council approved the initiative, effectively mooting the CEQA challenge. Lawsuits challenging the initiative followed. The trial court denied the petitions.

On appeal, the issue was whether the Legislature, in adopting the development agreement statute, intended to delegate approval of development agreements exclusively to local legislative bodies, such that development agreements are not subject to the initiative power. The appellate court regarded this issue as raising a purely legal question, to be resolved based on the statute and the Legislature's intent.

Government Code section 65867.5, subdivision (a), states: "A development agreement is a legislative act that shall be approved by ordinance and is subject to referendum." According to the court, the Legislature, in specifically stating that a development agreement is subject to referendum, omitted any reference to initiative. That omission was sufficient to divine the Legislature's intent to exclude development agreements from the initiative process.

The city and developer argued that the statute's reference to referenda was merely to emphasize its availability, and not to suggest that the initiative power was *unavailable*, noting that the initiative power is generally regarded as broader than the power of referendum. The court was unpersuaded; in its view, the express reference to "referendum" meant that the initiative power did not apply. In addition, Government Code section 65876.5 referred to the local "legislative body," further suggesting that the Legislature intended to deny the voters the initiative power with respect to development agreements.

The court also held that the development agreement statute addressed a matter of statewide concern, rather than a "municipal affair," suggesting that, under *Committee of Seven Thousand v. Superior Court* (1988) 45 Cal.3d 491, the Legislature intended to delegate authority to approve development agreements solely to the municipality's governing body, and not to the voters. "The development agreement statute was enacted to address a statewide impediment to land use development; namely, '[t]he lack of certainty in the approval of development projects' that resulted from the late vesting rule" established by *Avco Community Developers, Inc. v. South Coast Regional Com.* (1976) 17 Cal.3d 785.

The court rejected the city's attempt to analogize the development agreement statute with the Planning and Zoning Law, which (under *DeVita v. County of Napa* (1995) 9 Cal.4th 763) is subject to the initiative power. The court rejected this attempt even though the development agreement statute appears within the Planning and Zoning Law, and even though the development agreement statute does not apply to charter cities. As the court summarized, "[i]t is sufficient to conclude that development agreements implicate statewide concerns and that the statutory language regarding charter cities does not conclusively establish otherwise." (Slip op. at p. 20.)

The court agreed that, as a negotiated contract between a developer and a municipality, a development agreement was incompatible with the initiative process, in which the measure is proposed by the voters and, if approved, cannot be changed. By contrast, "the initiative process is consistent with planning and zoning changes, which do not require negotiation, and those changes generally are subject to initiative. The governing body takes action after public hearings, or the public takes action through the initiative. Although stakeholders like developers may participate, the purpose is not to reach a binding agreement with them, and there is thus no implied need for negotiation." (Slip op. at p. 24 [citations omitted].) Nor could the initiative process be squared with the requirement that a municipality perform ongoing monitoring and enforcement. Moreover, the court observed, "[i]f development agreements could be adopted by initiative, developers could obtain vested rights, without fulfilling the corresponding commitments envisioned by the statute." (Slip op. at pp. 25-26 [footnote omitted].)

Finally, the court cited legislative history dating to 1979, in which stakeholders endorsed including the reference to referenda, but made no mention to initiatives. In 2017, the Legislature adopted a measure prohibiting the adoption of development agreements via initiative. Governor Brown vetoed the measure. The city and developer characterized this bill as a failed attempt to change existing law. The legislative history of 2017's failed bill, however, stated that it was intended to "clarify" existing law, and observed that negotiated agreements (like development agreements) are "unsuitable for the initiative process." (Slip op. at p. 30.) "Thus, read in context and in light of the statutory scheme, the only reasonable interpretation of 'clarify' is that that the amendment barring approval by initiative was a clarification of the law, not a change to it." (*Ibid*.)

As the court summed up, "[w]e are sensitive to our duty to guard the right of initiative, and to resolve doubts in its favor. However, we are also required to ascertain the intent of the Legislature. There is

clear evidence that the Legislature intended to exclusively delegate approval of development agreements to governing bodies and to preclude the right of initiative." (Slip op. at p. 31.)

Spot Zoning

Citizens Coalition Los Angeles v. City of Los Angeles (2018) – Cal.App.5th – [slip op. dated August 23, 2018]

See summary above under "CEQA – Supplemental Review."

Fair Employment and Housing Act – Preemption

City and County of San Francisco v. Post (2018) 22 Cal.App.5th 121

The First District Court of Appeal held that the Fair Employment and Housing Act ("FEHA") did not preempt a city ordinance that prohibited landlords from refusing to rent to persons who receive Section 8 vouchers.

In 1998, the City and County of San Francisco adopted an ordinance prohibiting discrimination against tenants based on the source of income used to pay rent. The aim was to prevent discrimination against tenants who rely on Section 8 housing vouchers or other government housing subsidies. The Section 8 program provides these vouchers to qualifying low-income renters. The tenant provides the voucher to the landlord, and the landlord collects the money from the local agency implementing the Section 8 program.

In 1999, the State Legislature enacted FEHA, which included a similar prohibition against discrimination based on sources of income. But FEHA's definition of "sources of income" is narrower than that of the ordinance; it does not include government subsidies, does not prohibit a landlord from declining to rent to those receiving Section 8 vouchers, and thus allows a landlord to opt out of the Section 8 program.

A landlord in the city listed available units. The listing stated the landlord would not accept Section 8 tenants. The city initiated an enforcement action, stating that the listing violated the city ordinance. The landlord argued that FEHA preempted the city ordinance. The trial court disagreed. The landlord appealed.

The landlord argued that FEHA's source-of-income housing discrimination provision preempted the city's ordinance, citing Government Code section 12993, subdivision (c), in which the Legislature declared its intent to "occupy the field of regulation of discrimination in employment and housing" addressed by the legislation. The court read this language to preempt local ordinances only to the extent they addressed matters addressing discrimination that were encompassed by FEHA itself. Under this reading, FEHA's prohibition against discrimination based on the tenant's source of income does not address all such discrimination, but only discrimination based on sources of income *paid to the tenant* that is then used to pay rent. Section 8 subsidies are paid, not to the tenant, but directly to the landlord. By its terms, therefore, the sources of income addressed by FEHA do not include payments to someone other than the tenant. The preemption argument was also inconsistent with the general principle that, in the realm of land use, local agencies have broad police powers to address such matters as affordable housing; a local ordinance prohibiting discrimination against participants in the Section 8 program "fits

well within the sphere of land use regulation in which local ordinances are presumptively valid." (22 Cal.App.5th at p. 134, footnote omitted.)

The city's ordinance overlaps with the "source of income" provisions in FEHA, in that both the city ordinance and FEHA prohibited discrimination based on the source of a tenant's lawful income, to the extent that income is paid directly to the tenant. But the provision in the city ordinance at issue reached discrimination based on the tenant's participation in Section 8. FEHA addresses certain categories of discrimination, but not the particular category addressed by the city ordinance. Within this realm, there is no overlap, and no preemption.

Appellants argued that, even if FEHA did not expressly preempt the city ordinance, such preemption is nevertheless implied. In their view, FEHA embodies a policy choice to allow landlords to opt out of Section 8. The city ordinance deprives landlords of that choice. The court was unpersuaded because, while FEHA does not prohibit landlords from opting out of Section 8, it also does not guarantee that landlords can opt out. Rather than ensuring that landlords could choose whether to participate in Section 8, FEHA simply does not address the issue, leaving it to local agencies to decide whether to adopt an ordinance like the city's.

Ellis Act – Preemption

Small Property Owners of San Francisco Institute v. City and County of San Francisco (2018) 22 Cal.App.5th 77

The First District Court of Appeal held that a local ordinance imposing a ten-year waiting period on alterations to non-conforming residential units removed from the rental market imposed a substantive restriction on landlords that could not be squared with the Ellis Act.

The Ellis Act allows property owners who seek to exit the rental business to evict residential tenants, and prohibits local agencies from "compel[ling] the owner of any residential real property to offer, or to continue to offer, accommodations in the property for rent or lease." (Gov. Code, § 7060, subd. (a).) The City and County of San Francisco adopted an ordinance modifying the city's Planning Code. Previously, the Planning Code prohibited enlarging or altering non-conforming residential units. The amendments allowed altering or enlarging such non-conforming units in zoning districts where residential uses are principally permitted. A waiting period of ten years applied for changes to units if the landlord had evicted a tenant to withdraw the residential unit from the rental market under the Ellis Act. The amendments were designed to encourage improvements to non-conforming units – a source of relatively affordable housing – while discouraging landlords from removing these units from the rental market. The Small Property Owners of San Francisco Institute ("SPOSFI") sued. The trial court denied the petition. SPOSFI appealed.

SPOSFI argued that the ordinance was preempted by the Ellis Act because the ordinance imposed a ten-year waiting period on altering nonconforming units where a tenant was evicted by a landlord exercising its rights, guaranteed by the Ellis Act, to exit the rental market. The court agreed. The Ellis Act completely occupies the field of substantive eviction controls over landlords' desiring to exit the residential market. The ordinance was facially inconsistent with the Ellis Act. "By imposing a 10-year waiting period on alterations to non-conforming units where property owners have exercised their Ellis Act rights, the ordinance penalizes property owners who leave the rental market. The ordinance does not regulate the particulars of the remodeling of a nonconforming unit, but rather prohibits any such

changes for a period of 10 years after the property owner exits the rental business. By imposing such a prohibition on property owners who have left the rental market, the ordinance challenged here improperly enters the field of substantive eviction controls over such property owners. [Citation.]" (22 Cal.App.5th at pp. 87-88.) "[I]n every case where a property owner exercises the Ellis Act right to withdraw a nonconforming rental unit from the residential market, the property owner is met with a locally-imposed legal barrier: a 10-year waiting period before the unit can be remodeled. In this respect, the ordinance impedes property owners from exercising their Ellis Act rights to withdraw residential units from the rental market. It does not matter that the waiting period occurs after the Ellis Act eviction, rather than before it." (*Id*. at p. 88.) The ordinance's ten-year waiting period did not regulate the manner in which the landlord altered or remodeled the unit, and thus did not involve the city's acknowledged right to regulate local land-use. Rather, the waiting period focused on the removal of the unit from the rental market. "Rather than regulating the particulars of a property owner's proposed alteration of a nonconforming unit, the ordinance here prohibits a property owner who has withdrawn a nonconforming unit from the market from altering it for 10 years, and in doing so penalizes property owners who are protected by the Ellis Act." (*Ibid*.)

The city argued that the ordinance was aimed at protecting tenants, but whether such protection would be afforded was speculative. Moreover, the court saw no benefit to tenants from requiring a unit to remain unimproved and off the market for ten years.

The city argued the ordinance did not impose a prohibitive price on exiting the rental business. Under the Ellis Act, however, a local agency cannot impose significant restrictions on the landlord's use of the property, if those restrictions are tied to the exercise of Ellis Act rights. The city argued that the burden was reasonable because it paralleled the Ellis Act's provision allowing local agencies to require property owners who offer a unit for rent within ten years of its removal from the rental market to offer the unit to the displaced tenant. "But the ordinance does more than that. It does not simply require that a unit that is returned to the market be offered to the displaced tenant: it imposes a waiting period on the alteration of nonconforming units where an Ellis Act eviction has taken place, no matter the use to which the unit is put." (*Id*. at p. 90.) "We conclude that because it imposes a 10-year waiting period for alterations of properties that have been withdrawn from rental use under the Ellis Act, Planning Code section 181, subdivision (c)(3) conflicts with, and is preempted by, the Ellis Act." (*Ibid*.) The court reversed with instructions to the trial court to enjoin the city from enforcing this provision.

ISSUES THAT ARISE IN CEQA AND LAND-USE LITIGATION

Recovery of Costs for Preparation of Record

LandWatch San Luis Obispo Co. v. Cambria Comm. Serv. Dist. (2018) 25 Cal.App.5th 638

The Second District Court of Appeal ruled that the trial court acted within its discretion in awarding record-related costs to the respondent agency, even though the petitioner had elected to prepare the record, where the petitioner failed to prepare the record in a timely fashion.

In January 2014, the Cambria Community Services District ("District") approved an emergency water supply project. The District did not perform CEQA review. LandWatch sued and elected to prepare the record. LandWatch also sent the District a letter under the Public Records Act asking for the documents comprising the record. The District sent LandWatch the documents. A month later, the District informed LandWatch that additional documents had been identified, and that the District would provide them

upon payment. Three months passed before LandWatch asked for them, at which point the District provided the additional documents. By now, it was April 2015. In August 2015, LandWatch produced a draft index to the record. The District responded by noting that the index was both over- and under-inclusive. That same date, the District produced its own index and certified the record it had prepared. LandWatch filed a motion to include additional documents post-dating the January 2014 approval date. The trial court ordered the District to certify an appendix consisting of the additional documents. Weeks passed; LandWatch did not prepare the appendix. The District wrote that it would prepare the appendix itself. Only then did LandWatch prepare its own, competing appendix, which it lodged in February 2016, a month before the trial. The court accepted the District's appendix, and rejected the one prepared by LandWatch. Following trial, the court denied the petition. The District filed a memorandum of costs seeking $39K, including $4K for preparing the certified record, and $27K for preparing the appendix. LandWatch moved to tax costs. The trial court awarded the District $21K ($4K for preparing the certified record; $14K for preparing the appendix – half of the District's requested amount; and $3K for other items). LandWatch appealed.

LandWatch argued that, because it had elected to prepare the record, the District ought not to recover any record-related costs. The court noted, however, that in electing to prepare the record, LandWatch was required to do so within 60 days. LandWatch missed this deadline. LandWatch argued the District was to blame for the delays. The court disagreed. The trial court, as trier of fact, had concluded otherwise. "Here the trial court expressly found that the District acted properly in preparing the record. Implicit in the finding is that LandWatch unreasonably delayed. LandWatch's right to prepare the record is subject to a 60-day limitation. Having unreasonably delayed, it forfeited that right." (Slip op. at p. 6.) "… [U]nder the appropriate circumstances the trial court has discretion to award the agency costs for preparing the record notwithstanding the petitioner's election under section 21167.6, subdivision (b)(2). [¶] That is what the trial court did here and it was well within its discretion. The District has the right to a timely record." (*Id*. at p. 7.)

LandWatch argued the District ought not to recover costs associated with the appendix of post-approval documents because the District had resisted LandWatch's efforts to augment the record with them. The court was unmoved. The trial court had ordered the preparation of the appendix at LandWatch's insistence. "For LandWatch to now assert that the appendix is not part of the record to escape the costs it created is fanciful, if not perverse." (*Id*. at pp. 7-8.)

The trial court had awarded the District all of its costs for preparing the record, and half of its costs for preparing the appendix. LandWatch argued the 50% award for preparing the appendix was arbitrary, and fell short of the trial court's obligation to determine whether record-related costs were reasonable. The Court of Appeal disagreed, concluding that if anything a 50% award was too low.

LandWatch argued the trial court erred in awarding the District's court-call, copying and transcription costs. The appellate court noted that the trial court had already reduced the costs as requested by LandWatch, or had ample basis for finding the costs to be reasonable.

Attorneys Fees

La Mirada Avenue Neighborhood Assn. of Hollywood v. City of Los Angeles (2018) 22 Cal.App.5th 1149

The Second District Court of Appeals affirmed a trial court's award of attorneys fees under a "catalyst" theory, where the city responded to losing the first round of litigation by amending its zoning ordinance to allow the disputed project to proceed.

The underlying dispute concerned the City of Los Angeles' approval of a Target superstore in an area controlled by the subarea of a specific plan. In approving the project, the city granted eight variances to Target. Petitioners prevailed on their claim that the findings adopted to grant six of the eight variances were not supported by substantial evidence. The court denied petitioners' CEQA claims. Petitioners and Target both appealed. While the appeal was pending, the city approved a new planning subarea encompassing the project site. The Court of Appeal dismissed the appeal as moot. (*La Mirada Avenue Neighborhood Assn. of Hollywood v. City of Los Angeles* (2016) 2 Cal.App.5th 586 (*Mirada I*).) Petitioners filed a second lawsuit attacking the city's approval of the new planning subarea. The trial court granted the petition. The city and Target appealed. The second appeal remains pending.

Meanwhile, after the Court of Appeal dismissed the appeal in *Mirada I*, petitioners filed a motion for an award of attorneys' fees under Code of Civil Procedure section 1021.5. The trial court awarded roughly $973K. The city and Target appealed the fee award.

The city and Target argued that petitioners were not successful parties, and that no significant benefit had been conferred on a large class of persons. That was because Target successfully advocated for a change in the zoning ordinance, which allowed the store to proceed without variances, and the validity of the city's approval under the amended ordinance had yet to be determined. The city and Target also argued that, even if fees were permissible, the amount was too large.

The court disagreed. First, under the "catalyst theory," the petitioner can show that it was a successful party if it can demonstrate that its litigation caused the defendant to alter its behavior. The petitioner does not have to show that it achieved a specific outcome. Here, petitioners were "successful" in two ways. First, they vindicated their interest when the variances were set aside and further development was enjoined. Second, the suit prompted the "legislative fix" of creating a changed zoning subarea specifically tailored for the project.

Second, petitioners conferred a "significant benefit" to the entire city. That benefit consisted of forcing the city to comply with the municipal code concerning variances. This benefit transcended the Target project.

The city and Target argued that, because the appeal concerning the new zoning subarea was still pending, the rights at issue were still unsettled. The court disagreed. Where a party has obtained a final judgment in its favor on the merits, under the law in existence at the time, and where what remains to be finally adjudicated is the validity of a project under the law as subsequently amended, a petitioner is entitled to fees. The focus of the court's inquiry is the litigation objectives of the prevailing plaintiff, not on the defendant's goals. Here, petitioners accomplished their stated purpose of judicial review of the city's variance process. They did not need to show that they entirely stopped the project. Nor does section 1021.5 require a showing that the entire dispute is settled. Petitioners obtained a final judgment in their favor on the merits, under the law in existence at the time. A court can only resolve disputes

based on existing law, not the law as it might be amended in the future. The court declined to contemplate whether petitioners would be entitled to fees under the new zoning of the subarea, since the new zoning was not at issue in the *Mirada I* litigation.

In the unpublished portion of the decision, the court held that the trial court did not abuse its discretion in determining the amount of the fee award.

REGULATORY DEVELOPMENTS

Update to State CEQA Guidelines

On November 27, 2017, the Governor's Office of Planning and Research transmitted a set of proposed amendments to the CEQA Guidelines to the Natural Resources Agency. The proposed amendments proposed dozens of changes, and represented the first comprehensive update to the Guidelines in roughly 20 years.

In January 2018, the Natural Resources Agency published a "Notice of Proposed Rulemaking." In March 2018, the Agency held hearings on the proposed rulemaking. On July 2, 2018, the Agency issued a "15-day notice" setting forth proposed changes to the amendments. The comment period on the proposed changes ended on July 20, 2018. The Agency is expected to respond to comments received by July 20, and to proceed with the rulemaking. The process will likely conclude before the end of 2018. The updated CEQA Guidelines will apply prospectively only, and would not affect projects that have already commenced environmental review. Additionally, while a public agency could immediately apply the proposed new Guidelines section regarding the evaluation of transportation impacts (proposed Guidelines section 15064.3), statewide application of that new section would not be required until January 1, 2020.

The proposed changes set forth in the 15-day notice involve the following sections of the State CEQA Guidelines:

15004 – timing of CEQA review
15063 – initial studies
15064 – thresholds of significance
15064.3 – transportation impacts and vehicle miles traveled
15064.4 – analysis of greenhouse gas emissions
15125 – description of environmental setting in an EIR; "baseline"
15126.2 – analysis of significant impacts, including wasteful or unnecessary use of energy
15126.4 – mitigation measures, including deferral of mitigation
15182 – exemption for certain residential, mixed use or transit-oriented projects
15234 – addressing how an agency may respond to a successful court challenge
15301 – Class 1 categorical exemption – also applies to transit improvements
Appendix G – checklist revisions to address tribal resources, aesthetics in urban area
Appendix N – checklist for urban projects, revisions paralleling those in Appendix G

The rulemaking file is posted on the Agency's web site at:

http://resources.ca.gov/ceqa/

Technical Advisory re: CEQA Exemptions

In June 2018, the Governor's Office of Planning and Research issued a Technical Advisory entitled: "CEQA Exemptions Outside of the CEQA Statute." The advisory provides an inventory of statutory exemptions that are not located within the CEQA statute itself. (Pub. Resources Code, § 21000 et seq.) The advisory includes an appendix with the statutory language of these exemptions. The advisory is located at:

http://opr.ca.gov/docs/20180606-Tech_Advisory_CEQA_Exemptions.pdf

CEQA AND LAND-USE CASES PENDING IN THE SUPREME COURT

There are four CEQA and land-use cases pending at the California Supreme Court. The cases, listed newest to oldest, and the Supreme Court's summaries are as follows:

United Auburn Indian Community of Auburn Rancheria v. Brown, S238544. (C075126; 4 Cal.App.5th 36; Sacramento County Superior Court.) Petition for review after the Court of Appeal affirmed the judgment in action for writ of administrative mandate. This case presents the following issue: May the Governor concur in a decision by the Secretary of the Interior to take off-reservation land in trust for purposes of tribal gaming without legislative authorization or ratification, or does such an action violate the separation of powers provisions of the state Constitution? Briefing completed December 2017; oral argument not scheduled.

Union of Medical Marijuana Patients, Inc. v. City of San Diego, S238563. (D068185; 4 Cal.App.5th 103; San Diego County Superior Court.) Petition for review after the Court of Appeal affirmed the judgment in an action for administrative mandate. This case presents the following issues: (1) Is the enactment of a zoning ordinance categorically a "project" within the meaning of the California Environmental Quality Act (Pub. Resources Code, § 21000 et seq.)? (2) Is the enactment of a zoning ordinance allowing the operation of medical marijuana cooperatives in certain areas the type of activity that may cause a reasonably foreseeable indirect physical change to the environment? Briefing completed December 2017; oral argument not scheduled.

T-Mobile West LLC v. City and County of San Francisco, S238001. (A144252; 3 Cal.App.5th 334, mod. 3 Cal.App.5th 999c; San Francisco County Superior Court.) Petition for review after the Court of Appeal affirmed the judgment in a civil action. This case presents the following issues: (1) Is a local ordinance regulating wireless telephone equipment on aesthetic grounds preempted by Public Utilities Code section 7901, which grants telephone companies a franchise to place their equipment in the public right of way provided they do not "incommode the public use of the road or highway or interrupt the navigation of the waters"? (2) Is such an ordinance, which applies only to wireless equipment and not to the equipment of other utilities, prohibited by Public Utilities Code section 7901.1, which permits municipalities to "exercise reasonable control as to the time, place and manner in which roads, highways, and waterways are accessed" but requires that such control "be applied to all entities in an equivalent manner"? Briefing completed June 2017; oral argument not scheduled.

Sierra Club v. County of Fresno, S219783. (F066798, 226 Cal.App.4th 704; Fresno County Superior Court.) Petition for review after the Court of Appeal reversed the judgment of the trial

court in an action for writ of administrative mandate. This case presents issues concerning the standard and scope of judicial review under the California Environmental Quality Act. (CEQA; Pub. Resources Code, § 21000 et seq.) Briefing completed July 2015; oral argument letter sent October 2017; oral argument not scheduled.

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"A Cloud on Every Decision": Nollan/Dolan and Legislative Exactions

Friday, September 14, 2018 General Session; 8:00 – 10:00 a.m.

Glen Hansen, Senior Counsel, Abbott & Kindermann, Inc.

Notes:

"A CLOUD ON EVERY DECISION": *NOLLAN/DOLAN* AND LEGISLATIVE EXACTIONS

presented at

LEAGUE OF CALIFORNIA CITIES
2018 Annual Conference & Expo
City Attorneys' Track

Friday, September 14, 2018, 8:00 a.m. – 10:00 a.m.
Long Beach Convention Center, Long Beach, California

GLEN HANSEN
Senior Counsel

ABBOTT & KINDERMANN, INC.
ATTORNEYS AT LAW

CONTENTS:

SUMMARY:

In *Koontz*, a closely-divided Court held that the two-part *Nollan/Dolan* test applies to a government's demand for a monetary exaction imposed on a land-use permit applicant on an *ad hoc*, adjudicative basis. However, the *Koontz* decision did not address the issue of whether *Nollan/Dolan* applies to generally-applied legislative fees. Justice Kagan recognized that uncertainty in her dissent in *Koontz*: "[T]he majority's refusal 'to say more' about the scope of its new rule [of applying *Nollan/Dolan* to monetary exactions] now casts a cloud on every decision by every local government to require a person seeking a permit to pay or spend money." More recently, Justice Thomas similarly warned: "Until we decide this issue, property owners and local governments are left uncertain about what legal standard governs legislative ordinances and whether cities can legislatively impose exactions that would not pass muster if done administratively." (*California Building Industry Assn. v. City of San Jose*, 136 S. Ct. 928 (2016) (J.Thomas, concur. in den. cert.).) In several recent cases in California, property owners have argued that, following *Koontz*, all exactions must comply with *Nollan/Dolan.* This presentation, based on actual arguments successfully made in the California Superior Court, outlines why *Nollan/Dolan* should not apply to generally-applied legislative exactions.

PACE
ENVIRONMENTAL
LAW REVIEW

Let's Be Reasonable: Why Neither *Nollan/Dolan* nor *Penn Central* Should Govern Generally-Applied Legislative Exactions After *Koontz*

Glen Hansen

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II. KOONTZ EXTENDED THE HEIGHTENED SCRUTINY OF NOLLAN/DOLAN TO AD HOC, ADJUDICATIVE MONETARY EXACTIONS, BUT DID NOT ADDRESS WHETHER NOLLAN/DOLAN ALSO APPLIES TO LEGISLATIVE EXACTIONS

A. The Heightened Scrutiny in *Nollan/Dolan* Is Designed to Protect Land-Use Applicants from a Specific Type of Regulatory Taking

The Takings Clause in the Fifth Amendment provides "nor shall private property be taken for public use, without just compensation."[16] It does not prohibit the taking of private property, "but instead places a condition on the exercise of that power."[17] The Takings Clause is designed "to secure compensation in the event of otherwise proper interference amounting to a taking."[18]

The "paradigmatic" taking that requires just compensation is a "direct government appropriation or physical invasion of private property."[19] When the government physically takes possession of an interest in property for some public purpose, "it has a categorical duty to compensate the former owner, regardless of whether the interest that is taken constitutes an entire parcel or merely a part thereof."[20] That category of "physical takings" cases "requires courts to apply a clear rule."[21]

However, beginning with the 1922 case of *Pennsylvania Coal Co. v. Mahon*,[22] the U.S. Supreme Court recognized that "[g]overnment regulation of private property may, in some instances, be so onerous that its effect is tantamount to a direct appropriation or ouster—and that such 'regulatory takings' may

16. U.S. CONST. amend. V. The Takings Clause is made applicable to the States through the Fourteenth Amendment. Chi., Burlington & Quincy R.R. Co. v. City of Chicago, 166 U.S. 226, 241 (1897).

17. First English Evangelical Lutheran Church of Glendale v. County of Los Angeles, 482 U.S. 304, 314 (1987).

18. *Id.* at 315.

19. Lingle v. Chevron U.S.A. Inc., 544 U.S. 528, 537 (2005).

20. Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency, 535 U.S. 302, 322 (2002) (internal citation omitted).

21. *Id.* at 323 (quoting Yee v. Escondido, 503 U.S. 519, 523 (1992)).

22. 260 U.S. 393 (1922).

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be compensable under the Fifth Amendment."[23] A "regulatory takings" case "'necessarily entails complex factual assessments of the purposes and economic effects of government actions.'"[24] So far, the Court has recognized four (4) different theories under which a government regulation may be challenged under the Takings Clause. Two of those theories are deemed *per se* takings, and two of those theories are not. The two categories of regulatory action that are deemed *per se* takings are "where government requires an owner to suffer a permanent physical invasion of her property,"[25] and where regulations "completely deprive an owner of '*all* economically beneficial us[e]' of her property."[26] For regulatory actions that do not involve *per se* takings, the Supreme Court has historically applied either the factored analysis in *Penn Central* or the heightened standard of review in *Nollan/Dolan*.

Under *Penn Central*, the Court applied a three-factor regulatory takings analysis that examines the economic impact of the regulation, the extent to which it interferes with investment-

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23. *Lingle*, 544 U.S. at 537–38 ("In Justice Holmes' storied but cryptic formulation, 'while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking.'" (citing *Pa. Coal Co.* 260 U.S. at 415)).

24. *Tahoe-Sierra*, 535 U.S. at 323 (quoting *Yee*, 503 U.S. at 523). In *Tahoe-Sierra*, the Court explained the rationale as to why judicial review is different in physical takings cases and regulatory takings cases:

> This longstanding distinction between acquisitions of property for public use, on the one hand, and regulations prohibiting private uses, on the other, makes it inappropriate to treat cases involving physical takings as controlling precedents for the evaluation of a claim that there has been a "regulatory taking," and vice versa. . . . Land-use regulations are ubiquitous and most of them impact property values in some tangential way—often in completely unanticipated ways. Treating them all as *per se* takings would transform government regulation into a luxury few governments could afford. By contrast, physical appropriations are relatively rare, easily identified, and usually represent a greater affront to individual property rights.

Id. at 323–24.

25. *Lingle*, 544 U.S. at 538 (citing Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982)).

26. *Id.* (quoting Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1019 (1992)) (emphasis in original).

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backed expectations, and the character of the governmental action.[27]

Under the two-part inquiry of *Nollan/Dolan,* "a unit of government may not condition the approval of a land-use permit on the owner's relinquishment of a portion of his property unless there is a 'nexus' and 'rough proportionality' between the government's demand and the effects of the proposed land use."[28] In *Koontz*, the majority of the Justices held that this two-part test applies when the government demands a monetary exaction in order to obtain an adjudicative land use permit.[29]

B. The Majority in *Koontz* Applied *Nollan/Dolan* to *Ad Hoc*, Adjudicative Monetary Exactions

The petitioner in *Koontz* (and his father before him) sought to develop a portion of his 14.9-acre property, the southern portion of which included wetlands.[30] His development plans called for the development of the 3.7-acre northern section of his property.[31] Under Florida state law, a landowner wishing to undertake construction on that particular type of property had to obtain a management and storage of surface water permit (which could

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27. *See* Penn Cent. Transp. Co. (*Penn Central*) v. City of New York, 438 U.S. 104, 124 (1978); *see also* MacDonald, Sommer & Frates v. Yolo County, 477 U.S. 340, 349 (1986); Connolly v. Pension Benefit Guar. Corp., 475 U.S. 211, 224–25 (1986); Kaiser Aetna v. United States, 444 U.S. 164, 175 (1979). In *Lingle*, the Court explained the *Penn Central* analysis as follows:

> The Court in *Penn Central* acknowledged that it had hitherto been "unable to develop any 'set formula'" for evaluating regulatory takings claims, but identified "several factors that have particular significance." Primary among those factors are "[t]he economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations." In addition, the "character of the governmental action"-for instance whether it amounts to a physical invasion or instead merely affects property interests through "some public program adjusting the benefits and burdens of economic life to promote the common good" may be relevant in discerning whether a taking has occurred.

544 U.S. at 538–39 (internal citations omitted).

28. Koontz v. St. Johns River Water Mgmt. Dist., 133 S. Ct. 2586, 2591 (2013).

29. *Id.* at 2603.

30. *Id.* at 2591-92.

31. *Id.* at 2592.

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impose "such reasonable conditions" on the permit as are "necessary to assure" that construction will "not be harmful to the water resources of the district") and a wetlands resource management permit.[32] Petitioner sought such a permit from the St. Johns River Water Management District ("District").[33] To mitigate the environmental effects of his proposal, petitioner offered to foreclose any possible future development of the approximately 11-acre southern section of his land by deeding to the District a conservation easement on that portion of his property.[34] The District considered the proposed easement to be inadequate, and informed petitioner that the District would approve construction only if he agreed to one of two concessions: (a) Petitioner reduce the size of his development to 1 acre and deed a conservation easement to the District on the remaining 13.9 acres; *or* (b) proceed with the development on the terms proposed by petitioner *and* hire contractors to make improvements to District-owned land several miles away.[35] The District also said that it "would also favorably consider" alternatives to its suggested offsite mitigation projects if petitioner proposed something "equivalent."[36]

Petitioner filed suit in a Florida state court under a state law that provides money damages for agency action that are "an unreasonable exercise of the state's police power constituting a taking without just compensation."[37] The Florida trial court found that the District's demands failed to comply with *Nollan/Dolan*.[38] The Florida District Court of Appeal affirmed.[39] The Florida Supreme Court reversed on two grounds: (1) unlike the conditional approvals in *Nollan* or *Dolan*, the District here *denied* Petitioner's permit application; and (2) a monetary exaction cannot give rise to a takings claim under

32. *Koontz*, 133 S. Ct. at 2592.
33. *Id.*
34. *Id.* at 2592-93.
35. *Id.* at 2593.
36. *Id.*
37. *Id.* (quoting FLA. STAT. § 373.617(2) (2016)).
38. *Id.*
39. *Id.*

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Nollan/Dolan.[40] The U.S. Supreme Court reversed and held that the Florida Supreme Court erred on both grounds.[41]

First, the Court unanimously agreed the *Nollan/Dolan* standard may apply to the government's denial of a permit. Writing for the majority, Justice Alito stated that "the government's demand for property from a land-use permit applicant must satisfy the requirements of *Nollan* and *Dolan* even when the government denies the permit . . . ."[42] The dissent agreed: "The *Nollan-Dolan* standard applies not only when the government approves a development permit conditioned on the owner's conveyance of a property interest (*i.e.*, imposes a condition subsequent), but also when the government denies a permit until the owner meets the condition (*i.e.*, imposes a condition precedent)."[43]

Second, by a 5-4 margin, the Court held that "so-called 'monetary exactions' must satisfy the nexus and rough proportionality requirements of *Nollan* and *Dolan*."[44] The majority concluded that a government's "demand for property" from a land-use permit applicant must satisfy the requirements of *Nollan* and *Dolan*, "even when its demand is for money."[45] Thus, the majority in *Koontz* applied the heightened scrutiny of *Nollan* and *Dolan* to monetary exactions in an *ad hoc*, individualized context. The analysis below examines the constitutional rationales adopted by the majority in reaching that conclusion.

C. The Majority in *Koontz* Focused on Extortionate Governmental Demands and Monetary Targeting of Specific Properties

Writing for the majority, Justice Alito explained that the constitutional basis for the heightened scrutiny in *Nollan/Dolan* is the "unconstitutional conditions" doctrine. The Court explained that, because "the government may not deny a benefit to a person

40. *Koontz*, 133 S. Ct. at 2593-94.
41. *Id.* at 2603.
42. *Id.*
43. *Id.* (Kagan, J., dissenting).
44. *Id.* at 2599.
45. *Id.* at 2603.

because he exercises a constitutional right,"[46] the unconstitutional conditions doctrine "vindicates the Constitution's enumerated rights by preventing the government from coercing people into giving them up."[47] The premise of any unconstitutional conditions claim "is that the government could not have constitutionally ordered the person asserting the claim to do what it attempted to pressure that person into doing."[48] Justice Alito noted that *Nollan* and *Dolan* involve "'a special application' of [the unconstitutional conditions] doctrine that protects the Fifth Amendment right to just compensation for property the government takes when owners apply for land-use permits."[49]

The majority opinion discussed the "two realities of the permitting process" that warrant the "special application" of the unconstitutional conditions doctrine under *Nollan/Dolan*.[50] The first reality is "that land-use permit applicants are especially vulnerable to the type of coercion that the unconstitutional conditions doctrine prohibits because the government often has broad discretion to deny a permit that is worth far more than property it would like to take."[51] Justice Alito explains the "extortionate" nature of that relationship between permit applicants and local governments:

> By conditioning a building permit on the owner's deeding over a public right-of-way, for example, the government can pressure an owner into voluntarily giving up property for which the Fifth Amendment would otherwise require just compensation. So long as the building permit is more valuable than any just compensation the owner could hope to receive for the right-of-way, the owner is likely to accede to the government's demand, no matter how unreasonable. Extortionate demands of this sort frustrate

46. *Koontz*, 133 S. Ct. at 2594 (citing Regan v. Taxation With Representation of Wash., 461 U.S. 540, 545 (1983).

47. *Id.*

48. *Id.* at 2598.

49. *Id.* at 2594 (citing Lingle v. Chevron U.S.A. Inc., 544 U.S. 528, 547 (2005)).

50. *Id.*

51. *Id.*

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> the Fifth Amendment right to just compensation, and the unconstitutional conditions doctrine prohibits them.[52]

Justice Alito continues:

> Extortionate demands for property in the land-use permitting context run afoul of the Takings Clause not because they take property but because they impermissibly burden the right not to have property taken without just compensation. As in other unconstitutional conditions cases in which someone refuses to cede a constitutional right in the face of coercive pressure, the impermissible denial of a governmental benefit is a constitutionally cognizable injury.[53]

Thus, the potential for extortionate demands by the government warrants application of the heightened scrutiny of *Nollan/Dolan* in the land use context.[54]

The second reality of the permitting process, according to the majority, is that "many proposed land uses threaten to impose costs on the public that dedications of property can offset."[55] Justice Alito recognized that requiring landowners to internalize the negative externalities of their conduct "is a hallmark of responsible land-use policy, and we have long sustained such regulations against constitutional attack."[56]

The heightened scrutiny in *Nollan/Dolan* accommodates those two realities "by allowing the government to condition approval of a permit on the dedication of property to the public so long as there is a 'nexus' and 'rough proportionality' between the property that the government demands and the social costs of the

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52. *Koontz*, 133 S. Ct. at 2594-95 (internal citations omitted).

53. *Id.* at 2596 (emphasis added).

54. Because of that threat of extortionate demands in the adjudicative exactions context, the majority in *Koontz* explained that heightened scrutiny was needed, despite the potential applicability of other constitutional doctrines: the court has "repeatedly rejected the dissent's contention that other constitutional doctrines leave no room for the nexus and rough proportionality requirements of *Nollan* and *Dolan*. Mindful of the special vulnerability of land use permit applicants to extortionate demands for money, we do so again today." *Id.* at 2602–03.

55. *Id.* at 2595.

56. *Id.*

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applicant's proposal."[57] Thus, the Court's precedents combine those two realities by allowing the government "to insist that applicants bear the full costs of their proposals while still forbidding the government from engaging in *'out-and-out . . . extortion'* that would thwart the Fifth Amendment right to just compensation.[58] Those rationales must be addressed in any analysis of judicial scrutiny of legislative exactions.

Furthermore, the majority in *Koontz* essentially made four arguments in support of applying *Nollan/Dolan* to the *ad hoc* monetary exactions in that case. First, Justice Alito argued that it would be "very easy" for land-use permitting officials to evade the limitations of *Nollan/Dolan* if monetary exactions were not brought under that heightened scrutiny.[59] For example, "[b]ecause the government need only provide a permit applicant with one alternative that satisfies the nexus and rough proportionality standards, a permitting authority wishing to exact an easement could simply give the owner a choice of either surrendering an easement or making a payment equal to the easement's value."[60] Those "in lieu of" fees are "functionally equivalent to other types of land use exactions."[61]

Second, the *Koontz* majority distinguished the monetary exaction imposed on the particular real property in that case from general taxes that were addressed in *Eastern Enterprises v. Apfel*.[62] In *Eastern Enterprises*, the United States retroactively imposed on a former mining company an obligation to pay for the medical benefits of retired miners and their families.[63] A four-Justice plurality in *Eastern Enterprises* concluded that the statute's imposition of retroactive financial liability was so arbitrary that it violated the Takings Clause.[64] However, Justice Kennedy joined four other Justices in dissent in *Eastern Enterprises* in arguing that the Takings Clause does not apply to

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57. *Koontz*, 133 S. Ct. at 2595 (citing Dolan v. City of Tigard, 512 U.S. 374, 391 (1994); Nollan v. Cal. Coastal Comm'n, 483 U.S. 825, 837 (1987)).

58. *Id.* (emphasis added) (citing *Dolan*, 512 U.S. at 391; *Nollan*, 483 U.S. at 837).

59. *Id.* at 2599.

60. *Id.*

61. *Id.*

62. *Id.* (citing E. Enters. v. Apfel, 524 U.S. 498 (1998)).

63. *E. Enters*, 524 U.S. at 513-14, 517.

64. *Id.* at 538.

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government-imposed financial obligations that "d[o] not operate upon or alter an identified property interest."[65] The majority in *Koontz* distinguishes Justice Kennedy's opinion in *Eastern Enterprises* by focusing on the property-specific nature of the exaction at issue in *Koontz*. Justice Alito wrote that, unlike *Eastern Enterprises*, the demand for money in *Koontz* "'operate[d] upon . . . an identified property interest' by directing the owner of a particular piece of property to make a monetary payment," and "burdened petitioner's ownership of a specific parcel of land."[66] The *Koontz* case therefore bore a resemblance to cases holding that the government must pay just compensation "when it takes a lien–a right to receive money that is secured by a particular piece of property."[67] Justice Alito explained:

> The fulcrum this case turns on is the direct link between the government's demand and a specific parcel of real property. Because of that direct link, this case implicates the central concern of Nollan and Dolan: the risk that the government may use its substantial power and discretion in land-use permitting to pursue governmental ends that lack an essential nexus and rough proportionality to the effects of the proposed new use of the specific property at issue, thereby diminishing without justification the value of the property.[68]

Justice Alito added:

> [The petitioner] does not ask us to hold that the government can commit a *regulatory* taking by directing someone to spend money. As a result, we need not apply *Penn Central*'s "essentially ad hoc, factual inquir[y]," at all, much less extend that "already difficult and uncertain rule" to the "vast category of cases" in which someone believes that a regulation is too costly. *Eastern Enterprises*, 524 U. S. at 542, (opinion of Kennedy, J.). Instead, petitioner's claim rests on the more limited proposition that when the government commands the relinquishment of funds linked to a *specific, identifiable property interest* such as a bank account or par-

65. *E. Enters*, 524 U.S. at 540 (Kennedy, J., opinion concurring in judgment and dissenting in part).

66. *Koontz*, 133 S. Ct. at 2599.

67. *Id.*

68. *Id.* at 2600 (emphasis added).

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> cel of real property, a "*per se* [takings] approach" is the proper mode of analysis under the Court's precedent.[69]

Thus, the majority in *Koontz* emphasized the individualized, property-specific nature of the exaction that falls within *Nollan/Dolan*.

Third, Justice Alito rejected the argument that, if monetary exactions are made subject to scrutiny under *Nollan* and *Dolan*, then there will be no principled way of distinguishing impermissible land-use exactions from property taxes. He wrote that "[i]t is beyond dispute that '[t]axes and user fees . . . are not "takings,"'" and therefore the Court's holding in *Koontz* "does not affect the ability of governments to impose property taxes, user fees, and similar laws and regulations that may impose financial burdens on property owners."[70] Also, he explained, the Court has had "little trouble distinguishing" between the power of taxation and the power of eminent domain.[71]

D. The Dissent in *Koontz* Decried Judicial Intrusion into Local Land Use Decisions

Writing for the dissent, Justice Kagan refused to apply *Nollan/Dolan* to monetary exactions in the land use context. She explained that "[c]laims that government regulations violate the Takings Clause by unduly restricting the use of property are generally 'governed by the standards set forth in *Penn Central Transp. Co. v. New York City*, 438 U. S. 104, (1978).'"[72] While the *Penn Central* test "balances the government's manifest need to pass laws and regulations 'adversely affect[ing] . . . economic values,' with our longstanding recognition that some regulation 'goes too far,'" the *Nollan* and *Dolan* decisions are different because "[t]hey provide an independent layer of protection in 'the special context of land-use exactions.'"[73] She added: "*Nollan* and *Dolan* thus serve not to address excessive regulatory burdens on

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69. *Koontz*, 133 S. Ct. at 2600 (alteration in original) (emphasis added at "specific, identifiable property interest") (citations omitted).

70. *Id.* at 2600-01 (citing Brown v. Legal Foundation of Washington, 538 U.S. 216, 243 n.2 (2003) (Scalia, J., dissenting).

71. *Id.* at 2602.

72. *Id.* at 2604 (Kagan, J., dissenting) (citations omitted).

73. *Id.* (citations omitted).

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land use (the function of *Penn Central*), but instead to stop the government from imposing an 'unconstitutional condition'—a requirement that a person give up his constitutional right to receive just compensation 'in exchange for a discretionary benefit' 8having 'little or no relationship' to the property taken."[74] The dissent concluded that the unconstitutional conditions doctrine cannot apply to challenges to monetary exactions at all in the land use context.[75] Justice Kagan explained: "[A] court can use the *Penn Central* framework, the Due Process Clause, and (in many places) state law to protect against monetary demands, whether or not imposed to evade *Nollan* and *Dolan*, that simply "go[] too far."[76]

The dissent also highlighted the ambiguity regarding the scope of the majority's opinion. Specifically, Justice Kagan was concerned that, by extending *Nollan* and *Dolan*'s heightened scrutiny to a simple payment demand, "the majority threatens the heartland of local land-use regulation and service delivery, at a bare minimum depriving state and local governments of 'necessary predictability.'"[77] She lamented that, "[b]y applying *Nollan* and *Dolan* to permit conditions requiring monetary payments–with no express limitation except as to taxes–the majority extends the Takings Clause, with its notoriously 'difficult' and 'perplexing' standards, into the very heart of local land-use regulation and service delivery."[78] Justice Kagan was concerned that "the flexibility of state and local governments to take the most routine actions to enhance their communities will diminish accordingly."[79] The dissent questioned the majority's position that the decision will have only limited impact on localities' land-use authority, because "the majority's refusal 'to say more' about the scope of its new rule now casts a cloud on

74. *Koontz*, 133 S. Ct. at 2604-05 (Kagan, J., dissenting) (citations omitted).

75. *Id.* at 2606-07, -09 n.3 (Kagan, J., dissenting).

76. *Id.* at 2609 (Kagan, J., dissenting) (alteration in original) (citation omitted)

77. *Id.* (Kagan, J., dissenting) (quoting E. Enters. v. Apfel, 524 U.S. 498, 542 (1998) (Kennedy, J., opinion concurring in judgment and dissenting in part)).

78. *Id.* at 2607 (Kagan, J., dissenting) (citations omitted).

79. *Id.* (Kagan, J., dissenting).

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every decision by every local government to require a person seeking a permit to pay or spend money."[80]

E. *Koontz* Left Open the Question of Whether *Nollan/Dolan* Applies to Legislative Exactions

The majority in *Koontz* did not address the issue of whether legislatively applied exactions are also governed by *Nollan/Dolan*. Professor John Echeverria notes: "The majority opinion in *Koontz* is pointedly silent as to whether the ruling applies only to *ad hoc* fees or applies to fees imposed through general rules as well."[81] Professor Echeverria aptly predicts: "With respect to monetary fees, one issue that will preoccupy the lower courts in the years ahead is whether the *Koontz* ruling that monetary fees are subject to *Nollan/Dolan* applies to fees calculated and imposed, not in *ad hoc* proceedings, but through general legislation."[82] As discussed above, that ambiguity has led Justice Thomas to recently point out the "compelling reasons for resolving this conflict at the earliest practicable opportunity."[83]

For the reasons discussed below, this author recommends that the Court should follow Justice Kagan's suggestion in *Koontz* that the Court "approve the rule, adopted in several States, that *Nollan* and *Dolan* apply only to permitting fees that are imposed *ad hoc*, and not to fees that are generally applicable."[84]

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80. *Koontz*, 133 S. Ct. at 2608 (Kagan, J., dissenting).

81. John D. Echeverria, Koontz*: The Very Worst Takings Decision Ever?*, 22 N.Y.U. ENVTL. L.J. 1, 54-55 (2014).

82. *Id.* at 54.

83. Cal. Bldg. Indus. Ass'n v. City of San Jose, 136 S. Ct. 928, 929 (2016).

84. *Koontz*, 133 S. Ct. at 2608 (Kagan, J., dissenting) (citing as an example Ehrlich v. Culver City, 911 P.2d 429 (Cal. 1996)).

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OUTLINE OF THE LEGAL ARGUMENTS AS TO WHY, EVEN AFTER *KOONTZ*, THE HEIGHTENED SCRUTINY IN *NOLLAN/DOLAN* SHOULD NOT APPLY TO GENERALLY-APPLIED LEGISLATIVE EXACTIONS

I. State And Federal Courts In California Have Affirmed That *Koontz* Did Not Address The Issue Of Whether *Nollan/Dolan* Applies To Generally Applied Legislative Fees.

A. *See California Building Industry Assn. v. City of San Jose* (2015) 61 Cal. 4th 435, 457 ("*California Building*"), *cert. den., Cal. Bldg. Indus. Ass'n v. City of San Jose* (2015) 136 S.Ct. 928.) 61 Cal.4th at p. 460 & fn 11 ["An additional ambiguity arises from the fact that the monetary condition in *Koontz*, like the conditions at issue in *Nollan* and *Dolan*, was imposed by the district on an *ad hoc* basis upon an individual permit applicant, and was not a legislatively prescribed condition that applied to a broad class of permit applicants. In this respect, the money payment at issue in *Koontz* was similar to the monetary recreational facility mitigation fee at issue in this court's decision in *Ehrlich v. City of Culver City* (1996) 12 Cal.4th 854 (*Ehrlich*), where we held that because of the greater risk of arbitrariness and abuse that is present when a monetary condition is imposed on an individual permit applicant on an *ad hoc* basis, the validity of the *ad hoc* fee imposed in that case should properly be evaluated under the *Nollan/Dolan* test. (*Ehrlich, supra,* at pp. 874–885 (plur. opn. of Arabian, J.); *id.* at pp. 899–901 (conc. opn. of Mosk, J.); *id.* at pp. 903, 907 (conc. & dis. opn. of Kennard, J.); *id.* at p. 912 (conc. & dis. opn. of Werdegar, J.).) The *Koontz* decision does not purport to decide whether the *Nollan/Dolan* test is applicable to legislatively prescribed monetary permit conditions that apply to a broad class of proposed developments. (*See Koontz*, *supra*, 570 U.S. at 268 (Kagan, J., dissenting).)

B. See *Building Industry Association - Bay Area v. City of Oakland*, 289 F. Supp. 3d 1056, 1058 (N.D.Ca., Feb. 5, 2018) ("*BIA*") ["The Court did not hold in *Koontz* that generally applicable land-use regulations are subject to facial challenge under the exactions doctrine; it held only that the exactions doctrine applies to demands for money (not merely demands for encroachments on property). In reaching this holding, the Court went out of its way to make clear that it was not expanding the doctrine beyond that. *See* 133 S. Ct. at 2602 ('This case does not require us to say more.'); *id.* at 2600 n. 2 ([T]his case does not implicate the question whether monetary exactions must be tied to a particular parcel of land in order to constitute a taking.'). *Koontz* involved an adjudication by local land-use officials regarding an individual piece of property, and throughout its decision the Court spoke of the exactions doctrine in those terms. For example, the Court stated: 'The fulcrum this case turns on is the direct link between the government's demand and a *specific parcel* of real property.' [570 U.S. at 613] (emphasis added). 'Because of that direct link,' the Court stated, 'this case implicates the central concern of *Nollan* and *Dolan*: the risk that the government may use its substantial power and discretion in land-use permitting to pursue governmental ends that lack an essential nexus and rough proportionality to the effects of the proposed new use of the *specific* property at issue, thereby diminishing without justification the value of the property.' *Id.* (emphasis added); *see also id.* at [640-605] (noting that permit applicants are 'especially vulnerable' to government

coercion 'because the government often has broad discretion to deny a permit that is worth far more than property it would like to take')."]

II. The *Nollan/Dolan* Test Should Not Apply To Legislative Exactions That Are Generally Applied.

A. *Nollan* and *Dolan* did not involve generally-applicable legislative exactions.

1. In *Dolan*, the Chief Justice drew a distinction between generally-applicable legislative land use decisions and the adjudicatory decisions in that case:

a. *See Dolan,* 512 U.S. at 384-385 ["[T]he authority of state and local governments to engage in land use planning has been sustained against constitutional challenge as long ago as our decision in *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926). 'Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law.' *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 413 (1922)."]

b. *Id.* at 385 ["The sort of land use regulations discussed in the cases just cited, however, differ in two relevant particulars from the present case. First, they involved essentially *legislative determinations classifying entire areas of the city*, whereas here the city made an *adjudicative* decision to condition petitioner's application for a building permit on an individual parcel." (Emphasis added).]

2. That distinction in *Dolan* addressed the dissent's argument that the Court was changing the burden of proof that traditionally applied to land use decisions.

a. *Id.* at p. 391 fn. 8 ["Justice Stevens' dissent takes us to task for placing the burden on the city to justify the required dedication. He is correct in arguing that in evaluating most generally applicable zoning regulations, the burden properly rests on the party challenging the regulation to prove that it constitutes an arbitrary regulation of property rights. *See, e. g., Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365, 71 L. Ed. 303, 47 S. Ct. 114 (1926). Here, by contrast, the city made an *adjudicative decision* to condition petitioner's application for a building permit on an individual parcel. In this situation, the burden properly rests on the city. *See Nollan,* 483 U.S. at 836."]

b. *See* Winfield B. Martin, *Order for the Courts: Reforming the Nollan/Dolan Threshold Inquiry for Exactions*, 35 SEATTLE UNIV. L.REV. 1499, 1517 ["Chief Justice Rehnquist tethers the identification of legislative and adjudicative land use regulations to the question not of the method of implementation, but of whether the regulation has singled out individual property owners for special treatment. This distinction makes a natural threshold inquiry for *Nollan/Dolan* treatment-it lags regulations that pose a heightened risk of violating the *Armstrong* principle and therefore should not merit the deference to legislative bodies that the Court has found desirable. … The proposition, advanced by some critics, that all exactions be subjected to heightened scrutiny would unnecessarily sweep some legislatively imposed land use regulation into *Nollan/Dolan* examination that do not comport with the standard identified by

Chief Justice Rehnquist in *Dolan*. In that proposed scenario, the increased *Nollan/Dolan* scrutiny would impede the government's ability to engage in widespread land-use planning by endangering 'essentially legislative determinations classifying entire areas of the city,' rather than legislative determinations that focus on a smaller number of properties."]

3. The distinction drawn by the Chief Justice in *Dolan* between legislative and adjudicative decisions was necessary to address the presumptive constitutionality that the Court gives to legislative measures:

a. *See* Inna Reznik, *The Distinction Between Legislative And Adjudicative Decision In* Dolan v. City of Tigard, 75 N.Y.Y. L. Rev. 242, 274 (2000) ["Given the uncertainty over whether legislative land use decision-making is fairer than adjudicative processes, one may draw the conclusion that the 'rough proportionality' standard should be applied to all exactions without making the legislative/adjudicative distinction. However, such an extension of heightened scrutiny would be inconsistent with the *Dolan* Court's reasoning. The *Dolan* Court itself explained its creation of the 'rough proportionality' standard, which places the burden on the local government to justify the exaction, by limiting it to adjudication, as opposed to legislation which carries a presumption of constitutional validity. Therefore, the extension of the 'rough proportionality' test to all exactions would require new reasoning-currently unarticulated-which would be responsive to the *Dolan* dissent's argument that even the Court's current exactions review standard runs counter to accepted judicial review doctrine."]

b. *Id.* at 250-251 ["Therefore, in order to justify its standard and burden allocation, the Court characterized Tigard's exactions as adjudicative decisions, as opposed to legislative decisions that would deserve deference. The Court distinguished cases, such as *Village of Euclid v. Ambler Realty Co.* .... The Court characterized those cases as 'legislative determinations classifying entire areas of the city,' while asserting that the present case was 'an adjudicative decision to condition petitioner's application for a building permit on an individual parcel.' Thus, as a matter of doctrinal necessity, the Court limited its new 'rough proportionality' standard and burden shifting declaration to adjudicative government actions."]

4. The Court subsequently recognized that *Nollan* and *Dolan* involved adjudicatory decisions.

a. *See Lingle v. Chevron U.S.A. Inc.*, 544 U.S. 528, 554 (2005) ["Both *Nollan* and *Dolan* involved Fifth Amendment takings challenges to adjudicative land-use exactions."]

b. *Id.* at 547 ["The Court further refined this requirement in *Dolan*, holding that an adjudicative exaction requiring dedication of private property must also be '"roughly proportional" . . . both in nature and extent to the impact of the proposed development.'"]

c. *See Koontz,* 570 U.S. at 628 (Kagan, J., dissenting) ["The majority might, for example, approve the rule, adopted in several States, that *Nollan* and *Dolan* apply only to permitting fees that are imposed *ad hoc*, and not to fees that are generally applicable. *See, e.g., Ehrlich v. Culver City*, 12 Cal. 4th 854, 50 Cal. Rptr. 2d 242, 911 P. 2d 429 (1996). *Dolan* itself suggested that limitation by underscoring that there 'the city made an *adjudicative* decision to

condition petitioner's application for a building permit on an individual parcel,' instead of imposing an 'essentially legislative determination[ ] classifying entire areas of the city.'" (quoting *Dolan, supra,* 512 U.S. at p. 385).]

B. Because of the language in *Dolan* that distinguishes legislative decisions from adjudicative decisions, other courts have declined to apply the *Nollan/Dolan* test to generally applied legislative exactions.

1. *See California Building, supra,* 61 Cal. 4th at p. 460 & fn 11, cert. ["Our court has held that legislatively prescribed monetary fees that are imposed as a condition of development are not subject to the *Nollan/Dolan* test." (Citing *Ehrlich, supra,* 12 Cal.4th at 874–885 (plur. opn. of Arabian, J.); *id.* at pp. 899–901 (conc. opn. of Mosk, J.); *id.* at pp. 903, 907 (conc. & dis. opn. of Kennard, J.); *id.* at p. 912 (conc. & dis. opn. of Werdegar, J.); *San Remo Hotel v. City and County of San Francisco* (2002) 27 Cal.4th 643, 663-671; *Santa Monica Beach, Ltd. v. Superior Court* (1999) 19 Cal.4th 952, 966–967.)]

2. *See BIA, supra,* 289 F. Supp. 3d at 1058 ["But the Supreme Court has only applied this exactions doctrine in cases involving a particular individual property, where government officials exercised their discretion to require something of the property owner in exchange for approval of a project. And the Court has consistently spoken of the doctrine in terms suggesting it was intended to apply only to discretionary decisions regarding individual properties." (Citing *McClung v. City of Sumner*, 548 F.3d 1219, 1227 (9th Cir. 2008), *cert. denied* (2009) 556 U.S. 1282; *Ehrlich, supra,* 12 Cal.4th 854, 876-81; id. at 899-900 (conc. opn. of Mosk, J.).)]

3. *See also, City of Olympia v. Drebick* (Wash. 2006) 126 P.3d 802, 803, 808 fn. 4; *Spinell Homes, Inc. v. Municipality of Anchorage* (Alaska 2003) 78 P.3d 692, 702; *Krupp v. Breckenridge Sanitation District* (Col. 2001) 19 P.3d 687, 695-696; *Home Builders Association of Central Arizona v. City of Scottsdale* (Ariz. 1997) 930 P.2d 993, 1000; *Cass Water Res. Dist. v. Burlington N. R.R. Co.* (N.D. 1995) 527 N.W.2d 884, 896.

C. Generally-applied legislative exactions are "financial burdens on property owners" that are not subject to *Nollan/Dolan*.

1. In *Koontz*, the Court distinguished two types of financial burdens. One type, which is governed by *Nollan/ Dolan*, "'operate[s] upon or alter[s] an identified property interest' by directing the owner of a particular piece of property to make a monetary payment." (570 U.S. at 613 (quoting *Eastern Enterprises v. Apfel,* 524 U.S. 498, 540 (1998) (opinion of Kennedy, J.))). That individualized financial burden was at issue in *Koontz*: "The fulcrum this case turns on is the *direct link* between the government's demand and a *specific parcel of real property*. Because of that *direct* link, this case implicates the central concern of *Nollan* and *Dolan*: the risk that the government may use its substantial power and discretion in land-use permitting to pursue governmental ends that lack an essential nexus and rough proportionality to the effects of the proposed new use of the specific property at issue, thereby diminishing without justification the value of the property." (*Ibid.* (emphasis added).)

2. The second type of financial burden, not governed by *Nollan/ Dolan* and not part of the *Koontz* decision, involves "property taxes, user fees, and similar laws and regulations that may impose financial burdens on property owners." (570 U.S. at 615.) Those financial burdens describe legislative exactions that are generally applied because they do not target a "particular" or "specific parcel of real property." (*See Ehrlich, supra,* 12 Cal. 4th at 894 (con. opinion, Mosk, J.) ["But if a municipality can constitutionally impose a development tax as long as it is rationally based, why is a higher level of constitutional scrutiny required when, as in the case of generally applicable development fees, the 'tax' is earmarked for use in alleviating specific development impacts rather than for the general fund?"])

3. *Rogers Machinery, Inc. v. Washington County* (Or. 2002) 45 P.3d 966, 982 ["There is no principled basis on which to distinguish generally applicable development fees that fund the infrastructure expansion needed to support new development from other legislatively imposed and generally applicable taxes, assessments, and user fees."])

D. The constitutional rationales underlying *Koontz* do not apply to legislative exactions.

1. In *Koontz*, the Court considered the "realities of the permitting process" that underlie the application of the unconstitutional conditions doctrine, including the reality of an "extortionate" relationship between land use applicants and permitting agencies, and the "special vulnerability of land use permit applicants to extortionate demands for money." (570 U.S. at 619.)

2. That "extortionate" relationship is generally not a concern in the legislative context:

a. *See San Remo Hotel, supra,* 27 Cal.4th at 671 ["While legislatively mandated fees do present some danger of improper leveraging, such generally applicable legislation is subject to the ordinary restraints of the democratic political process. A city council that charged extortionate fees for all property development, unjustifiable by mitigation needs, would likely face widespread and well-financed opposition at the next election. *Ad hoc* individual monetary exactions deserve special judicial scrutiny mainly because, affecting fewer citizens and evading systematic assessment, they are more likely to escape such political controls."]

b. *See also McClung v. City of Sumner, supra,* 548 F.3d at 1228; *City of Olympia v. Drebick* (Wash. 2006) 126 P.3d 802, 803, 808 n. 4; *Rogers Machinery, supra,* 45 P.3d at p. 982; *Krupp, supra,* 19 P.3d 687; *Home Builders Assn. of Central Arizona, supra,* 930 P.2d at 1000.

c. *See generally, Ehrlich, supra,* 12 Cal.4th at pp. 899–901 (conc. opn. of Mosk, J.)[explaining why "a somewhat higher level of constitutional scrutiny should be applied to a development fee when it is imposed 'neither generally nor ministerially, but on an individual and discretionary basis.'"]

E. Extending the *Nollan/Dolan* test to generally applied legislative fees would improperly "open to searching judicial scrutiny the wisdom of myriad government economic regulations, a task the courts have been loath to undertake pursuant to either the Takings or Due Process Clause." (*San Remo Hotel, supra,* 27 Cal.4th at 672.)

1. Justice Kagan warned not to extend *Nollan/ Dolan* "into the very heart of local land-use regulation and service delivery" and no to diminish "the flexibility of state and local governments to take the most routine actions to enhance their communities …." (*Koontz, supra,* 570 U.S. at 626 (Kagan, J., dissenting).)

2. *Cf. McClung, supra,* 548 F.3d at p. 1227-1228 [extending *Nollan/Dolan* scrutiny "raise[s] the concern of judicial interference with the exercise of local government police powers."])

F. Not applying *Nollan/Dolan* to adjudicative exactions does not give blind deference to legislative exactions.

1. Generally applied legislative exactions are still governed by the reasonable relationship test in Government Code section 66001, subdivision (a).

2. Generally applied legislative exactions are still governed by the regulatory takings analysis in *Penn Central Transportation Co. v. City of New York* (1978) 438 U.S. 104, 124. (*See McClung, supra*, 548 F.3d at 1227; *BIA, supra,* 2018 U.S.Dist.LEXIS 18822 at *3-*4, *7.)

III. CONCLUSION.

This author concludes that both lower courts and eventually the Supreme Court will find that the *Nollan/Dolan* test should not apply to legislative exactions that are generally-applied. The *Dolan* case itself drew a distinction between adjudicative and legislative regulations. Also, generally-applied legislative exactions are akin to the "financial burdens on property owners" that the Supreme Court has exempted from *Nollan/Dolan.* In addition, the constitutional rationales underlying *Koontz* simply do not apply to legislative exactions. Furthermore, extending the *Nollan/Dolan* test to generally applied legislative fees would improperly invite judicial scrutiny to the wisdom of a myriad of government economic regulations.

Thus, local legislative bodies in California that comply with the reasonable relationship requirement in the Mitigation Fee Act (Govt. Code §66001, subd. (a)) should be able to defend generally-applied development fees from constitutional challenges based on *Nollan/Dolan.*

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How SGMA Will Affect Municipal Groundwater Supplies

Friday, September 14, 2018 General Session; 8:00 – 10:00 a.m.

Russell M. McGlothlin, Shareholder, Brownstein Hyatt Farber Schreck

Notes:

Brownstein Hyatt Farber Schreck

SEPTEMBER 14, 2018

An Assessment of the Sustainable Groundwater Management Act for Municipal Water Suppliers

presented for
League of California Cities
2018 Annual Conference

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The Sustainable Groundwater Management Act ("SGMA") is now in its fourth year of operation. Groundwater Sustainability Agencies ("GSAs") have been formed throughout the medium- and high-priority basins across California, and those GSAs are now developing Groundwater Sustainability Plans ("GSP"). The GSPs will ultimately afford greater long-term groundwater supply reliability by avoiding chronic groundwater depletion and other "undesirable results," such as significant loss of storage, water quality degradation, subsidence, and seawater intrusion. To achieve sustainable management in basins experiencing pronounced overdraft conditions, either augmented recharge will be necessary or groundwater extractions will need to be reduced over time. This process will affect municipal water suppliers that rely on groundwater basins that are subject to SGMA's provision. It is, thus, important that municipal water suppliers understand the requirements of SGMA, the potential impacts to their groundwater supplies, and the procedural and substantive options and strategies that should be considered throughout the process.

To that effect, this paper will cover:

1. An overview of SGMA and its essential provisions;
2. The issues that will need to be resolved to implement SGMA, including the potential division of available water supplies within a basin;
3. A summary of key groundwater rights laws;
4. A discussion of groundwater basin adjudications and new laws designed to streamline future adjudications and harmonize their results with SGMA; and
5. Strategies that municipal water providers may employ to optimize outcomes from the SGMA/adjudication process.

I. SGMA'S ESSENTIAL PROVISIONS

SGMA was enacted in 2014 (amended in 2015) to establish a comprehensive local process for sustainable management of groundwater in California.[1] SGMA requires the establishment of one or more GSAs, which must develop and adopt one or more GSPs for groundwater basins designated as medium- or high-priority by the Department of Water Resources ("DWR"). The GSPs must serve to eliminate overdraft conditions in the basin and to return the basin to a condition that assures long-term sustainability within twenty years of the GSP's implementation.

A. GSA Designation and Required Cooperation with Basin Interests

SGMA allows any local agency with water supply, water management or land use responsibilities to serve as a GSA.[2] The GSA may be a single entity or a group of entities organized under a memorandum of agreement or joint powers agreement.[3]

[1] Wat. Code §§ 10720 et seq.
[2] Wat. Code § 10721(j),(n).
[3] Wat. Code § § 10723.6

A GSA was required to be established for all areas of each medium- or high-priority basin or subbasin by June 30, 2017.[4] GSAs were established in nearly all subject basins by this deadline and this matter is now largely complete.

SGMA requires that a GSA "consider the interests of all beneficial uses and users of groundwater."[5] DWR has also adopted regulations detailing the required contents and framework for a GSP,[6] and these regulations require that a GSP include information describing the notice and communication procedures for stakeholder involvement.[7] Finally, SGMA encourages a GSA to appoint and consult with an advisory committee consisting of interested parties for the purpose of developing and implementing a GSP.[8]

B. GSA Powers

SGMA significantly expands the groundwater management powers of a local agency—or group of local agencies—acting as a GSA. However, a GSA cannot impose regulatory requirements under SGMA outside of its boundaries.[9] Once recognized as a GSA, SGMA authorizes the agency to, among other things:

- Adopt rules, regulations, ordinances, and resolutions;[10]
- Conduct investigation of water rights;[11]
- Require well registration;[12]
- Require well operators to measure and report extractions;[13]
- Require reporting of diversions of surface water to storage;[14]
- Acquire property and water rights;[15]
- Impose a voluntary program for the fallowing of agricultural lands;[16]
- Reclaim water;[17]
- Impose well spacing requirements;[18]
- Regulate groundwater extractions, including limiting or prohibiting groundwater production;[19]
- Impose fees and assessments;[20]

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[4] Wat. Code § 10735.2(a)(1).
[5] Wat. Code § 10723.2(a)(1).
[6] *See* 23 Cal. Code Regs. §§ 350-358.4.
[7] 23 Cal. Code Regs. § 354.10.
[8] Wat. Code § 10727.8(a).
[9] Wat. Code § 10726.8(b).
[10] Wat. Code § 10725.2(b).
[11] Wat. Code § 10725.4(b).
[12] Wat. Code § 10725.6.
[13] Wat. Code § 10725.8(a), (c) (These powers are exercised through the GSP).
[14] Wat. Code § 10726 (This requirement is also triggered after a GSA implements a GSP).
[15] Wat. Code § 10726.2(a), (b), (d).
[16] Wat. Code § 10726.2(c).
[17] Wat. Code § 10726.2(e).
[18] Wat. Code § 10726.4(a)(1).
[19] Wat. Code § 10726.4(a)(2)).

- Undertake enforcement actions for violation of a GSA's rule, regulation, ordinance, or resolution;[21] and
- Undertake well-permitting authority if designated to the GSA by the county.[22]

SGMA expressly states that neither the actions of a GSA nor a GSP shall determine or modify water rights.[23] Nonetheless, SGMA gives GSAs broad powers that could significantly impact water rights in practice. SGMA authorizes an agency to regulate groundwater extractions, including limiting or prohibiting groundwater production.[24] The process of limiting extractions will significantly affect groundwater rights. GSAs also have other powers that may indirectly impact water rights, including the ability to impose fees and assessments on groundwater production.[25]

C. GSA Financial Authority

SGMA authorizes a GSA to impose fees prior to GSP adoption to fund certain activities, including preparation, adoption, and amendment of a GSP; investigations; inspections; and program administration, among other things.[26] A GSA is authorized to adopt and impose fees by adopting a resolution or ordinance at a properly-noticed public meeting as required by Water Code section 10730(b). As an alternative method of fee collection, a GSA may collect fees in the same manner as ordinary municipal ad valorem taxes.[27] SGMA also authorizes a GSA to impose fees after adoption of a GSP in order to fund groundwater management activities.[28]

D. GSP Preparation

The fundamental requirement for sustainability under SGMA is that critically overdrafted basins achieve "the absence of undesirable results" within 20 years of GSP adoption – or by January 31, 2040, for critically overdrafted basins.[29] A GSP must set minimum thresholds to measure the absence of "undesirable results" in each of six areas: (1) chronic lowering of groundwater levels, (2) reduction of groundwater storage, (3) seawater intrusion, (4) degradation to water quality, (5) land subsidence, and (6) depletions of interconnected surface water.[30] The GSP must also include a water budget with an estimate of the "sustainable yield" for the subbasin or basin.[31]

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[20] Wat. Code §§ 10730 (before or after adoption of a GSP), 10730.2 (additional authority after adoption of a GSP).
[21] Wat. Code § 10732.
[22] Wat. Code § 10726.4(b).
[23] Wat. Code §§ 10720.5, 10726.8(b).
[24] Wat. Code § 10726.4(a)(2).
[25] Wat. Code §§ 10730, 10730.2.
[26] Wat. Code § 10730(a).
[27] Wat. Code § § 10730(d)(1).
[28] Wat. Code § 10730.2(a).
[29] 23 Cal. Code Regs. § 354.24.
[30] 23 Cal. Code Regs. § 354.28(c).
[31] 23 Cal. Code Regs. § 354.18(a),(b)(7).

Depending on the number of GSAs within a basin, there are three options for GSP submittals: (1) a single GSA developing a single GSP; (2) multiple GSAs developing a single GSP; or (3) multiple GSAs developing multiple GSPs, with a coordination agreement.[32]

There are several opportunities for participation of private stakeholders in GSP development. First, the GSP regulations require that a GSA publish and submit to DWR a written statement describing how interested parties can participate in the development and implementation of a GSP.[33] Second, a GSA must hold a public hearing on a GSP and must provide at least 90 days' advance notice of the hearing.[34] After a GSP is submitted, DWR must allow at least a 60-day comment period.[35]

E. DWR's Review of Gsps and Ongoing Oversight

Upon adoption of a GSP, the designated GSA must submit the GSP for DWR review.[36] DWR has developed detailed regulations with criteria for evaluating GSPs.[37] Upon completion of its review, DWR has the power to request changes to the GSP in order to address deficiencies.[38] DWR is required to re-evaluate GSPs every five years to ensure continued compliance and sufficiency.[39] After adoption of a GSP, the GSA must submit to DWR an annual compliance report containing basin groundwater data, including elevation, aggregate extraction, water usage and any changes in groundwater storage to monitor progress toward this sustainability goal.[40]

F. State Intervention

SGMA provides for state intervention—a "backstop"—when local agencies are unwilling or unable to manage their groundwater basin. Specifically, SGMA authorizes the State Water Resources Control Board ("SWRCB") to designate medium- and high-priority basins as probationary basins if prescribed local management requirements are not met; specifically if: (i) no local agency has been designated as the GSA by June 30, 2017 (no state intervention resulted for this milestone in any basin); (ii) the agency designated as the GSA fails to prepare and adopt a GSP by January 31, 2020 (for critically overdrafted basins) or January 31, 2022 (for non-critically overdrafted basins); or (iii) the GSP is inadequate and the basin is either in a condition of long-term overdraft or groundwater extractions are resulting in a significant depletion of interconnected surface waters.[41]

For those basins designated as probationary basins, SGMA authorizes the SWRCB to remove groundwater management authority from local agencies and to adopt and

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[32] Wat. Code § 10727.
[33] Wat. Code § 10727.8(a); 23 Cal. Code Regs. § 353.6(a).
[34] Wat. Code § 10728.4.
[35] Wat. Code § 10733.4(c); *see also* 23 Cal. Code Regs. § 355.8(b), (f).
[36] Wat. Code §§ 10733.4(a), 10733(a).
[37] See 23 Cal. Code Regs. § 350 et seq.
[38] Wat. Code § 10733.4(d).
[39] Wat. Code § 10733.8.
[40] Wat. Code § 10728.
[41] Wat. Code § 10735.2(a)(1), (4)-(5).

implement an interim plan.[42] Interim plans must identify actions to bring a basin into balance, indicate deadlines, and provide a description of the plan's monitoring components.[43] SGMA also allows interim plans to incorporate restrictions on groundwater extractions and principles and guidelines for the administration of surface water rights that are connected to the basin.[44] A GSA that subsequently adopts a GSP may petition the SWRCB for a finding that a local GSP has been adopted and is adequate, and for rescission of the interim plan.[45] The filing of a judicial order or decree entered in an adjudication action may also be sufficient to rescind an interim plan.[46]

SWRCB must exclude from probationary status any portion of a basin for which a GSA demonstrates "compliance with the sustainability goal."[47] This provision is intended to avoid penalizing GSAs and stakeholders in portions of a basin that are managing groundwater sustainably while other areas of the basin are not. However, demonstrating compliance with SGMA's sustainability goal may be difficult if there is insufficient coordination among diverse GSAs within a basin.

II. ISSUES THAT WILL NEED TO BE RESOLVED TO IMPLEMENT SGMA SUCCESSFULLY

While SGMA requires the adoption, and state approval, of GSPs, the legislature left key practical issues for future compromise or litigation. Importantly, it does not provide for determinations of groundwater rights and how they relate to pumping allocations and obligations to pay for basin replenishment and management.[48] Determining the basin's sustainable yield and other technical matters may also involve considerable controversy. Local stakeholders must resolve these issues through negotiated compromise, enforcement by the State Water Resources Control Board, or the courts.

A. Sustainable Yield and Other Technical Issues

A fundamental goal of the Act is to avoid extractions in excess of a basin's sustainable yield that will ultimately cause "undesirable results."[49] Determining sustainable yield may be controversial in many basins. Controversy may also develop concerning the merits of technical management options such as groundwater replenishment, storage programs, and other strategies.

As an initial measure to build consensus, the GSA might focus on collaboration respecting a technical work plan to produce the essential information necessary for future plan development. Divergent interests that share in the development of the technical study are often more likely to accept the technical findings and resulting management strategies. To

[42] Wat. Code § 10735.8(a).
[43] Wat. Code § 10735.8(b).
[44] Wat. Code § 10735.8(c).
[45] Wat. Code § 10735.8(g)(1)(A), (2), (4).
[46] Wat. Code § 10735.8(g)(1)(B), (2), (4).
[47] Wat. Code § 10735.2(e).
[48] Wat. Code §§ 10720.5, 10726.8(b).
[49] Wat. Code § 10721, paragraphs (t), (u), (v), and (w).

facilitate such efforts, the GSA might establish a technical committee populated by participating stakeholders to negotiate the elements of the work plan.

B. Plan Components

Among other requirements, a GSP must include provisions concerning the basin's physical characteristics and challenges, historic and projected demands, control of saline intrusion, wellhead protection and well abandonment, recharge area protection, abatement and remediation of contaminated groundwater, impacts on groundwater dependent ecosystems, monitoring protocols, overdraft mitigation, and measurable objectives to obtain sustainable groundwater management within a 20-year planning horizon.[50] Plans may also include provisions pertaining to groundwater storage, carryover, and voluntary transfers of production allocations. To implement these GSP components, many GSPs will need to determine the basin's sustainable yield, establish individual groundwater production allocations, implement replenishment strategies (if possible), and impose pump assessments to fund basin replenishment and other solutions.[51] Such determinations will often invoke controversy among affected stakeholders. The GSA should pursue early and diligent outreach to affected groundwater users to encourage consensus on these subjects.

Prior court actions to adjudicate groundwater rights and manage overdrafted basins may also offer some insight into how GSPs may be structured. In several cases, the courts allocated groundwater supplies among diverse users based on an assessment of groundwater rights and then reduced allocations over time to eliminate overdraft.[52] Many judgements also addressed pumping assessments to fund basin replenishment activities, trading of allocations, carryover of unused allocation from year to year, and storage of non-native water in the basin's available storage space. Similar provisions are likely to be included within future GSPs under SGMA.

C. Groundwater Rights

In practice, balancing basin yield and demands will frequently require reductions in cumulative and individual groundwater production and/or significant assessments to fund replenishment programs. Efforts to assign the burden for these difficult initiatives among competing groundwater users will often be met with claims respecting water right priorities.[53] As noted, the Act does not address or resolve groundwater rights. Thus, the GSA will need to resolve such claims through negotiation, litigation, or both.

The GSA may facilitate compromise by structuring the GSP in a manner that respects underlying groundwater rights while affording new opportunities. For example, the GSA might establish different classes of production allocations and distribute financial

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[50] Wat. Code §§ 10727.2 and 10727.4.
[51] Wat. Code §§ 10726.2 and 10726.4.
[52] *California American Water Company v. City of Seaside* (2010) 183 Cal.App.4th 471, 474-76 (hereinafter "Seaside"); *California Water Service Co. v. Edward Sidebotham & Son*, 224 Cal. App. 2d 715, 721-22.
[53] See e.g., *City of Barstow v. Mojave Water Agency* (2000) 23 Cal.4th 1224 (hereinafter, "*Mojave*") (discussing water right priorities and the necessity to consider such legal priorities in the context of developing a groundwater management regime).

responsibilities in a manner that reflects underlying groundwater right priorities.[54] Further, groundwater users might be enticed to support the GSP in order to participate in attractive new opportunities included within the GSP. Examples include opportunities to carry over unused production allocations from year to year, storage and conjunctive use programs, and voluntary transfers of production allocations.[55]

However, disagreements over the status of underlying common law water rights—e.g., whether prescriptive rights have developed[56]—may persist among groundwater users or between the GSA and certain groundwater users. In these circumstances, groundwater adjudications may be necessary to resolve water right claims and harmonize applicable water rights within a groundwater management plan.

D. Protecting the GSP and Future Conflict Resolution

Once a GSP is developed, the GSA should consider how to protect the GSP from future legal challenge and how to resolve subsequent disputes. The Act allows for the GSA to validate the GSP pursuant to the validation procedures set forth in the Government Code.[57] This process affords a means to immunize the GSP from future legal challenges pertaining to the GSP. However, a validation action will not define and allocate groundwater rights. Rather, a groundwater adjudication will be necessary if that result is desired.

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[54] The operable judgment in the Seaside Groundwater Basin is illustrative. It creates two classes of production allocation: "Standard Production Allocation," which is roughly similar to appropriative rights, and "Alternative Production Allocation," which is a landowner-based right that is similar to an overlying right. Both allocations are restricted to a maximum annual production quantity. This reflects a compromise by the landowners in that overlying rights are not fixed in quantity. However, the Standard Production Allocation producers bear the burden of ramping down production to bring collective allocations into balance with the basin's safe yield as well as the cost of management and replenishment imposed through pumping assessments. The Alternative Production Allocation producers (i.e., the landowners) do not bear such costs. This is consistent with the superior priority of overlying rights held by landowners under the common law. Similar to common law restrictions applicable to overlying rights, the landowners (Alternative Production Allocation Producers) cannot transfer their allocation, engage in basin storage, or carry over their Alternative Production Allocation from year to year. Only the Standard Production Allocation producers enjoy these benefits. However, the Alternative Production Allocation producers may convert their rights to Standard Production Allocation. Once they do so, their rights are subject to all prior rampdown and subject to the pumping assessments imposed on Standard Production Allocation. After conversion, the new Standard Production Allocation, which was converted from Alternative Production Allocation, is transferable. Thus, the formerly landowner-based right, which was "locked" on the property, can be transferred in exchange for compensation. This creates a means to take advantage of market-based reallocations of water rights, which incentivizes conservation, reveals the "true" price of water, and reallocates water from lower to higher-valued uses, in a manner that would not be available under the common law. Amended Decision, California Am. Water v. City of Seaside et al., No. M66343 (Monterey County Superior Court, filed Sept. 31, 2004); SGMA provides similar opportunities to cap the quantity of overlying rights and then allow the transfer of those rights. Wat. Code § 10726.4.

[55] *See* Wat. Code § 10726.4 (allowing a GSA to establish pumping allocations and transferability of such allocations as well as allocation carryover programs as a component of a GSP); Wat. Code § 10727.4 (providing for facilitation of conjunctive use and storage opportunities).

[56] *See* discussion, *infra,* Section III.B.

[57] Wat. Code § 10726.6 (providing for validation pursuant to sections 860 et seq. of the Code of Civil Procedure.)

A groundwater adjudication may be a prudent strategy to achieve finality respecting groundwater rights and GSP durability. Adjudications also benefit from the court's continued jurisdiction to resolve future conflicts pursuant to post-judgment proceedings, thereby avoiding the prospect that a future conflict could nullify aspects of the GSP or otherwise disrupt management.[58]

The downside of many past adjudications has been the substantial time and cost required to complete them. Earnest efforts to garner consensus for a negotiated GSP may reduce the time and cost of future adjudications. Where substantial consensus is achieved, stakeholders can request that the court enter the negotiated GSP in the form of a stipulated judgment among the settling parties. The adjudication can also proceed against objecting parties to bind them to the judgment, as necessary.[59] The greater the consensus, the greater the likelihood of expediting the process.

III. SUMMARY OF KEY GROUNDWATER RIGHTS LAWS

As noted above, SGMA expressly provides that neither the actions of a GSA nor a GSP shall determine or modify water rights. [60] Yet, the setting of pumping allocation, fee assessments on pumping, allocation transfer programs, and many other aspects of a GSP will frequently affect essentially all aspects of a water right, including the determination of how much groundwater one can produce, at what cost and under what rules and restrictions. GSA determinations in this respect that are inconsistent with common law water right priorities will often trigger a groundwater basin adjudication or other legal challenge to the GSA's actions. Therefore, whether acting as a GSA or considering how best to assure that future municipal water supplies derived from groundwater are maintained, municipal water suppliers must understand the basic contours of groundwater law.

In California, a water right, regardless of type, is an usufructuary right; it only conveys a right to *use* water on a recurring basis.[61] Usufructuary water rights are nonetheless a property entitlement.[62] However, an overarching limitation on all water rights is that the

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[58] A final adjudication can afford efficient and prompt future dispute resolution through the court's continuing jurisdiction as opposed to the prospect of a new lawsuit arising under SGMA management and possibly nullifying aspects of the GSP or otherwise disrupting basin management. The difference can be as stark as a six- to eight-week proceeding for a motion, hearing, order and return to management under a post-judgment proceeding versus a multi-year litigation under an SGMA conflict.

[59] *See e.g.,* Code Civ. Proc. § 850 (allowing aa trial court to impose a proposed stipulated judgment on objecting parties in a comprehensive groundwater basin adjudication if parties representing at least 50 percent of all parties and 75 percent of all water rights agree on the proposed stipulated judgment and the proposed stipulated judgment is: (i) consistent with Article X, section 2 of the California Constitution; (ii) is consistent with the water right priorities of non-stipulating parties; and (iii) treats objecting parties equitably).

[60] Wat. Code §§ 10720.5, 10726.8(b).

[61] *Turlock Irr. Dist. v. Zanker* (2006) 140 Cal.App.4th 1047 ("Water itself is not subject to ownership in California by private parties. Instead, a party can own the right to use water."); *accord Mojave,* 23 Cal.4th at 1236 n. 7 (hereinafter, "*Mojave*").

[62] *United States v. State Water Resources Control Bd.* (1986) 182 Cal.App.3d 82, 103 ("... once rights to use water are acquired, they become vested property rights. As such, they cannot be infringed by others or taken by governmental action without due process and just compensation.").

water be put to beneficial use by reasonable means.[63] In addition to affording legal rights to withdraw and use water, water rights designate priorities to use water among competing users in circumstances of shortage.

A. California's Dual System of Water Rights

California employs a dual system of water rights in which both riparian/overlying rights and appropriative rights are recognized.[64] Riparian/overlying rights arise from, and are based in, land ownership. A riparian right authorizes the owner of land adjoining or abutting a natural surface watercourse to divert and use water on the riparian land.[65] An overlying groundwater right, which is analogous to a riparian right to surface water, allows a landowner to extract and use groundwater on land overlying the groundwater supply.[66] Riparian and overlying rights are considered correlative rights.[67] Therefore, similarly situated property owners that abut or overlie a common source generally share an equal priority to withdraw and use water from the source.[68] The rights arise solely from property ownership and generally are not determined by the history or frequency of water use.[69]

Appropriative groundwater rights allow for the appropriation of groundwater for use on non-overlying properties, but only so long as there is water available for appropriation that is surplus to the present cumulative needs of the overlying owners.[70] The right to appropriate water is dependent upon continuous use, and therefore appropriative rights can be forfeited for extended non-use.[71] Priority between appropriative users is predicated on the rule of "first-in-time, first-in-right;" that is, the appropriator that commenced appropriation earlier in time is entitled the full amount of their historical appropriation before later-in-time appropriators may withdraw water.[72]

In supplying water to the public, municipal water suppliers act as appropriators even if they provide water service to customers overlying the same basin from which they draw their water supply.[73] Municipalities only enjoy overlying water rights with respect to the use of water on overlying parcels owned by the municipality, such as a city park.[74]

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[63] Cal. Const. art. X, sec. 2.
[64] *Mojave*, 23 Cal.4th at 1240.
[65] *Id.*
[66] *Id.*; *City of Pasadena v. City of Alhambra* (1949) 33 Cal.2d 908, 925 (hereinafter, "*Pasadena*").
[67] *Id*.
[68] *Tulare Irr. Dist. v. Lindsay-Strathmore Irr. Dist.* (1935) 3 Cal.2d 489, 524; *Wright v. Goleta Water District* (1985) 174 Cal.App.3d 74, 83-85 (hereinafter, "*Wright*").
[69] *Id*.
[70] *City of Los Angeles v. City of San Fernando* (1975) 14 Cal.3d 199, 282-86 (hereinafter, "*San Fernando*").
[71] *North Kern Water Storage Dist. v. Kern Delta Water Dist.* (2007) 147 Cal.App.4th 555, 560.
[72] *Wright*, 174 Cal.App.3d at 90; *Tehachapi-Cummings County Water District v. Armstrong* (1975) 49 Cal.App.3d 992, 1001 n.6 (hereinafter, "*Tehachapi*").
[73] *Town of Antioch v. Williams Irr. Dist.* (1922) 188 Cal. 451, 456. *See also Wright*, 174 Cal.App.3d 74; *Orange County Water Dist. v. City of Colton (*1964) 226 Cal.App.2d 642.
[74] *Wright*, 174 Cal.App.3d at 90; *Tehachapi*, 49 Cal.App.3d at 1001 n. 6.

While overlying rights are generally senior in priority to appropriative rights,[75] there is little case law addressing conflicts among overlying right holders where a common supply is insufficient to serve all overlying water users.

There is no statewide comprehensive permitting program for groundwater. Although appropriations of surface water (and groundwater flowing in a known and defined channel) is subject to the SWRCB's permitting jurisdiction, percolating groundwater is not.[76] Therefore, the determination of rights to percolating groundwater falls within the exclusive province of the courts.[77] If there is a physical interconnection between percolating groundwater and surface or subsurface flow, water rights in the two supplies can be adjudicated in the same legal proceeding.[78]

B. Safe Yield, Overdraft, Prescription, and Subordination

The "safe yield" of a basin (or in SGMA parlance, the "sustainable yield[79]) is the amount of water that can be extracted from a groundwater basin on an annual basis without causing an undesirable result.[80] Undesirable results have generally been understood to include long-term falling groundwater levels and depletion of storage, land subsidence, sea water intrusion, decline of water quality and similar adverse consequences of groundwater overdraft. SGMA borrowed the term "undesirable results" from case law and defined sustainable groundwater management in relation to avoiding six undesirable results specified in the law.[81]

In some instances, the natural safe yield (recharge from natural sources) may be distinguished from operating or perennial yield (recharge from all sources). The recharge of a basin from natural sources can be supplemented by a groundwater management program that utilizes nonnative supplies such as imported water, recycled water, or captured storm water. It may also be possible to increase the natural safe yield by inducing additional inflow and minimizing rejected recharge by regulating water levels in a basin. In these circumstances, the entity responsible for the augmented artificial recharge is entitled to the additional recoverable yield within the basin—a "fruits-of-one's-labor principle.[82]

When a basin's safe yield is exceeded, groundwater overdraft begins.[83] The senior priority enjoyed by overlying landowners can be lost after an extended period of overdraft condition if the landowners do not promptly seek judicial enforcement of their senior priority rights.[84] The overdraft establishes adversity for purposes of the appropriators,

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[75] *San Fernando*, 14 Cal.3d at 282-86.
[76] Wat. Code §§ 1200 et seq.
[77] *See Wright,* 174 Cal.App.3d 74, 87-89.
[78] *See Miller v. Bay Cities Water Co.* (1910) 157 Cal. 256, 272, 278-81; *Hudson v. Dailey* (1909) 156 Cal. 617, 628; *Peabody v. City of Vallejo* (1935) 2 Cal.2d 351, 372.
[79] Wat. Code § 10721(v).
[80] *Pasadena*, 33 Cal.2d 908.
[81] See Wat. Code §§ 10721(x), 10727.2(b)(4).
[82] *San Fernando*, 14 Cal.3d at 256-58; *City of Santa Maria v. Adam* (2012) 211 Cal.App.4th266, 304-305.
[83] *Pasadena*, 33 Cal.2d at 936-37.
[84] *San Fernando*, 14 Cal.3d at 284.

including municipal water suppliers, perfecting prescriptive groundwater rights.[85] If the overdraft continues for a period of at least five years, without objection by the overlying landowners, appropriators can prescribe rights from the overlying landowners. [86]

Under Civil Code section 1007, neither private parties nor public entities can obtain prescriptive rights against public utilities, municipalities or other public entities. Accordingly, private pumpers can only obtain prescriptive rights against other private pumpers. Although public pumpers cannot lose water rights by prescription, their acquisition of prescriptive groundwater rights can be limited by an overlying owner's "self-help"—groundwater pumping by the overlying owner during the prescriptive period.[87]

The doctrine of subordination may also be applied to cap and limit groundwater use by landowners in future adjudications of overdrafted basins. Through this doctrine, the dormant portion of a landowner's overlying rights may be "subordinated." The subordination doctrine has been applied in the surface water context, but not yet in the groundwater context. In the case *In re Water of Long Valley Stream System* ("*Long Valley*"), the California Supreme Court approved the SWRCB's subordination of the dormant riparian rights in the surface water context.[88] To date, the courts have not applied the same principle to subordinate dormant overlying rights.[89] However, as part of the recent groundwater basin adjudication reform law, the legislature explicitly permits the court to apply the principles set forth in *Long Valley* within a comprehensive groundwater basin adjudication.[90] Moreover, the California Supreme Court in *Mojave* explained that the subordination principle applied in *Long Valley* may need to be applied in the future to subordinate dormant overlying rights "to harmonize groundwater shortages with a fair allocation of future use."[91]

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[85] *Id.*

[86] *Id*.

[87] *See Hi-Desert County Water Dist. v. Blue Skies Country Club, Inc.* (1994) 23 Cal.App.4th 1723.

[88] In *In re Water of Long Valley Creek Stream System* (1979) 25 Cal.3d 339, 355, 357-359 (hereinafter, "*Long Valley*"), the California Supreme Court held that although unexercised riparian rights could not be extinguished entirely, in the context of a comprehensive stream adjudication, the state had the authority under Article X, section 2 of the California Constitution (state policy requiring maximum beneficial use of water) to subordinate the priority of dormant riparian rights to the priority of presently exercised riparian rights. The SWRCB has applied *Long Valley* to subordinate unexercised riparian rights in several instances, including to subordinate riparian rights unexercised for periods as short as approximately ten years. (*See, e.g., In the Matter of the Determination of the Rights of the Various Claimants to the Waters of Roaring Creek Stream System,* Order WR: 85–1, 1985 WL 20014, at *10–11; *In the Matter of the Determination of the Rights of the Various Claimants to Waters of Purisima Creek Stream System in San Mateo County, California*, Order WR 84-9, 1984 WL 19066, at *4; *In the Matter of the Determination of the Rights of the Various Claimants to the Waters of San Gregorio Creek Stream System, In San Mateo County, California*, Order WR 89-16, 1989 WL 98156, at *5 [amended in part by Order WR 90-6, 1990 WL 272140, at *1] [subordinating riparian rights unexercised for a period of approximately 10 years].)

[89] *Wright v. Goleta Water District* (1985) 174 Cal.App.3d 74, 87-89 (refusing to extend the principle applied in *Long Valley* to subordinate dormant overlying groundwater rights in a groundwater basin adjudication reasoning that the comprehensive legislative scheme applicable to adjudication of riparian rights is not applicable to overlying rights).

[90] Code Civ. Proc. § 830(b)(7).

[91] *Mojave*, 23 Cal.4th at 1249, n. 13.

IV. GROUNDWATER BASIN ADJUDICATIONS AND NEW GROUNDWATER BASIN ADJUDICATION LAWS

A groundwater basin adjudication is a lawsuit to determine groundwater rights that also typically establishes a basin-wide groundwater management plan, often referred to as a "physical solution."[92] Traditionally, adjudications have been used—mostly in Southern California—to determine the basin's "safe yield," limit cumulative groundwater production to the safe yield, establish programs to enhance the basin's yield, comprehensively adjudicate groundwater rights, and assign individual pumping allocations.[93] Adjudication judgments also typically allow for voluntary transfers of pumping allocations and maintain the court's continuing jurisdiction to oversee the management plan, adapt the plan over time, and resolve future disputes.[94]

In the SGMA era, adjudications will likely assume an expanded and slightly different role. In 2015, as a complement to SGMA, the state adopted legislation—AB 1390 (Alejo) and SB 226 (Pavley)—to establish a new procedure to process adjudications in a more efficient manner,[95] ensure that litigants don't obstruct or delay SGMA,[96] and harmonize future adjudications with groundwater management under SGMA.[97] This new "adjudication reform law" is intended to work in concert with SGMA to bring about sustainable groundwater management.[98]

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[92] *See e.g., Seaside,* 183 Cal.App.4th at 474-76,480.

[93] *Id.*

[94] *Id.*

[95] AB 1390 set forth new provisions in the Code of Civil Procedure designed to render future adjudications more efficient and expedited including provisions relating to: in rem jurisdiction and the comprehensive effect of the adjudication (Code Civ. Proc. § 834); efficient methods to serve all potential groundwater claimants, including all landowners overlying the basin, whether or not they are current pumpers (Code Civ. Proc. § 835); elimination of peremptory judicial challenges pursuant to Code of Civil Procedure section 170.6 and venue removal motions pursuant to Code of Civil Procedure section 394 (Code Civ. Proc. § 838(c)); establishing that comprehensive adjudications are presumed to be complex litigation (Code Civ. Proc. § 838(b)); electronic service of pleadings and papers (Code Civ. Proc. § 839); phasing of trial and limiting discovery to correspond to each phase (Code. Civ. Proc. § 840); formation of classes of overlying groundwater rights holders pursuant to Code of Civil Procedure section 382 (Code. Civ. Proc. § 840); appointment of special masters (Code. Civ. Proc. § 840); requiring litigants to make early factual disclosures concerning groundwater pumping and use, among other disclosure requirements (Code Civ. Proc. § 842(a)); requiring disclosures concerning expert witnesses accompanied by expert reports (Code Civ. Proc. § 843); and requiring parties to submit direct testimony through written affidavits or declarations rather than live testimony (Code Civ. Proc. § 844).

[96] *See* Wat. Code § 10737.2 (requiring that a court overseeing an adjudication for a basin required to have a GSP manage the proceeding in a manner that minimizes interference with the timely completion and implementation of a GSP, avoids redundancy and unnecessary costs in the development of technical information and a physical solution, and is consistent with the attainment of sustainable groundwater management within the time frames established by SGMA).

[97] *See* Wat. Code § 10737.4 (exempting a basin managed pursuant to a judgment entered in an adjudication from the state enforcement provisions of SGMA if the judgment is submitted to DWR for evaluation and DWR determines that the judgment satisfies the objectives of SGMA).

[98] *See* Wat. Code § 10737.8 (prohibiting a court from entering a judgment in an adjudication unless the court finds that the judgment will not substantially impair the ability of a GSA, SWRCB, or DWR to comply with SGMA and to achieve sustainable groundwater management.)

As discussed above, there is an apparent paradox between (i) the grant of powers to GSAs in SGMA to establish pumping allocations, restrict pumping, assess pumping fees, etc. and (ii) the act's declaration that it does not alter water rights and that pumping limitations by a GSA shall not be construed to be a determination of groundwater rights. The apparent paradox is resolved by understanding that an adjudication serves as a potential check on groundwater restrictions or extraction fees imposed by a GSA that run afoul of common law water rights. In practical effect, the GSP development process should be viewed as a stakeholder negotiation to seek agreement on management terms to either avoid litigation or narrow the issues to be litigated. If stakeholders are unable to agree, particularly on significant issues like pumping allocations and fee structures, an adjudication is likely.

It is important to understand that an adjudication will not preclude sustainable basin management.[99] Indeed, the new adjudication reform law directs the courts to manage adjudications to minimize interference with the timely completion and implementation of GSPs, consistent with the attainment of sustainable groundwater management.[100] Thus, adjudications are not tools to avoid groundwater management, but are a means to ensure that basin management is undertaken in a manner consistent with water law priorities and principles. Where a GSA proceeds in manner inconsistent with settled legal principles, the courts can order modifications to render GSPs lawful and mandate that GSAs correct errant decisions.[101]

Municipal water suppliers should participate collaboratively in the GSP development process. At the same time, they should understand the likely effects of an adjudication and develop a strategy if negotiations breakdown and adjudication becomes necessary. Where a GSA is proceeding fairly with due regard for both water right underpinnings and science-based management decisions, it will typically be best to avoid or postpone an adjudication. But, where a GSA or other basin stakeholders are not proceeding in an equitable, lawful, and science-based manner, stakeholders may consider an adjudication to right the process and should assess the pros and cons of an earlier than later filing.

V. CONSIDERATIONS FOR SGMA IMPLEMENTATION STRATEGIES FOR MUNICIPAL WATER SUPPLIERS

Municipal water suppliers will often be intimately involved with SGMA implantation, either as the GSA (or member of a GSA) to the extent they are a local agency that has elected to perform such function, or as a pumper that relies on the groundwater basin for part or all of the water supplies they serve to the public. In some instances, the municipal water supplier may fill both roles. Under such circumstances, it will be particularly important that the municipal water supplier demonstrate fairness and impartiality with respect to its role in developing the GSP, and particularly the division of basin groundwater between public

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[99] *See* Code Civ. Proc. § 847 (empowering the court to adopt a preliminary injunction limiting groundwater production while the adjudication proceeds within basins experiencing long-term overdraft); Code Civ. Proc. § 848(b) (authorizing the court to stay the adjudication to allow for progress on a GSP, the development of technical studies, or other settlement initiatives).

[100] Wat. Code § 10737.2.

[101] *Mojave*, 23 Cal.4th 12 at 1250.

and private users. More broadly, because the specter of adjudication will reside behind most GSP development efforts, and in light of the expense and delay that a contested adjudication may entail, it behooves stakeholders to seek a collaborative and consensual agreement on the terms of the GSP. This effort will require extensive engagement and transparency concerning the technical assessment of basin conditions and substantive groundwater management choices.

A. Technical Assessment of Basin Conditions

Whether a municipal water supplier is a member of the GSA developing a GSP or is simply a pumper reliant on the basin, an early undertaking will need to be a thorough and transparent assessment of the basin's technical condition. This will include amassing necessary technical data (e.g., historical pumping rates, well drilling logs and related information, well level records, geologic mappings, etc.), performing predictive groundwater modeling and simulations, and evaluating potential management actions (e.g., replenishment programs, brackish groundwater treatment, well relocation and water conveyance strategies, etc.). The technical effort will serve several functions. It will inform key elements for the GSP, including the assessment of undesirable results, sustainable yield, minimal thresholds, and measurable objectives. It will also help guide consideration of opportunities for optimal basin management strategies, including the pace of necessary ramp down in cumulative production if necessary. Finally, the technical work will assist in determining whether there is a strong case to support a finding of overdraft and the historical extent and period of overdraft, which are factual predicates to water right outcomes, including those resulting from prescription and subordination.

Retention of competent hydrogeologists to consult with the GSA and municipal water suppliers will be key to this effort. It will also be important to foster a collaborative technical process. Thus, technical advisory committees or working groups should be established to afford participation by technical representatives of the various stakeholders in the process.

B. Assessment of Likely Water Rights

Once the historical and current condition of the basin is understood, an assessment of water rights claims should be made. This will include determining whether prescriptive rights have likely developed on behalf of appropriators (including municipal water suppliers), the extent of preservation of overlying rights against prescription through "self-help" pumping, whether dormant overlying rights are subject to potential subordination, the availability of surplus groundwater available for appropriators, potential division of water supplies among correlative overlying landowners, and the existence of augmented artificial basin recharge to be claimed by those responsible for such recharge.[102] This assessment should occur both privately, with competent legal counsel to inform negotiating positions, and ultimately in a candid public setting as well to assist all

[102] See discussion, *supra*, at Section III.

stakeholders in discussing the likely contours of the water rights existing within the basin to which the GSP should conform.

C. Negotiation and Compromise

Although certain legal norms applicable to groundwater conflicts are well established, (*see* section III, *supra*), there are many unresolved legal questions concerning the division of groundwater rights under shortage conditions and with respect to unique circumstances. An assessment of these issues is beyond the scope of this paper, but examples include uncertainties concerning the relevance of historical production and the period of historical production to the division of rights, the practical outcome of prescriptive and "self-help" pumping, the factors relevant to division of groundwater among landowners holding correlative overlying rights, and entitlements to surface water diverted from surface water bodies flowing across the basin that subsequently seep into and recharge the basin. These difficult issues compel counsel with competent legal representation. They should also compel efforts to negotiate compromises that resolve competing claims without resort to litigation. In this respect, the risk of litigation should not be underappreciated. Not only is there vast uncertainty respective of legal outcomes, the time and expense to obtain a final judgment (likely after appeals) will often be substantial. Meanwhile, great utility may be lost from the legal and economic certainty that may otherwise be achieved through a negotiated compromise. Therefore, all stakeholders—GSAs and public and private pumpers alike—should earnestly explore means to negotiate contested issues relating to the GSP. GSAs might also consider retaining a professional facilitator with experience mediating large, multi-party conflicts over common-pool resources. Finally, stakeholders should explore opportunities for dynamic basin management options such as basin replenishment and developed-water programs and water trading markets, and whether opportunities for participation in such programs can improve settlement potential (i.e., allowing the parties to move beyond negotiating a "zero-sum" division of native yield).

D. Preparation for Litigation if Necessary

While municipal water suppliers should earnestly strive for negotiated compromise concerning the division of pumping rights and future basin management, they should also appreciate and plan for the prospect of a future adjudication. For example, they should develop and organize records that may be relevant to an adjudication including pumping and water delivery records, well drilling reports and data, groundwater assessments, publications and other information concerning overdraft conditions, etc. Municipal water suppliers should also consult with legal counsel concerning an adjudication strategy if necessary, including water rights claims, physical solution opportunities, potential expert witnesses, etc.

VI. CONCLUDING REMARKS

SGMA and the complimentary adjudication reform laws now afford the impetus and process to achieve sustainable groundwater management throughout California. It has taken decades to deplete many of our overtopped groundwater basins to their present

condition, and it will take many years to bring them back into a sustainable state. This process will often require difficult decisions, accompanied by comprise where possible and litigation when necessary. In the interim, as GSPs are being developed and adjudications are proceeding, uncertainty pertaining to water supply availability may be heightened as technical and legal questions are yet to be resolved. Ultimately, however, the outcome promises greater certainty and understanding of available groundwater supplies and opportunities. This, in turn, will afford great benefit to all public and private enterprise that depend upon the supply and foster improved water supply reliability planning.

Lessons from the San Bernardino Bankruptcy for City Attorneys

Friday, September 14, 2018 General Session; 10:15 a.m. – 12:15 p.m.

Paul R. Glassman, Chair of Bankruptcy & Restructuring Practice,
Stradling Yocca Carlson & Rauth, P.C.
Gary D. Saenz, City Attorney, San Bernardino

Notes:

A Guide to Municipal Bankruptcy for City Attorneys

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Gary D. Saenz, City Attorney, City of San Bernardino[1]

League of California Cities Annual Conference
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[1] The authors would like to acknowledge the assistance of Jeremy Rothstein in preparing this paper. The opinions expressed in this presentation and on the following slides are solely those of the authors and not necessarily those of the City of San Bernardino, Stradling Yocca Carlson & Rauth, P.C., or any of the firm's clients. The comments and opinions expressed herein do not represent, nor are they intended to imply the representation of, any official policy or position of the City of San Bernardino, Stradling Yocca Carlson & Rauth, P.C., or any of the firm's clients.

Introduction

Throughout California, cities' operating costs are growing faster than revenue. Increased pension costs are a primary driver of this growing crisis, though many cities face other pressures as well. Against this background, there is heightened interest in municipal bankruptcy under chapter 9 of the United States Bankruptcy Code.

A chapter 9 bankruptcy is a judicial proceeding that gives a municipality breathing room to operate and provide uninterrupted public services while formulating a plan to restructure its debts. Filing a bankruptcy petition immediately stops all collection actions against the debtor and its property. The end goal of a chapter 9 case is to confirm a plan of adjustment, which modifies the debtors' debts and obligations in accordance with the Bankruptcy Code and other applicable law.

A basic knowledge of chapter 9 may be helpful even for cities who never actually file for chapter 9 bankruptcy relief, as the possibility of bankruptcy can assist efforts to restructure and guide negotiations with stakeholders. This paper provides a brief overview of important municipal bankruptcy topics, with a particular emphasis on those relevant to city attorneys and illustrations from the bankruptcy of the City of San Bernardino. The first section discusses the challenges facing California cities and actions that may help a troubled city avoid bankruptcy. The second section summarizes the eligibility requirements under chapter 9, including the practical steps cities must take before they undertake a chapter 9 filing. The third section offers an overview of the administration of a chapter 9 case, from the preparation stage through the confirmation of a plan of adjustment. The final two sections provide a summary of the pros and cons of a chapter 9 bankruptcy and a list of key takeaways for city attorneys.

Please note that this paper is intended only as an overview of key issues. It is not a complete discussion of the law of chapter 9 bankruptcy and does not purport to be legal advice or an instruction manual. If at all possible, cities in financial distress should engage experienced insolvency counsel and financial advisors long before considering the commencement of a chapter 9 case.

I. Avoiding Bankruptcy

A. Financial Problems That May Lead to Bankruptcy

A city may find itself facing chapter 9 bankruptcy because of long-term structural problems or because a single event suddenly renders the city insolvent. The largest municipal bankruptcy in California history, Orange County, was caused by an unexpected $1.7 billion loss to investments in risky derivatives. *In re County of Orange*, 183 B.R. 594, 598 (Bankr. C.D. Cal. 1995). For the City of Desert Hot Springs and the Town of Mammoth Lakes, the one-time event was a large judgment entered against the city. *Silver Sage Partners, Ltd. v. City of Desert Hot Springs (In re City of Desert Hot Springs)*, 339 F.3d 782, 787 (9th Cir. 2003); *In re Town of Mammoth Lakes*, No. 2:12-bk-32463 (Bankr. E.D. Cal. 2012).

The three most recent bankruptcies of large California cities were caused by structural factors in the wake of the 2007-08 financial crisis. Before the crisis, most cities enjoyed rising property values and tax revenues. When pension fund portfolios were increasing and credit market conditions were favorable, cities could borrow money relatively easily. When the bubble burst, all of those positives turned into negatives. Property values, tax revenues, and pension fund assets fell while labor and pension costs continued to rise. This led to budget shortfalls and underfunded pension liabilities, while a tightening credit market reduced access to borrowing. That perfect storm challenged many cities, and it drove Vallejo, Stockton, and San Bernardino into bankruptcy.

San Bernardino was hit particularly hard by the national collapse of the housing market. The city's population grew during the real estate boom, leading to more public services and, consequently, more city employees. After the collapse, the city's property and sales tax revenues declined steeply, but personnel costs continued to rise. The city offered more generous retirement benefits than most California cities, including higher employer pension contributions, and the city charter set police officer and firefighter salaries by formula. These and other factors left San Bernardino with high labor costs, comprising approximately 75% of annual general fund expenditures, and little room to generate savings. Worse, the city did not realize the true urgency of its problems until it was on the verge of running out of cash, leading to an emergency bankruptcy filing.

More recently, structural factors drove both Detroit's 2014 chapter 9 filing and the still-unfolding restructuring of Puerto Rico under the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA, codified at 48 U.S.C. § 2101, *et seq.*). *In re City of Detroit*, 504 B.R. 191 (Bankr. E.D. Mich. 2013; *In re City of Detroit*, 504 B.R. 191 (Bankr. E.D. Mich. 2013); *In re Fin. Oversight & Mgmt. Bd.*, No. 17 BK 3283-LTS, 2018 U.S. Dist. LEXIS 117348 (D.P.R. July 13, 2018).

Today, California cities are facing mounting fiscal pressures, with little sign of relief on the horizon. Rising pension costs are of particular concern, driven by the confluence of several factors. The California Public Employees' Retirement System ("CalPERS") and other pension funds performed below expectations in recent years, particularly during the financial crisis. In December 2016, CalPERS voted to its lower expected investment return from 7.5% to 7% by 2020, requiring public employers to make up the resultant increase in unfunded liability. Meanwhile, life expectancy has continued to increase, producing longer periods for which benefits must be paid to retirees.

Ever-increasing contribution requirements will place steadily greater burdens on cities' general funds. According to a recent League of California Cities report, cities expect to spend an average of 15.8% of their general fund budgets on pensions by fiscal year 2024-25, up from the current average of 11.2%. In fiscal year 2006-07, the average

was 8.3%. *League of California Cities Retirement System Sustainability Study and Findings*, January 2018, at 4.[2]

Other personnel costs place financial pressure on cities too. The same life expectancy changes that drive increased pension costs also increase the cost of other post-employment benefits, namely retiree health care. The cost of providing healthcare to current employees continues to rise as well. In addition, cities may face unsustainable debt burdens from bonds issued under different economic conditions.

Against increased costs, some cities face flat or even declining revenues. The California Constitution's requirement that cities receive voter approval for higher taxes limits the ability to raise revenue. There may be limited appetite for tax increases, as many cities facing financial distress already have high tax rates. A future economic slowdown could well force some cities to seek bankruptcy relief.

B. Identifying Financial Challenges and Developing a Fiscal Plan to Address Them

For a city seeking to avoid bankruptcy, the first step is to clearly evaluate its financial picture, including the factors driving the city into insolvency. In some distressed cities, financial controls and reporting systems may slip, obscuring the depth and nature of financial problems. One particular risk is that, if funds are not tracked closely, a distressed city may run afoul of limitations on the use of restricted funds as it depletes its general fund cash. Also, if a municipality has publicly traded securities, it may be obligated to make disclosures related to its financial condition.

After diagnosing the problems, the next step is to develop detailed financial and operational plans to restore the city to health. While finding solutions may be difficult, cities that take on their structural problems proactively will fare better than the cities that wait. In fact, as we will see later, in determining whether a California city is even eligible for chapter 9 protections and debt relief, a bankruptcy court will likely require that such preliminary pre-bankruptcy efforts be made. Measures may include outsourcing or reducing services, renegotiating employee salaries and benefits, restructuring financial debt, or raising taxes or other revenue.

Financial advisors and bankruptcy counsel can provide crucial assistance both in identifying problems and finding solutions. Unfortunately, it is all too common for restructuring professionals to be brought in too late—the earlier they start, the greater the chance of success, and the less painful the process in the long run. The city attorney can be instrumental in identifying the need for professionals and participating in the selection process.

[2] The report is available at: https://www.cacities.org/Resources-Documents/Policy-Advocacy-Section/Hot-Issues/Retirement-System-Sustainability/League-Pension-Survey-(web)-FINAL.aspx (accessed Aug. 3, 2018).

C. Engaging and Obtaining Concessions from Stakeholders

To achieve its restructuring goals, a city will have to negotiate with and obtain concessions from stakeholders, who will be asked to "buy in" to the city's proposals. Stakeholders generally include unions, CalPERS, retired employees, bondholders, financial institutions, litigation plaintiffs, and other major creditors. Those stakeholders will require financial information necessary to respond to the city's proposals.

For cities in significant distress, stakeholders should be aware that a city may have to file for bankruptcy if an agreement cannot be reached. The possibility of bankruptcy and likely outcomes may encourage all sides to negotiate constructively toward a solution, and temper the parties' negotiating positions. So, ironically, preparing for a bankruptcy filing may be the best way to avoid one. This makes it all the more important to engage professionals with a deep understanding of chapter 9 as soon as practically possible.

To aid negotiations, the city should prepare a summary plan of adjustment or term sheet, supported by detailed projections. The proposal must explain what creditors would receive and how the plan will be carried out. The proposal will communicate the gravity of a city's situation and provide a useful reference point for what can often be complex, multilateral negotiations. If the city ultimately does file for bankruptcy, as discussed in more detail below, the conduct, extent and duration of negotiations with creditors may be key issues in the determination of whether the city is eligible to be a chapter 9 debtor. Every step of the negotiations should therefore be documented in preparation for a contested hearing or trial on eligibility.

II. Requirements to Become an Eligible Chapter 9 Debtor

Eligibility for chapter 9 protection and debt relief is often an early flashpoint in a chapter 9 case. A debtor must prove its eligibility to be a chapter 9 debtor, and creditors may object vigorously because their leverage may decline precipitously if eligibility is established. Accordingly, the trial or contested hearing over eligibility and related proceedings can be long, contentious affairs. The city attorney will participate in these proceedings and collaborate with bankruptcy counsel, as he or she will for other matters in the case.

The bankruptcy court may review in minute detail the sources and uses of the city's revenues and the constraints on the city's ability to apply certain restricted funds to general obligations. A municipality's conduct in the period preceding bankruptcy, including its negotiations with each stakeholder, may also come under close scrutiny. Accordingly, preparation for a fight over eligibility should begin well before the petition is actually filed.

There are essentially six requirements for a municipality to be eligible to file under chapter 9:

i. a debtor must be a municipality;

ii. it must be specifically authorized by state law to file chapter 9 (and meet any additional requirements imposed by the state);

iii. it must be insolvent;

iv. it must desire to effect a plan to adjust its debts;

v. it must either (a) obtain majority agreement of each class of claims affected by its plan, (b) have negotiated in good faith but failed to obtain such an agreement, (c) show that negotiation would be impracticable, or (d) reasonably believe that creditor may attempt to obtain a preferential payment; and

vi. it must prove that it filed the petition in good faith.

The first five requirements are listed in section 109(c) of the Bankruptcy Code; section 921(c) provides the sixth. 11 U.S.C. §§ 109(c), 921(c).

A. Definition of "Municipality"

Turning to the first requirement, only a "municipality" can file under chapter 9. The term "municipality" is defined as a "political subdivision or public agency or instrumentality of a State." 11 U.S.C. § 101(40). Cities, counties, and townships will generally fall within the definition of "political subdivision." "Public agency or instrumentality of a State" may include a wide variety of entities, such as school and hospital districts, sanitation and irrigation districts, public improvement districts, boards, commissions, and authorities, as well as certain revenue-producing bodies that provide services paid for by charges or tolls rather than taxes. Indeed, most municipal debtors are these other types of public entities, although cities and counties get the most attention.

B. State Authorization to File

In deference to the powers reserved to the states under the Tenth Amendment of the United States Constitution, the Bankruptcy Code confers upon each state the absolute right to act as a gatekeeper to decide whether to permit its municipal entities to file under chapter 9. Some states have a broad enabling statute, but others impose additional requirements, such as obtaining permission of the governor. Conn. Gen. Stat. Ann. Sec. 7-566. Approximately half of the states have no authorizing statute at all, and a specific law must be passed to allow a filing.

Until 2011, California allowed its municipalities to file for bankruptcy without meeting any additional requirements. That changed in 2011, when California enacted Assembly Bill No. 506 (codified at Cal. Gov't Code § 53760). Now, to be authorized to file for chapter 9, a California municipality must first either pursue a neutral evaluation process or declare a fiscal emergency.

1. Neutral Evaluation Process

The neutral evaluation process is a mediation among the municipality and "interested parties" that conforms to the statutory requirements of California Government Code § 53760.3. The "interested parties" must include any union, major creditor, or pension fund, among others. Cal. Gov't Code § 53760.1(e). All participants are required to negotiate in good faith, and the process is to be kept confidential, unless all parties expressly agree to disclosure or a bankruptcy judge later needs the information to determine whether the municipality is eligible for chapter 9. Cal. Gov't Code § 53760.3(q). The process is to last 60 days but may be extended by an additional 30 days. Cal. Gov't Code § 53760.3(r).

The neutral evaluator (essentially a mediator) is selected by the participants and may ask for documentation and other information, such as "the status of funds of the local public entity that clearly distinguishes between general funds and special funds, and the proposed plan of readjustment prepared by the local public entity." Cal. Gov't Code § 53760.3(k). Because of those information requirements, it is imperative that a municipality enter the neutral evaluation process with financial transparency and with a well-developed "ask" in the form of a proposed plan of adjustment.

The City of Stockton engaged in neutral evaluation processes before filing for chapter 9. It entered with a detailed proposed plan of adjustment that impaired bondholders and included "painful cuts to organized labor." *In re City of Stockton*, 493 B.R. 772, 782-85 (Bankr. E.D. Cal. 2013). The city reached agreements with its labor unions, but its capital markets creditors refused to negotiate and did not pay any costs of neutral evaluation. *Id.* at 786. The bankruptcy court concluded that Stockton had fulfilled the neutral evaluation requirement because the capital markets creditors had refused to negotiate in good faith.

2. Declaration of Financial Emergency

The other route into bankruptcy is to declare a financial emergency. To do so, it must adopt "a resolution by a majority vote of the governing board at a noticed public hearing that includes findings that the financial state of the [municipality] jeopardizes the health, safety, or well-being of the residents . . . absent the protections of Chapter 9." Cal. Gov't Code § 53760.5. The resolution must include findings that the public entity is or will be unable to pay its obligations within the next 60 days. The municipality must also take public comment at a noticed public hearing on its fiscal condition. *Id.*

The City of San Bernardino was forced to take this path. While the city had faced structural issues for some time, the depth of the city's liquidity crisis was obscured by understaffing and turnover in its finance department. When a new finance director stepped in, he discovered that the city was unable to meet even its current obligations, which necessitated an emergency chapter 9 filing. *In re City of San Bernardino*, 499 B.R. 776, 779-80 (Bankr. C.D. Cal. 2013). As a result, San Bernardino entered bankruptcy

without complete financials, a proposed plan of adjustment, or agreements with any key stakeholders, all of which made the case considerably more challenging.

C. Insolvency

To be an eligible chapter 9 debtor, a municipality must be insolvent, which is generally determined on a cash-flow basis. A debtor is insolvent if is not paying undisputed debts as they come due or will be unable to pay debts based on projections for the current or next succeeding fiscal year. *In re City of Vallejo*, 408 B.R. 280, 290 (B.A.P. 9th Cir. 2009); *In re City of Stockton*, 493 B.R. 772, 789 (Bankr. E.D. Cal. 2013).

Bankruptcy courts have also considered whether a municipality is "service-delivery insolvent," *i.e.*, unable to provide services "at the level and quality that are required for the health, safety, and welfare of the community." *Stockton*, 493 B.R. at 789 (Bankr. E.D. Cal. 2013); *In re City of Detroit*, 504 B.R. 191, 263 (Bankr. E.D. Mich. 2013); *In re City of San Bernardino*, 499 B.R. 776, 787 (Bankr. C.D. Cal. 2013) (describing budget cuts' negative impact on services and safety). In *Stockton* and *Detroit*, the bankruptcy courts determined that the respective cities were both cash-flow and service-delivery insolvent. Both decisions highlighted rising crime levels as the crucial factor in service-delivery insolvency; the cities could not afford to adequately invest in their police forces unless their debts were adjusted in a bankruptcy proceeding. The *Stockton* court also noted that the city could not count on a tax increase to fund its police force, because the requirement for voter approval rendered any such measure uncertain.

No court has yet found that a municipality is insolvent based on service-delivery insolvency alone, without cash-flow insolvency. A municipality with burdensome long-term obligations must still be prepared to make the requisite showing of cash-flow insolvency in the short term.

D. The Debtor's Desire to Effect a Plan, Good Faith, and Efforts to Negotiate

The last three chapter 9 eligibility requirements are similar.

The fourth requirement is that the municipality "desires to effect a plan to adjust" its debts. 11 U.S.C. § 109(c)(4). This means that the filing must not simply be to buy time or thwart creditors.

The fifth requirement is that the debtor must satisfy one of four conditions. It must either:

i. have obtained the consent of a majority of each of its impaired classes ;

ii. failed to obtain such consent after negotiating in good faith;

iii. be unable to negotiate because it would be impracticable; or

iv. reasonably believes a creditor may attempt to obtain a transfer that is avoidable as a preference.

11 U.S.C. § 109(c)(5). Whether a municipality has negotiated in good faith with its creditors is an oft-litigated issue.

To demonstrate good faith, a municipality should present creditors with a specific plan of adjustment. *In re City of Detroit*, 504 B.R. 191, 267 (Bankr. E.D. Mich. 2013). Creditors should be given sufficient time to respond, and constructive creditor counterproposals should receive genuine consideration. However, a municipality need not offer concessions to creditors who refuse to negotiate, nor accept a proposal that provides short-term relief but merely delays an inevitable filing. *In re City of Vallejo*, 408 B.R. 280, 297 (B.A.P. 9th Cir. 2009); *In re City of Stockton*, 493 B.R. 772, 793 (Bankr. E.D. Cal. 2013).

In some cases, negotiating with some or all creditors will be impracticable. In both *Stockton* and *Detroit*, negotiating with retirees was held to be impracticable because there was no representative who could bind thousands of individuals to an agreement. *Stockton*, 493 B.R. at 794; *Detroit*, 504 B.R. at 194. San Bernardino's sudden discovery of its financial emergency made pre-bankruptcy negotiations impracticable. *In re City of San Bernardino*, 499 B.R. 776, 786 (Bankr. C.D. Cal. 2013).

The sixth requirement is that the debtor filed the petition in good faith. 11 U.S.C. § 921(c). Factors relevant to the court's good faith determination include whether the debtor's actions are consistent with chapter 9, the breadth and depth of the debtor's financial problems, and the extent of the debtor's prepetition negotiations and consideration of alternatives to chapter 9. *San Bernardino*, 499 B.R. at 790.

In *San Bernardino*, CalPERS alleged that the city did not have the desire to effect a plan and did not file its petition in good faith. *San Bernardino*, 499 B.R. at 778. The bankruptcy court rejected both arguments, because it found that the city's filing was consistent with the purposes of chapter 9: "to give a municipality a breathing space from a cash crunch and an opportunity to address its long term solvency through an organized process of proposing a long term plan of adjustment." *Id.* at 791. The court acknowledged that San Bernardino did not meaningfully negotiate with creditors or consider alternatives to chapter 9 but, under the circumstances, the city had no reasonable alternative other than an emergency chapter 9 filing. *Id.*

III. The Chapter 9 Case

A. Preparation for Filing

A chapter 9 case is commenced by the filing of a petition under section 301 of the Bankruptcy Code. 11 U.S.C. § 921(a). The filing must be properly authorized under local law, generally by resolution of the city council. Typically, the action is taken at an open meeting, but the deliberations surrounding the bankruptcy filing occur in a closed session.

City attorneys must ensure authorization is proper and should carefully safeguard the confidentiality and privilege of deliberations.

The city attorney may also take a central role in managing communications and maintaining confidentiality and privilege more generally, both before and during the bankruptcy. As a main point of contact between the city and its bankruptcy counsel, the city attorney will assist and advise as to what information should be made public, provided to the council, or kept among city management and advisors. In the San Bernardino bankruptcy, the city attorney was the city's spokesperson on legal matters, regularly drafting press releases and issuing statements to the press about the bankruptcy case.

Before the case begins, the city attorney may also have to address and seek outside counsel assistance on various matters of non-bankruptcy law, such as the securities disclosure and restricted fund issues mentioned above.

B. Effect of the Chapter 9 Petition

1. The Automatic Stay

Filing the petition immediately triggers the "automatic stay" of litigation and collection actions against the debtor and its property, even if a dispute over eligibility is pending. The automatic stay provides the debtor with breathing room to move toward a plan of adjustment. In chapter 9, the automatic stay also extends to actions against the debtor's officers and inhabitants that seek to enforce a claim against the debtor, such as mandamus actions. 11 U.S.C. § 922(a).

Under certain circumstances, creditors may ask the bankruptcy court for relief from the automatic stay to proceed with an action. For example, because San Bernardino faced a liquidity crisis at the beginning of its case, the city was unable to continue making certain payments to CalPERS. In response, CalPERS brought a motion for relief from the automatic stay seeking to pursue its state court remedies, which the bankruptcy court denied. In the end, the city and CalPERS reached an agreement that allowed the city to repay CalPERS over time.

2. Limited Authority of the Bankruptcy Court

The bankruptcy court's actual power over a chapter 9 debtor is circumscribed by the Tenth Amendment of the United States Constitution. Therefore, unlike in a typical chapter 11 business bankruptcy case, a chapter 9 debtor does not need to obtain bankruptcy court permission to make expenditures, enter into contracts, borrow money, sell assets, engage professionals, or engage in transactions out of the ordinary course of business. 11 U.S.C. §§ 903, 904. Likewise, a bankruptcy court cannot interfere with "(1) any of the political or government powers of the debtor; (2) any of the property or revenues of the debtor; or (3) the debtor's use or enjoyment of any income-producing property." 11 U.S.C. § 904. As a consequence, the bankruptcy court's ability to order the debtor to take a particular action is limited. That limitation, together with the automatic

stay, provides a chapter 9 debtor with significant flexibility in addressing short-term financial challenges. Also, unlike in a chapter 11 business bankruptcy case, the creditors cannot propose their own plan of adjustment, seek appointment of a trustee to control the debtor, or convert the case into a liquidation.

3. Appointment of Committees

The United States Trustee, the federal administrator charged with bankruptcy oversight, may appoint one or more official committees to represent creditors holding similar interests. In Vallejo, Stockton, and San Bernardino, the United States Trustee appointed an official committee of retirees. In other cases, such as Detroit and Puerto Rico, the United States Trustee also appointed an official committee of unsecured creditors. Once appointed, the official committees select counsel and financial advisors to provide advice and advocate on their behalf. In some cases, similarly situated creditors may also form unofficial, or ad hoc, committees to represent their common interests in the case.

While the Bankruptcy Code does not require a chapter 9 debtor to pay the professional fees of official committees, the debtor will often agree to do so within a negotiated budget. By organizing a constituency and serving as a point of contact for negotiations, official committees often prove useful in chapter 9 cases. And, while a committee cannot bind individuals to vote for a proposed plan of adjustment, the class represented by a committee will generally follow its recommendation.

4. Mediation with Stakeholders

Formal mediation among the city and its stakeholders will generally begin soon after the determination that the city meets the chapter 9 eligibility requirements, although in some cases the bankruptcy judge sends the parties to mediation even earlier. The city attorney will often attend or participate in these mediation sessions.

The goal of mediation will be to reach a consensual plan of adjustment, or at least to obtain the consent of as many stakeholders as possible. The mediation participants will likely be familiar faces from pre-bankruptcy negotiations, with the addition of any official committees appointed in the case. The mediators are often, though not always, present or former bankruptcy judges. The mediator in the Stockton case was Bankruptcy Judge Elizabeth Perris, the mediator in the San Bernardino case was Bankruptcy Judge Gregg W. Zive, and the mediator for Detroit was then-Chief Judge Gerald E. Rosen of the U.S. District Court for the Eastern District of Michigan.

Mediation has proven highly effective in bringing parties together to support chapter 9 plans. In *Stockton*, the city's plan of adjustment was confirmed over only one objection, a capital markets creditor. In *San Bernardino*, the city used mediation to reach agreements with its major creditor constituencies; only a group of litigation claimants maintained objections to the plan of adjustment, all of which were overruled by the bankruptcy court.

C. Treatment of Pensions, Benefits and Collective Bargaining Agreements

One of the most powerful tools available to a chapter 9 debtor is the ability to assume or reject executory contracts (a contract with material obligations remaining for both the debtor and a counterparty) and unexpired leases with the approval of the bankruptcy court. 11 U.S.C. § 365. Executory contracts are especially important in chapter 9 cases involving cities because they typically include collective bargaining agreements ("CBAs"). The Bankruptcy Code authorizes a chapter 9 debtor to reject contracts, including CBAs. 11 U.S.C. § 365(a). Contract rejection means that the debtor is no longer required to perform under the contract, and the creditor receives a general unsecured claim for the contract breach. 11 U.S.C. § 502(g).

Not all employee benefits will be owed under executory contracts; for some, the relevant contract may no longer be executory. For instance, health benefits owed to retirees are not executory contracts, because the retirees have already performed their side of the bargain. In such cases, the chapter 9 debtor may still reduce or eliminate the benefit, and the retiree will simply have a general unsecured claim against the debtor for amounts owing, as happened in the Stockton and San Bernardino chapter 9 cases.

1. Pension Benefits

While the Bankruptcy Code grants no special priority to pensions, the California Supreme Court has recognized a strict "vested right" in public employee pension benefits under the California Constitution (the so-called "California Rule"). Any modification of active employees' vested pension rights must, among other things, "be accompanied by comparable new advantages." *Marin Ass'n of Pub. Employees v. Marin Cty. Employees' Retirement Ass'n*, 2 Cal. App. 5th 674, 697 (2016) (citing *Allen v. Board of Administration*, 34 Cal. 3d 114, 120 (1983). And the pensions of retirees are to "receive an extra measure" of protection beyond that.[3] *Id.* at n.19.

In the Stockton case, CalPERS asserted that the California Rule prevented pension obligations from being modified under a plan of adjustment (though, in fact, Stockton was not seeking to impair pensions).[4] *In re City of Stockton*, 526 B.R. 35, 55-56 (Bankr. E.D. Cal. 2015). The bankruptcy court rejected CalPERS' argument, ruling that

[3] Recent decisions of the California Courts of Appeal have called the inflexibility of the California Rule into question. *Alameda Cnty. Deputy Sheriff's Ass'n v. Alameda Cnty. Employees' Retirement Ass'n*, 19 Cal. App. 5th 61 (2018); *Marin*, 2 Cal. App. 5th 674. *Marin* allowed "reasonable" modifications to the pensions of active employees without a comparable new advantage. *Marin*, 2 Cal. App. 5th, at 697-700 (2016). The *Alameda* court disagreed with the holding of *Marin*. It would permit changes only if there were "compelling evidence" that the changes were necessary for continued operation of the pension system. *Alameda*, 19 Cal. App. 5th at 123. The issue is expected to come before the California Supreme Court shortly.

[4] Because Stockton did not attempt to impair pensions, CalPERS did not oppose the plan of adjustment. Rather, the bankruptcy court decided the issue because an objecting capital markets creditor argued that Stockton should be *required* to impair pensions. *Stockton*, 526 B.R. 35.

the Bankruptcy Code preempted a California statute (Cal. Gov't Code § 20487) that purported to limit the rejection of pension contracts. The bankruptcy court concluded that pensions contracts could be rejected and pensions may, as a matter of law, be modified by a chapter 9 plan of adjustment. 526 B.R. at 62. The court reasoned that pension rights are contract rights. And, while a state may decide whether or not its municipalities can file for bankruptcy, the debtor's ability to impair contracts under the Bankruptcy Code is available to states only on "an all-or-nothing, take-or-leave-it basis." *Id.* at 55. Thus, if a state allows its municipalities to file for bankruptcy, it cannot prevent those municipalities from impairing particular contracts. *See id.* at 57.

Had Stockton rejected or otherwise attempted to impair its contractual relationship with CalPERS, it could then be liable for the CalPERS termination charge under Cal. Gov't Code § 20577. CalPERS asserted that Stockton would owe $1.6 billion, but the bankruptcy court suggested that CalPERS would not have been able to enforce its statutory lien under Cal. Gov't Code § 20574 because certain liens can be avoided (made unenforceable) in bankruptcy cases. If that were the case, CalPERS' termination charge would have been only a general unsecured claim in the bankruptcy. The statutory lien issue was not actually litigated in the recent Stockton or San Bernardino cases, and no California bankruptcy court has yet addressed the enforceability of the lien.

The bankruptcy court in Detroit followed Stockton on bankruptcy impairment of pension obligations, holding that the city could impair pensions notwithstanding the Michigan State Constitution provided that pensions and retirement benefits were contractual obligations that could not be impaired. *In re City of Detroit*, 504 B.R. 191, 244 (Bankr. E.D. Mich. 2013).

Despite the Stockton bankruptcy court's ruling that pension contracts could be rejected and pensions could be modified, Stockton did not reject its agreement with CalPERS or attempt to modify pension benefits under its plan of adjustment. San Bernardino made a similar decision in its chapter 9 bankruptcy. Both faced the same fundamental issue: pensions are a crucial component of employee compensation, and there is no pension administrator in the marketplace comparable to CalPERS. Rejection of a CalPERS contract would have chilled negotiations with unions and retirees, and might even have precipitated a mass exodus of employees. However, the continuing rise in pension costs will no doubt lead cities to seriously consider attempting to impair pension obligations in future chapter 9 cases.

Both Stockton and San Bernardino were ultimately able to reach new CBAs and other agreements with unions and retirees that provided substantial pension savings for the cities. Stockton reached some of those agreements before bankruptcy, while San Bernardino first imposed the changes unilaterally in the first few months of its bankruptcy case, then moved for bankruptcy court approval of rejection of the CBAs, and finally reached consensual agreements with the retirees and new CBAs with the unions that were implemented under the chapter 9 plan. San Bernardino's new CBAs included a variety of provisions that reduced pension and benefit costs, including requiring employees to contribute the full statutory employee rates, eliminating the employer paid

member contribution, removing pension-spiking provisions, reducing accruals and cash-outs of leave time, modifying retirement health benefits, and other related changes.

2. Other Post-Employment Benefits

Early in Stockton's bankruptcy, the city unilaterally suspended the payment of retiree health benefits. *Assoc. of Retired Employees v. City of Stockton (In re City of Stockton)*, 478 B.R. 8, 13 (Bankr. E.D. Cal. 2012). Retirees asked the court to order Stockton to continue making payments, arguing that their health benefits were vested rights. The bankruptcy court ruled in favor of Stockton, holding that the benefits were contract rights that could be unilaterally "modified or suspended" during the pendency of the case, notwithstanding California law. *Id.* at 23-24. The retirees would have a claim against the debtor for lost benefits, which would be dealt with in a plan of adjustment. *Id.* at 24-25. San Bernardino took a similar approach, using the Bankruptcy Code power to impair contract rights to reduce retiree health benefits.

3. Collective Bargaining Agreements

In chapter 9, a bankruptcy court will authorize the rejection a CBA under section 365 of the Bankruptcy Code if (a) the agreement burdens the debtor; (b) the equities balance in favor of rejecting the agreement; and (c) reasonable efforts to negotiate a voluntary modification have been made and are not likely to produce a prompt and satisfactory solution. *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 104 S.Ct. 1188 (1984); *In re City of Vallejo*, 432 B.R. 262, 270 (E.D. Cal. 2010). The resultant union and employee damages claims will be treated as general unsecured claims. *In re City of San Bernardino*, 530 B.R. 489, 498 (C.D. Cal. 2015). Moreover, even before the debtor seeks to reject a CBA (or the court approves that decision), a debtor can *unilaterally* modify a CBA on an interim basis without violating the labor laws. *Retired Employees v. Stockton*, 478 B.R. at 23 (citing *Bildisco*, 465 U.S. at 527-34); *Vallejo*, 432 B.R. at 271.

The bankruptcy power to unilaterally modify employee wages and benefits, then actually reject a CBA, allows municipalities to impose changes to the terms of employment without following the procedures required under state labor law. *San Bernardino*, 530 B.R. at 497; *Vallejo*, 432 B.R. at 270. Under California labor law, the cities and unions must generally negotiate to impasse before any modifications to terms and conditions of employment can be made, a period that can last many months or even years—time that a city with a cash flow crisis cannot wait for. San Bernardino, for example, was quickly running out of cash at the beginning of its bankruptcy case, and bankruptcy allowed it to unilaterally impose interim changes to certain CBAs and immediately reduce the cost of operating the city. When the bankruptcy court granted the city's motion to reject the CBAs, the city made the imposed changes permanent. *San Bernardino City Prof'l Firefighters Local 891 v. City of San Bernardino (In re City of San Bernardino)*, 530 B.R. 474, 489 (C.D. Cal. 2015).

In addition to using bankruptcy to make necessary modifications to its CBAs, San Bernardino also determined to contract out the provision of fire services. The city's

firefighters union opposed those efforts, arguing that state law and the city's charter prohibited the city from contracting out. However, the bankruptcy court ruled that San Bernardino could contract out fire services, and the decision was upheld on appeal. *San Bernardino City Prof'l Firefighters Local 891 v. City of San Bernardino (In re City of San Bernardino),* No. 5:15-cv-01562-ODW, 2015 U.S. Dist. LEXIS 170882 (C.D. Cal. Dec. 22, 2015). Ultimately, after winning on the issue of contracting out, the city obtained approval from the local agency formation commission to annex into the county firefighting agency, and the city reached a financial settlement with the firefighters union as part of the city's chapter 9 plan.

Chapter 9 debtors often find it advantageous to have the bankruptcy court adjudicate such issues. The bankruptcy court will have a deep knowledge of how a particular dispute fits into the overall context of the bankruptcy, and litigation in bankruptcy courts often proceeds over an expedited timeframe. The city attorney plays a key role in coordinating the purely bankruptcy legal battles with other state-law related issues like contracting out and local agency formation commission negotiation and compliance.

D. Bond Debt

Special revenue bonds are bonds secured by "special revenues," which include receipts from providing transportation and utility services, and taxes specifically levied to finance a project or system (*e.g.*, ad valorem property taxes used to build sewage systems and schools). 11 U.S.C. § 902(2). Special revenue bonds are the most common type of secured debt of a municipality.

Special revenue bondholders are given enhanced protections under the Bankruptcy Code. The liens of special revenue bondholders extend to special revenues acquired after commencement of the case, and they may demand interest and principal payments during the bankruptcy case. 11 U.S.C. §§ 922(d), 928(a). There are, however, limitations on the rights of special revenue bondholders. The revenues may be used to pay the operating expenses of the underlying project, 11 U.S.C. § 928(b), and if there are not enough special revenues to pay the special revenue bond obligations in full, the bondholders are not entitled to a claim for the deficiency. 11 U.S.C. § 927.

General obligation bonds issued by cities, in contrast, are not secured by a particular stream of income or assets and are typically treated differently than bonds secured by "special revenues." General obligation bonds can often be classified as general unsecured debt in chapter 9 and heavily impaired.

In the San Bernardino case, the city sought to treat pension obligation bondholders as unsecured creditors under its chapter 9 plan of adjustment. The pension obligation bondholders argued that their bonds were entitled to the same priority of payment as CalPERS (*i.e.*, paid in full instead of being treated as general unsecured claims). The bankruptcy court ruled in favor of the city, the bondholders appealed, and a

settlement was achieved in mediation that substantially discounted the bondholder claims.

In 2015, California enacted Senate Bill 222, which provides a statutory lien for certain general obligation bonds. The scope and impact of SB 222 has not been addressed by any state or federal court.

E. Litigation Claimants

Litigation claims against a municipality for damages are also treated as general unsecured claims under the Bankruptcy Code, and they can therefore be subject to significant impairment. However, many litigants assert claims not just against a municipality but also against employees acting in the ordinary course of their employment. Under California law, the municipality is obligated to fully indemnify the employees, but a typical plan of adjustment only modifies claims against the municipality itself. As a consequence, a municipality would have to pay judgments against employees in full, even though similar claims against the municipality might receive only pennies on the dollar. This issue is particularly significant in light of increasing verdicts against police officers for actions within the scope of employment.

San Bernardino addressed this problem by requesting and obtaining a plan injunction that was the first of its kind issued in connection with a chapter 9 plan of adjustment. *In re City of San Bernardino*, 566 B.R. 46 (Bankr. C.D. Cal. 2017). The injunction enjoined litigants from collecting judgments against individual employees, instead providing them with a general unsecured claim and the ability to collect from any available insurance. The bankruptcy court granted the injunction, supported by detailed findings that the injunction was necessary to the success of San Bernardino's plan of adjustment and subsequent financial recovery. The court found that without the plan injunction, the city could not afford to maintain public safety or provide essential services to its citizens. San Bernardino's plan, including the injunction, has since been fully implemented, and no appeals are pending.

While the injunction was grounded in San Bernardino's unique circumstances, and such injunctions outside chapter 9 are generally disfavored in the Ninth Circuit, the San Bernardino precedent may well be of great interest to municipalities in financial distress where the city's debt burden includes judgments and pending claims against the city's police officers or other employees.

F. Exiting Bankruptcy: Confirmation of a Plan of Adjustment

The ultimate goal of a chapter 9 case is for the debtor to emerge with a successful plan of adjustment that restructures its debt and obligations to a sustainable level. The plan of adjustment is a formal document that provides for the treatment of the various classes of claims against the municipality, as well as for the means of implementation. 11 U.S.C. § 1123. For San Bernardino, the means of implementation included, among other things, operational improvements, the outsourcing of fire and waste management

services, city charter reform, new revenues, and various cost-reduction measures to generate substantial savings.

1. Summary of Plan Process

A municipal debtor must submit the plan of adjustment, along with an explanatory disclosure statement, to the holders of claims and the bankruptcy court for approval and confirmation. 11 U.S.C. § 1125. Only the municipal debtor may be a plan proponent in a chapter 9 case. 11 U.S.C. § 941. This gives the debtor a significant measure of strategic control, as there can be no creditor-sponsored competing plans.

The creditors may vote on and raise objections to the plan (though successful mediation may render most creditor votes a foregone conclusion). The court then holds a confirmation hearing to consider the plan, objections, and votes. 11 U.S.C. § 1128. If the court decides the plan meets the requirements of the Bankruptcy Code, then the court confirms the plan, and it becomes binding upon the debtor and creditors. 11 U.S.C. § 1129. The key confirmation requirements are summarized below.

2. Confirmation Requirements

The plan must be in the best interest of creditors. 11 U.S.C. § 943(b)(7). To meet this requirement, a debtor need only show that its plan of adjustment is "better than any of the alternatives." *Sanitary & Improvement District No. 7,* 98 B.R. 970 (Bankr. D. Neb. 1989); *Franklin High Yield Tax-Free Income Fund v. City of Stockton (In re City of Stockton),* 542 B.R. 261, 285 (B.A.P. 9th Cir. 2015). And, since confirmation and dismissal are the only two possible outcomes in a chapter 9 case, this is often not a difficult test to meet. Dismissal is usually not an attractive option for the creditors.

The plan must also be feasible, meaning there is a reasonable prospect that the debtor will be able to perform under the plan. 11 U.S.C. § 943(b)(7). The court will usually make this determination by reviewing the reasonableness of the projections provided by the debtor. Experts and consultants usually assist in the preparation and presentation of these projections.

A plan will be confirmed if it meets the requirements above and each impaired class of creditors votes to accept it. 11 U.S.C. § 1129(a)(8). Impairment essentially means that the rights of the creditor are altered in some way. 11 U.S.C. § 1124. A class of creditors accepts a chapter 9 plan if more than two-thirds in dollar amount and majority in the number of creditors voting in that class vote to accept the plan. 11 U.S.C. § 1126(c). The San Bernardino chapter 9 plan was accepted by all classes of voting creditors.

3. Cram Down of Dissenting Classes

If a municipal debtor's plan meets all of the other requirements of confirmation, but a class of creditors fails to accept the plan, the court may nevertheless approve the plan over the objection of the dissenting class of creditors and "cram down" the plan on

that dissenting class of creditors, but only if (i) the plan is "fair and equitable," (ii) the plan "does not discriminate unfairly," and (iii) at least one class of impaired claims voted in favor of the plan. 11 U.S.C. §§ 1129(a)(10), 1129(b).

A debtor's ability to impair secured claims by cram down is limited, because secured creditors have constitutionally protected property rights. That said, in appropriate cases a debtor can often achieve interest rate reductions, lengthened payment periods, and alteration of terms. Also, because special revenue liens are typically non-recourse, *see* 11 U.S.C. § 927, the debtor may be able to cram down a reduction in principal if the present value of the payment stream is less than the value of the bonds.

For unsecured creditors, a plan is considered "fair and equitable" if the amount to be received by the dissenting class is "all they can reasonably expect to receive under the circumstances." *Lorber v. Vista Irrigation Dist.*, 127 F.2d 628, 639 (9th Cir. 1942). Thus, general unsecured claims can be often be impaired significantly. The appropriate payout will be based on what the court believes the debtor can afford to pay and, under that standard, the municipality does not have to discontinue its services. The municipality must be permitted to continue to operate as a viable entity and provide basic services; it may have to scale down, but it only has to pay its creditors what a court finds to be reasonable—and that may sometimes be a fairly low hurdle to meet. San Bernardino's confirmed plan paid one cent on the dollar to general unsecured claims, and it saved hundreds of millions of dollars through the reduction of claims and operating expenses.

IV. Chapter 9: Advantages and Disadvantages

Distressed cities should carefully consider the advantages and disadvantages of a potential chapter 9 filing. This section provides a brief summary of each.

A. The Advantages of Chapter 9

Relief from Creditor Action: Breathing Room. The most immediate protection conferred by chapter 9 is relief from creditor action. The filing of a chapter 9 bankruptcy invokes an automatic stay of any lawsuits or other collection action against a municipality and certain other parties. A municipality will therefore have breathing space while it attempts to resolve cash flow problems and formulate a plan of adjustment. If the entity is facing a lawsuit or other imminent action such as judgment enforcement, the automatic stay can be a very significant advantage for a municipal debtor.

Adjustment of Debt. The bankruptcy court in a chapter 9 case can compel a recalcitrant creditor or class of creditors to accept a plan over their objections, under the cram down powers of the bankruptcy court. The power of a chapter 9 filing to force a plan on the creditors that reduces their claims, perhaps substantially to "tiny bankruptcy dollars," can result in large savings for the municipality.

Rejection of Burdensome Contracts. A municipal debtor has the ability to reject burdensome executory contracts, including collective bargaining agreements.

Consolidate Disputes in Single Forum before Restructuring Expert. The municipality can consolidate all disputes before one forum as opposed to multiple courts, and centralize the resolution of these disputes. This may be particularly important if the case involves a number of complex issues. The bankruptcy judge has expertise in debtor/creditor and inter-creditor disputes and will be familiar with the municipality's debt structure and operations. Bankruptcy litigation also generally proceeds much faster than litigation before other state and federal courts.

Few Operational Impediments. A municipality can continue its day-to-day operations, without interference by the bankruptcy court or other parties. The bankruptcy court may not interfere with the municipality's political or governmental powers, property or revenues.

B. The Disadvantages of Chapter 9

Expense. There are significant ongoing costs associated with retaining legal and financial professionals to assist with administration of the case, negotiating with creditors, and developing a plan of adjustment, and professional fees are generally paid monthly. Nevertheless, the short-term savings made available under the bankruptcy powers generally exceed the costs of the bankruptcy, and the long-term savings from confirming a chapter 9 plan of adjustment can run into the hundreds of millions of dollars.

Attention of Staff. A filing will distract elected officials and government personnel who must field questions about the filing and assist in the administration of the case. Staff must devote time to management and administration of the case, dealing with court filings, outside professionals, creditors, and disclosure requirements.

Reaction of Credit Markets and Vendors. When a municipality files chapter 9, its credit rating will go down and be watched more carefully in the future. Even discussion of bankruptcy can affect markets. Creditors will be reluctant to extend credit, at least at the beginning of the case, and this may cause further tightening to an already strapped municipal budget. Yet a chapter 9 can also be a vehicle to return a municipality to financial health and allow it to re-enter the credit markets. Several large municipalities have restructured successfully and had their access to the capital markets restored.

V. Conclusion and Key Takeaways

Chapter 9 bankruptcy often represents a distressed city's last resort. Indeed, even the Bankruptcy Code requires municipalities to make a good faith effort to avoid bankruptcy before they can be eligible to file for chapter 9. Nonetheless, in the coming years, some California cities will find themselves facing down a bankruptcy. Even for those cities who never file, the looming threat of chapter 9 may help spur the tough decisions and painful compromises necessary to avoid bankruptcy.

With that in mind, city attorneys will benefit from having a working knowledge of some the chapter 9 issues discussed in this paper. In particular, city attorneys thinking about chapter 9 should take away the following key points from this paper:

- Cities should fully understand the nature of their financial problems and take whatever steps possible to address them, as early as is practicable. City attorneys should also be alert to issues surrounding the use of restricted funds.

- At an early juncture, a troubled city should hire experienced bankruptcy counsel and financial consultants, a process that will likely involve the city attorney. Experienced professionals can help identify financial problems and find solutions. Also, bankruptcy law will likely impact a city's negotiations with stakeholders to avoid bankruptcy.

- If a city does decide to file, it will have to meet the eligibility requirements for a filing, namely that the city is insolvent and has engaged in good faith negotiations with creditors to the extent practicable. It may require substantial advance preparation to meet these requirements and to prove them to the bankruptcy court.

- The city attorney will be closely involved in the chapter 9 case, both before and during proceedings. That involvement may include managing communications and the press, ensuring the city remains in compliance with applicable non-bankruptcy law, and appearing and assisting at hearings throughout the case.

- The Bankruptcy Code allows chapter 9 debtors to reject CBAs and impair pension obligations and post-employment benefits, upon appropriate showings.

- Mediation, in which the city attorney will participate, is an important part of the chapter 9 case. Several chapter 9 debtors have used mediation to achieve near-complete consensus on a plan of adjustment.

- A city exits bankruptcy by confirming a plan of adjustment, which modifies its debts and may generate significant savings. If a city cannot obtain the agreement of certain classes of creditors, it may be able to "cram down" those modifications.

After a Natural Disaster: Government Communications and Actions

Friday, September 14, 2018 General Session; 10:15 a.m. – 12:15 p.m.

David N. Bruce, Partner, Savitt Bruce & Willey, LLP

Notes:

After a Natural Disaster:

Government Communications and Actions

Presented to the League of California Cities 2018 Annual Conference

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SOME SAY FIRE, SOME SAY ICE:[1] A PRIMER ON MUNICIPAL RESPONSE TO NATURAL DISASTER IN CALIFORNIA[2]

> Things fall apart; the centre cannot hold;
> Mere anarchy is loosed upon the world.[3]

The "Golden State" is also the state of disaster: floods, fires, and tsunamis; earthquakes and landslides; volcanoes and tempests.[4]

The rock on which we built our firm foundations whirls through the void, rips at the seams, and suffers the lash of the elements. We huddle together in cities but are powerless to prevent natural catastrophe. When the cracks open and the edifice crumbles, when family or neighbors perish in flood or fire, we turn to the government.

And the cavalry comes. In the grip of the maelstrom, municipalities face urgent decisions, and typically try to provide immediate relief and find funding. Section A gives an overview of legal considerations bearing on these issues. Before long, some affected citizens will claim that their local government should compensate their losses. Section B identifies typical claims and provides authority pertinent to key defenses. Finally, as the dust settles, municipalities typically take measures to reduce future risks to the public. Section C provides an overview of these issues.

Presentations on natural disasters often focus on the specific steps that a city must take when responding (*e.g.* activating the Emergency Operations Center, preparing a resolution declaring the emergency, considering other resolutions relating to, for example, curfews, submitting costs to the various agencies for reimbursement when the disaster is over, *et cet.*) Although this paper touches on some of these issues, and while I will address in the live presentation certain communications issues that arise in the immediate wake of disaster, the focus of this paper is on municipal liability issues related to natural disasters, and on the legal concerns presented for municipalities responding to natural disasters and trying to manage natural risk.[5]

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[1] Paraphrasing R. Frost's "Fire and Ice." Some say the whole thing will just slide into the ocean, *e.g.*, S. Goldberg, *Falling into the Pacific: California Landslides and Land Use Controls*, 16 S. Cal. Rev. L. & Soc. Just. 95 (2006).

[2] As to all these issues, the law of California is rich and deep. Discretion being the better part of valor, I do not suggest that a Washington disaster lawyer can teach California law to a convention center full of California city attorneys. This paper only scratches the surface, and with a rather blunt instrument at that.

[3] W.B. Yeats, *The Second Coming*, in MICHAEL ROBARTES AND THE DANCER (1921).

[4] The legal issues discussed in this paper arise from various kinds of natural disasters. Some have been more litigated than others, and not all present the same concerns. Floods, for example, present a set of issues, largely omitted below, arising out of the National Flood Insurance Program, *see generally*, 42 U.S.C. § 4001 *et seq*. Earthquakes do not present these issues. Interestingly enough, and counterintuitively, wildfires may, *see* https://www.fema.gov/wildfires-you-need-flood-insurance.

[5] Natural disasters present many other legal issues not canvassed here. For example, as with any other issue of pressing public concern, municipal actors must take care to stay within the bounds drawn by California's Open Meeting Act, Cal. Gov. Code §§ 11120 – 32; Public Records Act issues can arise, Cal. Gov. Code § 6250, *et seq*.; implementation of a litigation hold is critical in order to avoid later spoliation accusations; and issues about attorney-client privilege, the identity of the client, and intra-client conflicts are not uncommon. I cannot and do not attempt to treat all fine points and particulars. This is an overview of common issues.

A. In the thick of it

1. Decisions under fire

Municipalities are given broad immunity for discretionary actions, including those arising out of an emergency, *see* the California Emergency Services Act ("CESA"), Cal. Gov. Code. § 8550 *et seq*. Section 8655 provides: "[t]he state or its political subdivisions shall not be liable for any claim based upon the exercise or performance, or the failure to exercise or perform, a discretionary function or duty on the part of a state or local agency or any employee … in carrying out the provisions of this chapter." The municipal immunity granted by CESA is broad, recognizing that split-second decision making is sometimes required in an unfolding emergency.

Thus, for example, in *Thousand Trails, Inc. v. California Reclamation Dist. No. 17*,[6] campground owners sued the defendant district after a flooded campground was further inundated by a cut in the levee made by the district in the midst of the emergency. In affirming summary judgment for the district, the appellate court noted that: "[i]n situations in which the state must take steps necessary to quell an emergency, it must be able to act with speed and confidence, unhampered by fear of tort liability." The district had declared a state of emergency and took emergency action to cut the levee to prevent massive flooding of the entire district, and was held to be immune for its discretionary decision.

In general, to obtain immunity for discretionary actions (or inactions) during an emergency, the municipality should be able to demonstrate that a state of emergency existed and had been declared, and that its decisions were both reasonable and focused on the primary goal of insuring public safety in a time of crisis.[7]

There also is an emergency exception to the just compensation requirement in inverse condemnation cases where damage to private property is inflicted by government under the pressure of public necessity and to avert impending peril. This emergency exception is based upon proper exercise of a public entity's police power. The California Supreme Court explained: "[t]he state or its subdivisions may take or damage private property without compensation if such action is *essential* to safeguard public health, safety, or morals." However, it also warned of a threshold: "[i]n certain circumstances, however, the taking or damaging of private property for such a purpose is not prompted by so great a necessity as to be justified without proper compensation to the owner."[8] As a result, courts tend to narrowly circumscribe the type of emergency that shields public entities from inverse condemnation liability.[9]

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[6] 124 Cal. App. 4th 450, 461, 21 Cal. Rptr. 3d 196, 204 (2004).
[7] *Id*.
[8] *House v. L.A. County Flood Control Dist.*, 25 Cal. 2d 384, 388-89, 153 P.2d 950 (1944).
[9] In *Odello Brothers v. County of Monterey*, 63 Cal. App. 4th 778, 785-86, 73 Cal. Rptr. 2d 903, 907 (1998), the court held that the county was not automatically shielded from inverse condemnation liability in breaching a levee and flooding farm lands where the emergency itself was caused by inadequacy of another levee, which was acknowledged by county six years earlier. The court held that "[i]t would be antithetical to principles of Constitution . . . to permit a public entity to burden private property without compensation, under emergency doctrine, simply because the public entities' inadequate flood control measures threatened other, more populated property."

While not a California disaster, the Mount St. Helens eruption produced cases confirming the discretion vested in government actors trying to cope with natural disaster. Washington's once-conical St. Helens erupted in 1980, killing approximately 57 people, and causing millions, if not billions, in damages. Geologists saw it coming, and prior to the eruption, then-Governor Dixy Lee Ray[10] imposed a restricted "red zone" around the volcano. This both (a) damaged local businesses, and (b) failed to prevent the deaths. Litigation ensued. The Washington Supreme Court held that discretionary immunity barred the business owners' claim, *Cougar Business Owners Association v. State*,[11] and the Washington Court of Appeals reached essentially the same result as to claims brought by the personal representatives of persons killed, *Karr v. State*.[12]

2. Disaster relief

In the immediate aftermath of a disaster, emergency responders will conduct the most urgent disaster relief efforts. Survivors will be rescued and taken to hospitals or local triage or evacuation centers, fires will be contained and extinguished, and other urgent necessities dealt with. Once some semblance of stability returns, citizens and agencies will look to city officials for leadership and help. Accessing funds for clean-up and mitigation efforts is critical, and state and/or federal assistance is often a must.

Declaring a local emergency allows cities to request financial and other assistance from the Federal Emergency Management Agency (FEMA) and from the State. The California Disaster Assistance Act (CDAA) authorizes the Director of the California Governor's Office of Emergency Services (Cal OES) to administer a program that provides financial assistance for costs incurred by local governments resulting from a disaster event, and in certain circumstances will even match FEMA contributions. For more information, see the Cal OES web site, http://www.caloes.ca.gov/, and in particular, its Fact Sheet on the disaster proclamation and CDAA processes, http://www.caloes.ca.gov/RecoverySite/Documents/CDAA%20Fact%20Sheet.pdf. Note the helpful list of factors considered in assessing local government requests for disaster funding.

To be eligible for assistance under the Act, a city or county must proclaim a local emergency within ten days of the actual occurrence of a disaster and the proclamation must be acceptable to the Secretary, or the Governor must make a State of Emergency Proclamation. The application process is set out in detail in Title 19 of the California Code of Regulations, Chapter 6, section 2970.

3. Insurance

The next step is to compile and review the city's most current insurance policies to determine possible coverage, including both primary and excess policies. Every policy should be carefully reviewed, page by page, with a broker or risk manager assisting. Letters must be sent to all the insurance carriers and risk pools notifying them of the disaster.

[10] I swear I am not making up that name, Google™ her.
[11] 97 Wn.2d 466 (1982).
[12] 53 Wn. App. 1 (1988).

Property damage policies cover damage to property owned by the city. Some policies cover business interruption, lost revenue, and public relations costs. Liability policies may cover the damage or injuries to others caused by the city's acts.

Perhaps most important, promptly consult insurance coverage counsel as needed.

B. Claims, damages, and defenses

Property owners affected by natural disaster pursue a variety of claims against municipalities. They seek, in effect, to make the municipality the insurer of last resort: the claims often are brought principally because there is no one else to blame and no other pocket available.

The claims depend in part upon the fact scenario presented and in part upon the creativity of the lawyers involved. We sketch below some of the most typical claims and damages, and discuss certain key defenses.

1. Claims

a. Negligence, failure to warn, and permitting

In some disaster cases, a negligence claim against a municipality may arise out of a public work or project. For example, a municipality might own a dam, and fail to maintain it, leading to a disastrous flood. The municipality would be liable in tort for the damages of those harmed. But these cases – in which the municipality is alleged to have been the primary cause of the harm – are not truly "natural" disaster cases.

Truly natural disasters often raise "failure to warn" claims. Although no one can accurately predict the weather, let alone earthquakes, volcanic eruptions, floods or wildfires, government agencies have made remarkable strides in hazard assessment and risk prediction. But no good deed goes unpunished. Municipalities now typically hold much more information about natural hazards than does any given property owner. And from this imbalance in information arises a legal argument that, among other things, the municipality should be liable for the property owner's damage because it knew the risk and failed to provide an adequate warning.[13]

Another frequent argument is that the government should not have permitted private development which later was destroyed or severely damaged by natural disaster. As we shall see below, this is not a proper theory of liability, but it nonetheless comes up with some frequency.

b. Invasion of property rights: your dirt (or mud, or water) on my property

In some cases, the municipality owns land that is the source or cause of damage to neighboring privately-owned property. This scenario arises in landslide cases in which, for example, the municipality owns steep-slope property that slides onto private property below. The affected property

[13] *See Alvis v. County of Ventura*, 178 Cal. App. 4th 536, 100 Cal. Rptr. 3d 494 (2009) (see *infra* n. 32).

owners likely would assert claims for inverse condemnation,[14] trespass, and nuisance (in addition to negligence).[15] California imposes upon uphill landowners a general duty of reasonableness,[16] even as to natural uphill hazards, but any such claim against a municipality would be limited by Cal. Gov. Code §831.25, discussed below.[17]

c. Land sales liability

Disaster claims against municipalities occasionally arise out of the municipality's former ownership of property where, for example, the municipality sells surplus property to a private developer and eventually homes or other improvements are damaged in a natural disaster.

Under California law, transferors of real property located in designated hazard zones are required to disclose that information to prospective buyers prior to the close of escrow. California Civil Code Section 1103 provides these disclosure requirements for natural and other hazards.[18] Section 1103.2 provides a template form for a Natural Hazard Disclosure Statement and gives guidance on how to determine whether property has a land condition that should be disclosed.

[14] Inverse condemnation of course arises in other disaster contexts as well, for example, the levee breach cases discussed above. And inverse condemnation, like eminent domain (*see, infra* n. 54), opens a big can of worms. Suffice to say that (a) these claims arise in natural disaster cases, *e.g.*, *Bunch v. Coachella Valley Water Dist*, 15 Cal. 4th 432, 935 P.2d 796 (1997); *Ingram v. City of Redondo Beach*, 45 Cal. App. 3d 628, 45 Cal. Rptr. 688 (1975), and (b) are subject to important defenses and limitations, *e.g.*, *Biron v. Redding*, 225 Cal. App. 4th 1264, 170 Cal. Rptr. 3d 848 (2014) (in order to establish a causal connection between the public improvement and the plaintiff's damages, there must be a showing of 'a substantial cause-and-effect relationship excluding the probability that other forces *alone* produced the injury'); *Tri-Chem, Inc. v. Los Angeles County Flood Control District*, 60 Cal. App. 3d 311, 312, 132 Cal. Rptr. 142, 143 (1976) (the design capacity doctrine provides that the government has no inherent duty to protect property from floods; a public entity cannot be held liable unless it subjects property to more flooding than would have occurred absent construction of an improvement).

[15] *See, e.g.*, *Locklin v. City of Lafayette*, 7 Cal. 4th 327, 967 P.2d 724 (1994) (property owners brought inverse condemnation, negligence, and trespass claims against city for landslide allegedly caused by city's improvements on publicly owned land); *Gutierrez v. County of San Bernardino*, 198 Cal. App. 4th 831, 130 Cal. Rptr. 3d 482 (2011) (homeowners brought action for inverse condemnation against county after their properties were inundated with water, dirt, and debris allegedly caused by public improvements and roads); *Goebel v. City of Santa Barbara*, 92 Cal. App. 4th 549, 111 Cal. Rptr. 2d 901 (2001) (homeowners brought inverse condemnation action against city arising from damage resulting from landslide that was allegedly caused by city's broken water main on nearby public property); *Smith v. County of Los Angeles*, 214 Cal. App. 3d 266, 262 Cal. Rptr. 754 (1989) (homeowners brought action for inverse condemnation, dangerous condition of public property, and nuisance resulting from damage to their property allegedly due to county cutting into hill to create road, thus removing support and causing landslide).

[16] *Sprecher v. Adamson Co.*, 30 Cal. 3d 358, 636 P.2d 1121 (1981). In *Sprecher*, a downhill landowner brought an action against the uphill landowner for damage to his property caused by a natural slide condition existing on the uphill landowner's land. In reversing an order granting summary judgment for the defendant, the California Supreme Court held that an uphill landowner owes a duty of reasonable care to the downhill landowner to protect the latter from harm caused by a natural condition of uphill landowner's land. This is not the traditional rule, and differs from the rule applied in other jurisdictions, *e.g.*, Washington. *See Price v. City of Seattle*, 106 Wn. App. 647, 652 - 56, *rev. den.* 145 Wn.2d 1011 (2001) (rejecting *Sprecher* and holding that duty of possessors of land to prevent landslides is limited to situations where the possessor of land has actual or constructive notice of a hazard produced by an alteration to the natural condition of land).

[17] *See Wildensten v. East Bay Reg'l Park Dist.*, 231 Cal. App. 3d 976, 283 Cal. Rptr. 13 (1991) (declining to extend *Sprecher* rule to a public entity under Cal. Gov. Code §831.25).

[18] *See* 1 Cal. Real Est. § 2:27 (4th ed.) ("[b]y statute, all transferors of real property and their agents are required to disclose whether the property is located in one of several types of areas designated with natural hazard characteristics . . .").

Purchasers of property damaged by natural disaster have sued California sellers for non-disclosure, asserting comparable pre-code common law theories.[19] We have found no California cases addressing allegations that a municipality failed to disclose natural hazards in the sale of real estate, but the issue has arisen elsewhere. The potential claim is akin to a misrepresentation claim, and a California municipality sued on this theory might assert that it is immune by virtue of California Government Code § 818.8 ("[a] public entity is not liable for an injury caused by misrepresentation by an employee of the public entity, whether or not such misrepresentation be negligent or intentional.").

2. Damages

Most typically, Plaintiffs suing municipalities over damages arising out of a natural disaster seek compensation for the diminution in the value of their property (and often its total loss); loss of use; damage to other property; and emotional distress.[20] In this regard, *Haggis v. City of Los Angeles*[21] is typical. The 1994 Northridge earthquake caused severe damage to plaintiff's house, and he sought compensation for property damage, loss of use, and emotional distress.

Punitive damages are not available against municipalities. California Government Code § 818 provides "[n]otwithstanding any other provision of law, a public entity is not liable for damages awarded under Section 3294 of the Civil Code or other damages imposed primarily for the sake of example and by way of punishing the defendant."[22]

[19] *See Easton v. Strassburger*, 152 Cal. App. 3d 90, 199 Cal. Rptr. 383 (1984) (appellate court upheld judgment finding real estate brokers and their sellers liable for failure to disclose the property's history of landslides and potential future landslide risks); *Buist v. C. Dudley De Velbiss Corp.*, 182 Cal. App. 2d 325, 6 Cal. Rptr. 259 (1960) (action for fraud in sale of hillside house and lot, where contractor allegedly concealed presence of fill, ancient landslide, and subsurface water).

[20] In *Smith*, *supra* n. 15, 214 Cal. App. 3d 266, the appellate court affirmed the trial court's judgment in favor of homeowners against county in an action for inverse condemnation and nuisance following a landslide. The homeowners claimed that the county had destabilized the hillside where homeowners' residences are located when it cut into the hillside to build roads. The county was found liable for nuisance (among other causes of action), and the court held that homeowners were entitled to recover damages for emotional distress based upon their nuisance claim. *See generally City of San Jose v. Superior Court*, 12 Cal. 3d 447, 464, 525 P.2d 701, 712 (1974) ("damages recoverable in a successful nuisance action for injuries to real property include not only diminution in market value but also damages for annoyance, inconvenience, and discomfort . . ."); *Acadia, California, Ltd. v. Herbert,* 54 Cal. 2d 328, 337, 353 P.2d 294 (1960); *Smart v. City of Los Angeles*, 112 Cal. App. 3d 232, 239-240, 169 Cal. Rptr. 174 (1980).

[21] *Haggis v. City of Los Angeles*, 22 Cal.4th 490, 497, 993 P.2d 983, 986 (2000).

[22] *E.g.*, *Committee for Immigrant Rights of Sonoma County v. County of Sonoma*, 644 F. Supp. 2d 1177 (N.D. Cal. 2009) (holding that under California law, punitive damages cannot be recovered against a public entity); *Marron v. Superior Court*, 108 Cal. App. 4th 1049, 134 Cal. Rptr.2d 358 (2003), *reh. den.* (holding that a plaintiff who alleges injury caused by a public entity may be entitled to actual damages for that injury, but not punitive damages); *But cf., C.N. v. Wolf*, 410 F. Supp. 2d 894 (C.D. Cal. 2005) (holding that the California statute barring punitive damages against public entities did not bar punitive damages claims against individual defendants in their personal capacities).

Plaintiffs sometimes seek both costs of repair and diminution in value. This is a double-count and it is improper, and the cases so hold.[23] Plaintiff must elect a remedy, and of course, if the cost of repair exceeds the diminution in value, plaintiff properly will be limited to the latter.[24]

3. Defenses[25]

a. Government immunity

In keeping with the venerable maxim that the King can do no wrong,[26] the general rule is that municipalities are not liable for torts under California law, unless expressly authorized by statute. California Government Code § 815 provides:

> Except as otherwise provided by statute:
>
> (a) A public entity is not liable for an injury, whether such injury arises out of an act or omission of the public entity or a public employee or any other person.
>
> (b) The liability of a public entity established by this part (commencing with Section 814) is subject to any immunity of the public entity provided by statute, including this part, and is subject to any defenses that would be available to the public entity if it were a private person.

The intent of the section is to abolish all liability for public entities, except as required by the Constitution (*e.g.*, inverse condemnation) or the legislature. But beyond that broad statement, as so often in the law, the contours of municipal liability in California are defined by a series of exceptions to the general rule, and by various rules for special cases. We present the most pertinent of these below.

i. Permits, inspections & enforcement: look what you let me do!

The first response to foreseeable natural disaster impacting public property is often: why did the government let them build there? It is a fair question, and the argument might well get traction with a jury.

Fortunately for municipalities and those who defend them, in California (as in many other jurisdictions) there is no such thing as negligent permitting. The Code provides unequivocal and robust immunity for the issuance or denial of a permit, Cal. Gov. Code § 818.4. Similar protections

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[23] *See Safeco Ins. Co. v. J & D Painting*, 17 Cal. App. 4th 1199, 1202, 21 Cal. Rptr. 2d 903 (1993) (in a suit for negligent damage to real property, a plaintiff may recover either the cost of repair or the diminution in value, but not both).

[24] *Id.* at 1202. ("[i]t is ordinarily appropriate to employ the lesser of the two measures [citations omitted]; otherwise plaintiffs might recover large sums for "injury" to property that subtracts little or nothing from – or occasionally even adds to – its value.").

[25] The following discussion omits important points. Claims arising out of natural disasters are subject to the same defenses and limitations as any other claim against a municipality. Plaintiffs must comply, for example, with the California Tort Claims Act, Cal. Gov. Code §§ 810 *et seq.*, and abide by applicable statutes of limitation.

[26] *Rex non potest peccare.*

extend to the failure to inspect property to determine whether it complies with enactments or is hazardous, Cal. Gov. Code § 818.6, *see also* Cal. Gov. Code § 821.4, and also to the failure "to enforce any law." Cal. Gov. Code § 818.2.

The cases test the reach of these rules with reference to the countervailing rule that a municipality is liable for damages proximately caused by the municipality's failure to discharge a mandatory duty with reasonable diligence, *see* Cal. Gov. Code § 815.6. Thus, in *Haggis*,[27] the plaintiff whose home was severely damaged by the Northridge earthquake claimed that the City of Los Angeles should be held liable, notwithstanding the general immunity for failure to inspect, because the City allegedly had failed to comply with various Municipal Code provisions, including one requiring the recording of a certificate stating that property was unstable, if and after the Superintendent of Building had inspected and found a property to be unstable.

The Supreme Court carefully examined the Municipal Code provisions at issue to determine (a) whether the provision created a mandatory duty, and (b) whether it was designed to protect against the kind of injury the plaintiff suffered. The Court determined that while the most pertinent Code provision may have had some warning effect, this was only incidental, that the ordinance was not designed to protect against the kind of injury at issue here, and that the City therefore was immune.[28]

ii. Discretionary acts and the like

As a general rule, public employees (and by extension, municipalities[29]) are not liable for damages resulting from discretionary acts or omissions. Cal. Gov. Code § 820.2. The Mount St. Helens cases discussed above are good examples of the application of discretionary immunity to claims arising out of a natural disaster, and California courts also have examined the defense in the natural disaster context.[30] Hundreds of California cases treat the contours of discretionary immunity, and I will not try to do so here. At the highest level, the issue is whether the complaint is about government policy-making.[31]

And, while the press and public may argue that the government should have taken legislative action to (for example) restrict zoning to prevent development of vulnerable property, California municipalities also are not liable for "any injury caused by adopting *or failing to adopt* an enactment". Cal. Gov. Code § 818.2 (emphasis added).

Design immunity is a related defense that can arise in natural disaster cases if plaintiffs seek to blame their damages on failed government infrastructure. The Code provides for immunity where a municipality exercises design discretion in the planning and design of public works (many other limits apply to this immunity).[32]

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[27] *Haggis*, *supra* n. 21, 22 Cal. 4th 490, 993 P.2d 983.
[28] *See also, Cancun Homeowners Ass'n v. City of San Juan Capistrano*, 215 Cal. App.3d 1352, 264 Cal. Rptr. 288 (1989).
[29] *See* Cal. Gov. Code § 815.2(b).
[30] *See Thousand Trails, Inc*, *supra* n. 6, 124 Cal. App. 4th 450, 21 Cal. Rptr. 3d 196; *Odello Brothers*, *supra* n. 9, 63 Cal. App. 4th 778, 21 Cal. Rptr. 2d 903.
[31] *Johnson v. State*, 69 Cal. 2d 782, 789-90, 447 P.2d 352, 357-58 (1968).
[32] *See Alvis v. County of Ventura*, 178 Cal. App. 4th 536, 100 Cal. Rptr. 3d 494 (2009).

In *Alvis*, plaintiffs who suffered injuries or who had relatives who died in the massive 2005 La Conchita landslide sued the County of Ventura for the allegedly dangerous condition of public property, nuisance, and inverse condemnation. The Court of Appeal affirmed summary judgment in favor of the County and rejected plaintiffs' claims.

As discussed in *Alvis*, design immunity provides a defense if there was: (1) a causal relationship between the plan and the accident; (2) discretionary approval of the plan prior to construction of a retaining wall; and (3) substantial evidence supporting the reasonableness of the plan or design.[33] The Court of Appeal rejected plaintiffs' argument that negligent maintenance, rather than design, caused the slide, concluding that the purported "maintenance" instead was a design factor.[34] As to the second element, the Court concluded that the county's board of supervisors exercised its discretion to approve plans for the project.[35] Finally, there was "ample evidence" to support the reasonableness of the design, and the statute may provide immunity even where the evidence of reasonableness is contradicted.[36]

iii. Government property in natural condition

The land of California is so notoriously unstable that the Legislature has expressly addressed the government's liability for damages that unimproved public property causes *off* public property.[37]

Thus, as a general rule, "neither a public entity nor a public employee is liable for any damage or injury to property . . . off the public entity's property caused by land failure of any unimproved public property if the land failure was caused by a natural condition of the unimproved public property." Cal. Gov. Code § 831.25(a). Section 831.25 is intended to relieve "public entities of the responsibility to protect adjacent properties from its land failures caused by natural conditions."[38] "Land failure" means "any movement of land, including a landslide, mudslide, creep, subsidence, and any other gradual or rapid movement of land." Cal. Gov. Code § 831.25 (c).

[33] *Id*. at 550, citing *Grenier v. City of Irwindale*, 57 Cal. App. 4th 931, 939, 67 Cal. Rptr. 2d 545 (1997).
[34] *Id*. at 551. The "maintenance" at issue was a suggestion to drill weep holes in the wall and install horizontal drain pipes. This addition would have changed the design and was therefore a design factor, not maintenance (*i.e*., unclogging an existing drainage pipe). The plaintiff also attempted to raise other issues as to independent causes, all of which were summarily rejected by the court.
[35] *Id*. at 552.
[36] *Id*. at 554.
[37] Other Code provisions apply to injuries sustained *on* state-owned property, *see, e.g*., Cal. Gov. Code §§ 831.2 and 835 *et seq*.
[38] *Schooler v. State of California*, 85 Cal. App. 4th 1004, 1012, 102 Cal. Rptr. 343 (2000). *Schooler* upheld the dismissal of Schooler's claim that the State of California, which owned the eroding bluff adjacent to his property, should be subject to injunctive relief ordering the State to do something to stabilize its bluff and, hence, Schooler's property. Citing Cal. Gov. Code § 831. 25 (among other things) the Court of Appeal upheld summary judgment dismissing the claim. *Id. See also, Wildensten, supra* n. 17, 231 Cal. App. 3d 976, 283 Cal. Rptr. 13 (rejecting claim that park district should be liable under *Sprecher* as uphill landowner, and applying Section 831.25); *Yunker v. City of San Buenaventura*, 2002 WL 31684975, Not Reported in Cal. Rptr. 2d (2002) (affirming judgment and associated advisory jury verdict and finding evidence sufficient to support finding that slope failure was caused by a combination of human and natural forces).

The Section 831.25 defense is subject to important limitations.[39] The statute provides that its protection is not available to a public entity if (a) it had actual notice of probable damage likely to occur outside the public property, and (b) the public entity failed to give a reasonable warning of the danger to the affected property owners. This language arguably creates a duty to warn under certain circumstances.

iv. Gradual earth movement

In another demonstration of California's geological instability, the legislature enacted Cal. Gov. Code §§ 865 – 867. Recognizing that gradual earth movement "can result in danger to persons or property" the Legislature enacted the referenced Code sections, providing for immunity for damages resulting from municipal action taken to abate perils from gradual earth movement, subject to certain qualifications.

These provisions are not precisely applicable to disaster response, but might immunize measures taken to avert a natural disaster. Section 866 has produced one reported opinion, *City of Pomona v. Superior Court*.[40] A child was killed in a cave on City property. In consultation with a geological engineering firm, the City determined, among other things, that gradual movement made the cave hazardous, and that it should be closed using explosives. The cave then was successfully collapsed, but nearby homes were damaged by the explosion (and/or the collapse). The Court of Appeal held that Section 866 immunity applied to the City and that the trial court erred in holding otherwise.[41]

b. Assumption of risk

Assumption of risk is generally an affirmative defense to personal injury and negligence claims. Primary assumption of risk insulates a defendant from liability where a plaintiff is injured due to a risk or danger that is inherent in an activity in which the plaintiff chooses to participate. The determination of whether assumption of risk bars recovery depends on whether a defendant owed a duty to the injured plaintiff, not on whether the plaintiff acted reasonably or unreasonably in encountering a known risk.[42]

To prove the defense, a municipality should be prepared to show: (1) the plaintiff had *actual knowledge* of the risk involved in the conduct or activity, and (2) the plaintiff *voluntarily accepted the risk*, either expressly through agreement or implied by his words and conduct.[43] We have found no California cases discussing the applicability of the defense to a plaintiff's purchase of property subject to known or apparent natural hazards, but the defense has been successfully applied elsewhere.

[39] In addition to the point treated in text, the practitioner should note carefully important wrinkles with respect to emotional distress damages and minor improvements to the government property.
[40] 182 Cal. App. 3d 1093, 227 Cal. Rptr. 714 (1986).
[41] *Id*.
[42] *Knight v. Jewett*, 3 Cal. 4th 296, 834 P.2d 696 (1992).
[43] *See generally Carr v. Pacific Tel. Co.*, 26 Cal. App. 3d 537, 103 Cal. Rptr. 120 (1972).

c. Acts of God

California has been concerned about acts of God for at least 150 years:

> [T]he earth must be convulsed, the lightning must kindle the fire, the air must blow in tempests or tornadoes, and the water must come in waterspouts or sudden [e]ruptions of the sea . . . by the forces of nature, uncontrolled and unaided by the hand of man . . .[44]

And so it remains today. The act of God defense may be raised to shield liability from damage caused by unforeseeable natural events. The defense applies only when human agency does not participate in proximately causing the harm. As explained in 6 Witkin, Summary of California Law (10th ed. 2005) Torts, Section 1199, page 577: "an 'act of God,' i.e., an extraordinary natural force, that brings about harm different from that threatened by the defendant's negligence is a superseding cause; but if it merely increases or accelerates the results of the defendant's negligence, it is not." If a defendant's negligence combines with an act of God to cause injury, then liability will result.[45]

In *Mancuso v. Southern Cal Edison Co.*,[46] a public utility attempted to raise the act of God defense to defend against a customer who brought an action for the destruction of his business resulting from an electrical fire, where lightning during an unusually intense electrical storm struck the utility's facilities adjacent to the plaintiff's business. The transformer exploded into flames and the lightning-generated electricity sought a path to the ground, traversing the service conductors and wires to plaintiff's building, eventually causing the fire which completely destroyed the premises.

The lower court barred the utility from using the defense, finding plaintiff's argument that the lightning strike was foreseeable persuasive. The appellate court reversed and remanded, holding that the utility should have the opportunity to present evidence that "the lightning, or at least its particular intensity, was so unusual that neither it, nor the harm it caused, could have reasonably been anticipated."[47]

d. Common enemy doctrine

Flooding cases involving government infrastructure historically involved application of the so-called "common enemy doctrine," a common law rule characterizing surface water as a common enemy from which landowners were entitled to protect themselves by, *e.g.*, obstructing the flow of that surface water, regardless of damage to neighboring parcels. The doctrine was first applied to a California government agency in *San Gabriel Valley Country Club v. Los Angeles County*.[48]

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[44] *Polack v. Pioche*, 35 Cal. 416, 417 (1868)(from argument of Appellant).
[45] *Dufour v. Henry J. Kaiser Co.*, 215 Cal. App. 2d 26, 29, 29 Cal. Rptr. 871 (1963).
[46] *Mancuso v. Southern Cal Edison Co.*, 232 Cal. App. 3d 88, 283 Cal. Rptr. 300 (1991).
[47] *Id.*
[48] *San Gabriel Valley Country Club v. Los Angeles County*, 182 Cal. 392, 188 P. 554 (1920).

More recently, the sweep of the common law rule has been ameliorated by a reasonableness rule. In *Locklin v. City of Lafayette*, the California Supreme Court established that even public entities, as property owners, could be held liable when alterations or improvements on upstream property discharged an increased volume of surface water into a natural watercourse, where that increase in volume or velocity of waters caused property damage to other properties.[49] The test set forth in *Locklin* was "whether, under all the circumstances, the upper landowner's conduct was reasonable . . . [t]his rule of reasonableness applies to both private and public landowners, but it requires reasonable conduct on the part of downstream owners as well."[50]

C. Never again – mostly land use

Not long after the peril ebbs, the public and policymakers typically employ a variety of techniques to try to manage or eliminate future risks. We review several of these below.

1. Red-tagging

Identifying uninhabitable and unsafe structures after a disaster is an important step to limit further loss of life or limb. Many communities practice red-tagging to accomplish this. A red tag adhered to the outside of the structure indicates that the property is too hazardous to re-enter. A yellow tag indicates some level of danger but allows residents to re-enter in order to retrieve personal possessions. Cities typically employ a city inspector or other building official to make the determination on a building-by-building basis. Red-tagging after a disaster is an accepted practice in California to communicate the finding of unsafe conditions to property owners and to the general public.

2. Zoning

Natural disasters can spur zoning efforts aimed at restricting development in areas that present risks of future natural disaster.

California law requires that cities and counties have a "general plan" as a broad guideline to future development goals for the community. Cal. Gov. Code § 65302 identifies elements that must be included. Again, California's geological instability is evident: this section includes a safety element which should address risks associated with "the effects of seismically induced surface rupture, ground shaking, ground failure, tsunami . . . slope instability leading to mudslides and landslides . . . and other geologic hazards . . . flooding; and wildland and urban fires." This element of the general plan also should include "mapping of known seismic and other geologic hazards [and] . . . address evacuation

[49] *Locklin*, *supra* n. 15, 7 Cal. 4th at 337, 967 P.2d at 728.
[50] The *Locklin* test built on the reasonableness test stated in *Belair v. Riverside County Flood Control Dist.*, 47 Cal. 3d 550, 764 P.2d 1070 (1988), where owners of property damaged when flood control levee failed brought an action against the state to recover on theory of inverse condemnation. The California Supreme Court held that when the flood control levee failed to retain waters within its designated capacity, property owners who suffered damage from the resulting flooding were not entitled to recover on theory of inverse condemnation without showing that damage was caused by unreasonable conduct on part of public entities charged with construction or maintenance of the levee.

routes, military installations, peak load water supply requirements, and minimum road widths and clearances . . . as those items relate to . . . geologic hazards," and so forth.

For zoning and ordinance considerations generally, public entities should support discretionary decisions with empirical scientific data as much as possible. In reviewing whether an ordinance constitutes a valid exercise of police power, courts look to see if (1) its object is a proper government objective, and (2) whether the means chosen reasonably relates to that objective.[51]

To completely prohibit development, as discussed below, municipalities should be prepared to prove that the area is extremely hazardous and/or unstable. Expect some trouble with takings claims, which will have a higher chance of success the more permanent and complete the prohibition. Other, less injurious alternatives may warrant consideration, including transfer of development rights from the regulated areas to areas with less risks, or permitting construction contingent on strict adherence to engineering mitigation measures.[52]

3. Building moratoria

After disasters, especially landslides and earthquakes, cities may elect to issue building moratoria until stability can be reassessed and plans made to ensure public safety in the future. California cases have upheld moratoria on the issuance of building permits as valid exercises of the police power pending the adoption of a comprehensive zoning ordinance.[53]

Building moratoria and takings[54] came before the U.S. Supreme Court in *Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency*.[55] In that case, an upsurge in development near Lake Tahoe caused damage to the lake. The commission decided to temporarily halt development, passing an ordinance that prohibited new development in affected areas of California and Nevada for two years. The moratorium was extended another eight months, and then a district court injunction further extended it another three years. The Court held that as long as the moratorium was temporary, it was not a taking and did not require just compensation.

[51] *Helix Land Co. v. City of San Diego*, 82 Cal. App. 3d 932, 147 Cal. Rptr. 683 (1978). In *Helix*, a landowner brought an inverse condemnation and nuisance action against city and state to recover for various actions or nonactions in land use control which allegedly resulted in deprivation of all economic use of the property. The Court of Appeal affirmed the case's dismissal, holding that the city's actions in adopting zoning ordinances to establish floodway and floodplain fringe zones did not constitute a taking of land that would entitle landowner to compensation. Similarly, in *Turner v. County of Del Norte*, 24 Cal. App. 3d 311, 101 Cal. Rptr. 93 (1972), the appellate court again affirmed judgment for the defendant. Landowners alleged that the county's zoning of their property under county flood plain ordinance amounted to a taking without compensation. The court held that flood plain zoning ordinance prohibiting specified types of buildings in an area subject to flooding, and limiting use of land in such areas to parks, recreation, and agriculture, did not constitute unlawful taking of property, and was within police power of county board.

[52] Robert B. Olshansky & J. David Rogers, *Unstable Ground: Landslide Policy in the United States*, 13 Ecology L.Q. 939 (1987).

[53] *State of California v. Superior Court*, 12 Cal. 3d 237, 255, 524 P.2d 1281 (1974).

[54] A comprehensive treatment of takings claims is beyond the scope of this paper. *See generally*, *Dolan v. City of Tigard*, 512 U.S. 374 (1994) and *Nollan v. California Coastal Com'n*, 483 U.S. 825 (1987).

[55] 535 U.S. 302 (2002).

In *Kopetzke v. County of San Mateo*, lot owners brought an inverse condemnation action against the county for requiring a geological report showing soil stability as a condition to granting a building permit.[56] The county was presented with information from representatives of the United States Geological Survey who, in the course of a nearby mapping project, concluded that there was significant soil instability in the area that plaintiffs' land was located. In response, the county initially issued a building moratorium and before lifting it required owners to conduct and submit a geological report as a condition to any development.

The court held that the restriction was a valid exercise of police power and did not constitute a taking. Notably, the court found that the county's actions were "taken to protect the public health, safety and welfare, upon the information that soil instability in the coastal area could present a danger to both life and property," and that the building moratorium was of a "temporary nature" with "obvious efforts made to lift it as soon as possible." The court also held that the requirement to obtain an evaluation of possible dangers presented by the soil instability was a fully justifiable condition to the issuance of building permits.

Not all building moratoria are equal. More permanent prohibitions are significantly more likely to constitute takings. In *Monks v. City of Rancho Palos Verdes*, the city council enacted an ordinance prohibiting the development of property in an ancient landslide area following land movement in the region.[57] The Court of Appeal reversed the lower court's judgment for the city, finding that the ordinance at issue was, in effect, permanent, and that it therefore deprived the landowners of all economically beneficial use of their land. In relevant part, the court held that "because the city deprived plaintiffs' land of all economically beneficial use without proving a justification therefore under state principles of nuisance or property law, it has violated the state takings clause."

4. Grading ordinances and geotechnical requirements

Many municipalities have grading ordinances and geotechnical requirements intended to reduce geological hazards to private property. California has some statewide statutes requiring municipalities to adopt grading ordinances. For example, Cal. Pub. Res. Code § 2697 provides that all cities and counties in California must require a geotechnical report defining and delineating any seismic hazard for approval of any project located in a seismic hazard zone.

Municipalities may choose to adopt grading ordinances and geotechnical requirements that go beyond statutory requirements. Los Angeles, for example, has grading ordinances and related development regulations for flood hazard areas, general hazards, hillside management areas, coastal zones, watersheds, and more.[58]

[56] 396 F. Supp. 1004 (N.D. Cal. 1975).
[57] *Monks v. City of Rancho Palos Verdes*, 167 Cal. App. 4th 263, 64 Cal. Rptr. 3d 75 (2008).
[58] *See generally Tower Lane Properties v. City of Los Angeles*, 224 Cal. App. 4th 262, 168 Cal. Rptr. 3d 358 (affirming petition for writ to compel city to set aside grading permit condition for hillside area where hillside grading ordinance was written in such a way as to only apply to subdivisions); *Haggis*, *supra* n. 21, 22 Cal. 4th at 507, 993 P.2d at 993; See *also* http://dpw.lacounty.gov/ldd/lddservices/grading/grading.shtml

5. Waivers and exculpatory covenants

Municipalities in some states have required waivers or exculpatory covenants as a condition of issuance of a permit to build in geologically hazardous areas. *E.g., 1515-1519 Lakeview Boulevard Condominium Association v. Apartment Sales Corporation*, 146 Wn.2d 194 (2002) (waiver of claim against the City of Seattle required as a condition of permit issuance for construction on steep slope; waiver held not to violate abolition of sovereign immunity).

A somewhat similar approach was rejected in *Salton Bay Marina, Inc. v. Imperial Irrigation Dist*.[59] In *Salton Bay*, the Court of Appeal held that agreements and an ordinance purporting to exculpate the county and the irrigation district were void as against public policy for lack of bargaining and consideration; the agreements were standardized, property owners could not bargain for terms, and the District paid no consideration for execution of the agreements. The Court of Appeal also noted the existence of mandatory duties relating to the prevention of flooding. It is unclear whether a California court would categorically reject an exculpatory covenant under the somewhat different circumstances presented by the City of Seattle's approach.

* * *

As noted at the outset, this paper only scratches the surface. I hope that it is a helpful reference and, if nothing else, an aid to issue-spotting. I am happy to discuss further. You can reach me at SAVITT BRUCE & WILLEY LLP, dbruce@sbwllp.com, or 206.749.0500.

[59] *Salton Bay Marina, Inc. v. Imperial Irrigation Dis.*, 172 Cal. App. 3d 914, 932-33, 218 Cal. Rptr. 839 (1985). Property owners brought an action against the district for inverse condemnation, negligence, nuisance and trespass after flooding caused substantial damages. The county permitted development in a flood-risk area adjacent to the Salton Sea but required property owners to absolve the county and the district from liability for the sea's rising. Before 1957, this absolution occurred through written agreements. After that period, the requirement was codified into an ordinance requiring property owners to grant the district a flooding easement before a building permit could be obtained.

Rules of Professional Conduct: Almost 70 New Ways to be More Ethical!

(MCLE Specialty Credit for Legal Ethics)

Friday, September 14, 2018 General Session; 10:15 a.m. – 12:15 p.m.

Joseph M. Montes, City Attorney, Alhambra, Santa Clarita and Assistant City Attorney, Rosemead

Notes:

League of California Cities Annual Conference

September 2018

Joseph Montes

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NOTE ON THE USE OF THIS PAPER:

This paper is intended to be read in concert with the California Supreme Court Approved California Rules of Professional Conduct:[1]

http://www.calbar.ca.gov/Portals/0/documents/Supreme%20Court%20Order%202018-05-09.pdf

Unless otherwise indicated, all references herein to reports of and tables prepared by the California State Bar Rules Revision Commission can be found in pdf format at:[2]

http://www.calbar.ca.gov/Attorneys/Conduct-Discipline/Ethics/Committees/Rules-Revision/Rules-Commission-2014/Proposed-Rules

References to reports of the Revision Commission will be cited as "Rule XX Report, p. YY."

[1] Last viewed August 13, 2018.
[2] Last viewed August 13, 2018.

If you are like me, it may be some time since you read through the California Rules of Professional Conduct—maybe since [insert your date of bar passage here]. Absent some problem, most of us just deal with select rules once every 3 years or so, for about an hour, to satisfy the "ethics" MCLE requirement. We may occasionally have to look up the rule on conflicts, or perhaps identity of the client. But on a day to day basis, the Rules exist in the background of our professional lives, operating either as a badge of professionalism,[3] or a trap for the unwary.[4]

The Rules of Professional Conduct have been around since 1928, and have only been updated three times in the last forty years (1975, 1989, 1992)—until this past March, when the California Supreme Court approved 69 of 70 revised rules of professional conduct submitted for consideration by the California State Bar.[5] This comprehensive update of the rules represents 17 years of effort on the part of the Bar and the Supreme Court. The new rules go into effect November 1, 2018, so if you haven't sat down with a warm cup of cocoa to read through them yet[6], you probably should get cracking. And since we each have to read through all of the rules, this paper will focus[7] on some of the changes and the rationale for same, gleaned from the reports and comments available on the State Bar website.

The Process for Amendment

The State Bar's process for amending the rules began in 2001, with the establishment of the Commission for the Revision of the Rules of Professional Conduct (the "Rules Commission" or "RC"). From 2001 to 2009, the RC worked on revisions, which were ultimately approved by the State Bar Board of Trustees. The Board then submitted 17 proposed rule revisions to the Supreme Court.[8] Rather than approve those rules, the Supreme Court and the State Bar worked together to develop a new approach. A second Commission for the Revision of the Rules of Professional Conduct was empaneled ("Rules Commission 2" or "R2C2"), and R2C2 was given a new charge[9] to undertake a comprehensive update of the Rules, with the goal of bringing the rules more into conformity with those of the ABA and other states. Specifically, the R2C2 charter reads as follows:

[3] Like still having to wear suits in court.
[4] Like malware.
[5] Rule 1.14 "Client with Diminished Capacity" was not approved by the Court, although it is unclear as to whether that is because a) the Court feels the rule is unnecessary as duties owed to a client do not change based upon the client's capacity, or b) the Court feels the rule is redundant because all clients suffer from diminished capacity.
[6] Or a STRONG cup of coffee…or maybe a stiff drink.
[7] Fair warning, though, the focus is occasionally tongue in cheek in a possibly ill-conceived attempt to add some entertainment value to the material—like "comedy" traffic school.
[8] Per Business and Professions Code sections 6076 and 6077, the State Bar, with the approval of the California Supreme Court, can adopt rules for professional conduct and subject members to discipline for violation of same.
[9] *A New Hope*, if you will.

Commission Charter

The Commission is charged with conducting a comprehensive review of the existing California Rules of Professional Conduct and preparing a new set of proposed rules and comments for approval by the Board of Trustees and submission to the Supreme Court no later than March 31, 2017. In conducting its review of the existing Rules and developing proposed amendments to the Rules, the Commission should be guided by the following principles:

1. The Commission's work should promote confidence in the legal profession and the administration of justice, and ensure adequate protection to the public.
2. The Commission should consider the historical purpose of the Rules of Professional Conduct in California, and ensure that the proposed rules set forth a clear and enforceable articulation of disciplinary standards, as opposed to purely aspirational objectives.
3. The Commission should begin with the current Rules and focus on revisions that (a) are necessary to address changes in law and (b) eliminate, when and if appropriate, unnecessary differences between California's rules and the rules used by a preponderance of the states (in some cases in reliance on the American Bar Association's Model Rules) in order to help promote a national standard with respect to professional responsibility issues whenever possible.
4. The Commission's work should facilitate compliance with and enforcement of the Rules by eliminating ambiguities and uncertainties.
5. Substantive information about the conduct governed by the rule should be included in the rule itself. Official commentary to the proposed rules should not conflict with the language of the rules, and should be used sparingly to elucidate, and not to expand upon, the rules themselves.

The proposed amendments developed by the Commission should be accompanied by a report setting forth the Commission's rationale for retaining or changing any rule and related commentary language.

The State Bar website includes the following documents, which may be of use to you in your study of the new rules, and which were reviewed for the preparation of this paper[10]:

- Existing Rules (through 10/31/2017)
- Proposed New Rules (Board adopted March 9, 2017)
- Tables cross-referencing old to new rules and vice versa
- For each proposed new rule, a report by the Commission that includes:
    - Text of New Rule
    - Commission Executive Summary
    - Redline
    - Rule History

[10] http://www.calbar.ca.gov/Attorneys/Conduct-Discipline/Ethics/Committees/Rules-Revision/Rules-Commission-2014 (last viewed August 13, 2018). Note that there is yet another Commission working on further draft revisions to ultimately submit to the Court—the 2017 Commission, or Commission 3 Proposing an Order—("C3PO").

    - Office of the Chief Trial Counsel/State Bar Court comments (with Commission responses)
    - Public Comments (with Commission responses)[11]
    - Related California Law and ABA Model Rule Adoptions
    - Concepts Accepted/Rejected (with pros and cons discussed)
    - Changes in Duties/Substantive Changes to the Current Rule summarized
    - Non-substantive changes to the current rule summarized
    - Alternatives Considered
    - Dissent commentary from individual Commissioners (if any) and response
    - Commission Recommended Action on proposed rule
- May 9, 2018 Supreme Court Administrative Order S240991, approving new rules (with modifications)
- Clean version of Court- approved new rules.

Mining all of the above, I have attempted to extract information and details that illustrate nuances, ambiguities, and areas of concern, all with a focus on our unique corner of the legal world—work for public entities.[12]

Client-Lawyer Relationship (Rules 1.0-1.18)

Rule 1.0 Purpose and Function of the Rules of Professional Conduct

(AKA You need to find more hours in the day.)

So the first thing to notice is that the numbering system for all of the rules has changed—tracking the ABA Model Rules numbering system. So for anyone familiar with the current rules by number, your most valuable resource will be one of the two tables available on the State Bar website that cross reference current rules to new rules and vice versa.[13] Additionally, the term "member" has been replaced with "lawyer" throughout the new rules, to mirror the language of other jurisdictions, and to expand the application of the rules to non-members (such as those practicing *pro hac vice*[14]).

Beyond that, the most interesting part of this rule is the comments that follow it. Comments are not grounds for discipline, but rather are intended to provide guidance for interpreting and practicing in compliance with the rule[15]. That said, R2C2 felt compelled to add Comment 5:

[11] Just a brief summary—the actual comments are available upon request from the State Bar.
[12] But you're still going to have to read all of the new rules yourself…and you might want to dust off a copy of the State Bar Act (B&P sections 6000-6243), which also governs lawyer conduct, while you are at it.
[13] http://www.calbar.ca.gov/Portals/0/documents/rules/Cross-Reference-Chart-Rules-of-Professional-Conduct.pdf (Last viewed August 13, 2018).
[14] See discussion concerning Rule 8.5, *infra*.
[15] Rule 1.0, paragraph (c).

"The disciplinary standards created by these rules are not intended to address all aspects of a lawyer's professional obligations. A lawyer, as a member of the legal profession, is a representative and advisor of clients, an officer of the legal system and a public citizen having special responsibilities for the quality of justice. A lawyer should be aware of deficiencies in the administration of justice and of the fact that the poor, and sometimes person who are not poor, cannot afford adequate legal assistance. Therefore, all lawyers are encouraged to devote professional time and resources and use civic influence to ensure equal access to the system of justice for those who because of economic or social barriers cannot afford or secure adequate legal counsel. In meeting this responsibility, every lawyer should aspire to render at least fifty hours of pro bono public legal services per year. In fulfilling this responsibility, the lawyer should provide a substantial majority of such hours to indigent individuals or to nonprofit organizations with a primary purpose of providing services to the poor or on behalf of the poor or disadvantaged. Also, lawyers may fulfill this pro bono responsibility by providing financial support to organizations providing free legal services. See Business and Professions Code Section 6073."

While this seems like a pretty substantive provision, R2C2 opted to have this included as a comment to the rule based upon the Commission's Charter, which require that the rules set forth clear and enforceable disciplinary standards, rather than purely aspirational objectives. Further, the comment arguably does not "provide guidance for interpreting and practicing in compliance with the rules."

Rule 1.0.1 Terminology

(AKA It's still fraud, even if no one was fooled.)

To mirror the ABA Model Rules, this separate definitions rule has been created. "Person" has been clarified to include an organization as well as a natural person.

In the comments to the rule, whether an "of counsel" attorney is a member of a "firm" is to be determined on a case by case basis[16].

In terms of "fraud", discipline can be imposed, even if no one has relied on or been damaged by the fraud—the definition is intended to regulate conduct, not the consequences of such conduct[17].

There is also a definition of "screened" in recognition of the need for ethical walls in certain situations.

Throughout the new rules an asterisk has been placed next to terms that are defined in this Rule 1.0.1, to remind us that the rule contains a defined term.[18]

[16] Comment 2.
[17] Comment 3.

Rule 1.1 Competence

(AKA It's OK to be simply negligent—just don't be gross about it.)

The current rule incorporated the duties of competence, diligence and supervision—but these concepts are now addressed in three separate rules, again to more closely mirror the ABA Model Rules and those of other jurisdictions.

This rule continues to differ from the ABA Model Rule, in that it prohibits "gross negligence" as opposed to "simple negligence." According to the R2C2's report, "a lawyer's single act of simple negligence should not be the basis for discipline because it does not imply that the lawyer is unfit to practice law or that permitting the lawyer to practice would present a danger to the public."[19]

Of particular interest to me, the Rule does not incorporate the ABA comment language addressing a lawyer's responsibilities concerning the use of technology. According to the R2C2 report, competent use of technology is already implied in the rule, and is also addressed in State Bar opinions.[20]

Rule 1.2 Scope of Representation and Allocation of Authority

(AKA Better get it in writing.)

This rule largely mirrors the ABA Model Rule—previously there was no similar rule in California. Criticism of the rule in the report indicates that this rule is unnecessary because the substance is already covered by caselaw and statute[21]. Of particular note for City Attorneys: Comment 3 specifically states "A lawyer's representation of a client, including representation by appointment, does not constitute an endorsement of the client's political, economic, social or moral views or activities."[22]

Practice Pointer: The rule requires that the scope of representation may be limited with the "informed consent" of the client. The Office of Chief Trial Counsel[23] suggested that the rule require "informed written consent" and the R2C2 agreed, indicating that the rule would be revised[24]—but for some reason the final version of the rule does not require a writing. As a practical matter, after the promulgation of this rule, any limited engagement should be express and in writing.

[18] Or to make us think we are missing a footnote…
[19] Rule 1.1 Report, p. 13.
[20] Rule 1.1 Report, p. 15, referring to Cal. State Bar Formal Op. Nos. 2010-179 and 2012-184. See also, "Preserving Client Confidentiality in a High-Tech Environment: Why Ignorance is no Longer Bliss" by Joseph Montes, League Fall Conference 2015, pp. 2-6.
[21] Rule 1.2 Report, p. 14.
[22] Notwithstanding what non-incumbent candidates may believe in City Council elections.
[23] The chief enforcement officer for the State Bar Attorney disciplinary system per B&P Code Section 6079.5.
[24] Rule 1.2 Report, page 7.

Rule 1.2.1 Assisting, Soliciting, or Inducing Violations

(AKA Almost clears up the cannabis haze.)

Rather than adopt the R2C2's recommendations, the Court renumbered rule 1-120 and approved that as the new rule, pending the submittal of further revisions to the rule by the State Bar. Those revisions deal with the comments to the rule and the issue of advising medical marijuana dispensaries[25]. One version of the draft language would indicate that a lawyer can assist a client in complying with California law, provided that the client is advised of the conflict with Federal law. Alternate language provides the same, "even if the client's actions might violate the conflicting federal law." From a City Attorney perspective, this language would be helpful for lawyers advising jurisdictions that wish to accommodate cannabis businesses, even though such accommodation might be viewed as assisting violations of Federal law.[26]

Rule 1.3 Diligence

(AKA Slow and steady may still win the race.)

This is part 3 of the split of the current competency rule into three parts: competence, diligence and supervision. The split was undertaken primarily to track the format of the ABA Model Rules. One issue that was considered by the R2C2 was whether or not to include a requirement for "promptness" into the rule. But the R2C2 indicated that other more specific requirements for promptness are found elsewhere in the rules and a blanket requirement might just cause confusion[27].

Rule 1.4 Communication with Clients

(AKA Good news and bad news…only later.)

This rule expands the prior rule concerning communication, to add specificity to the various aspects of communication with clients. The rule is supplemented by the State Bar Act obligations (B&P sections 6068(m) and (n)—duty to respond promptly re status request and to provide certain documents). Of note, in expanding the rule, the R2C2 has added the following language to the substantive portion of the rule (as opposed to the comments) that would allow a lawyer to delay bad news:

[25] See 2017 Commission (or C3PO) Report at http://www.calbar.ca.gov/About-Us/Our-Mission/Protecting-the-Public/Public-Comment/Public-Comment-Archives/2018-Public-Comment/2018-07 (last viewed August 13, 2018).
[26] This language would eliminate exposure for a State Bar violation—but would not insulate anyone from exposure to Federal prosecution.
[27] Rule 1.3 Report Executive Summary, p. 2.

(c) A lawyer may delay transmission of information to a client if the lawyer reasonably believes that the client would be likely to react in a way that may cause imminent harm to the client or others.[28]

Rule 1.4.1 Communication of Settlement Offers

(AKA Sometimes our rules are just better than the ABA's.)

Unlike most of the updated rules, which seek to conform California's current rules to those of the ABA, there is no equivalent ABA rule for Communication of Settlement Offers (separate from the ABA rule pertaining to Communication with Clients). This new rule largely mirrors current rule 3-510. The R2C2 felt that the communication of settlement offers should continue to stand on its own to accentuate this important duty[29].

Rule 1.4.2 Disclosure of Professional Liability Insurance

(AKA For those who dare to go bare.)

State law requires lawyers to maintain professional liability insurance under certain circumstances.[30] For lawyers not governed by those State law provisions, this rule (which largely reiterates current rule 3-410) describes when a lawyer must disclose the lack of professional liability insurance. The rule still exempts **government lawyers** and in-house counsel from the disclosure obligation. But lawyers providing services to **governmental entities** under contract are still subject to the rule.

Rule 1.5 Fees for Legal Services

(AKA Unreasonable fees are still OK.)

Rather than adopt the ABA Model Rule that prohibits a lawyer from charging "unreasonable" fees, the new rule retains the language from the current rule: lawyers are prohibited from charging "unconscionable" fees. There are standards in the rule to measure "unconscionability", but generally it must be a fee that is "so exorbitant and wholly disproportionate to the services performed as to shock the conscience of those to whose attention it is called."[31] The R2C2 expressed concern that a reasonableness standard would bog down the discipline system with ordinary fee disputes. California law, unlike other states, provides a client with other forums, in particular mandatory fee arbitration, to contest an unreasonable fee.[32]

[28] Which may be useful when trying to decide whether or not to publicly correct a councilmember during a council meeting.
[29] Rule 1.4.1 Report, p. 8.
[30] See, e.g., B&P Sections 6171(b), 6174.5, 6155(f)(6), Corp. Code Sections 13406(b), 16956.
[31] *Goldstone v. State Bar* (1931) 214 Cal. 490, 498.
[32] Rule 1.5 Report, p 9.

Of note for lawyers providing services under a contract that includes the term "retainer," the rule allows for non-refundable fees for "retainer" agreements. The rule defines a true retainer as a fee that a client pays to a lawyer to ensure the lawyer's availability to the client, but not to any extent as compensation for legal services performed or to be performed. The first Commission had a comment to this rule that indicated that "a payment purportedly made to secure a lawyer's availability, but that will be applied to the client's account as the lawyer renders services, is not a true retainer."[33] This begs the question of how the rule applies to a contract that provides for a "retainer" that gets applied against work performed, when little or no work is performed. At what point does that retainer then become "unconscionable?"

Rule 1.5.1 Fee Divisions Among Lawyers

(AKA I can't do it—but I knows a guy.)

Again, this rule preserves the California standard, rather than adopt the ABA Model Rule standard for fee-splitting arrangements. Under the ABA standard, a referring lawyer can only be compensated for work done on the matter, or if the referring lawyer retains joint responsibility for the matter. The California rule allows for "pure" referrals, provided that the arrangement between the lawyers is in writing and the client consents in writing. This rule not only preserves the California status quo, but is also intended to encourage lawyers who are not competent to handle a matter to refer it to a lawyer who is.[34]

Rule 1.6 Confidential Information of a Client

(AKA Why Government lawyers can't whistle.)

Unlike most jurisdictions where the duty of confidentiality arises out of common law, California duty arises out of statute. Business and Professions Code section 6068 provides in relevant part that a lawyer's duty includes an obligation:

(e) (1) To maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client.

(2) Notwithstanding paragraph (1), an attorney may, but is not required to, reveal confidential information relating to the representation of a client to the extent that the attorney reasonably believes the disclosure is necessary to prevent a criminal act that the attorney reasonably believes is likely to result in death of, or substantial bodily harm to, an individual.

The new rule largely tracks the old rule, and because the duty is statutory, the bulk of the rule continues to be a lengthy set of comments intended to assist a lawyer in determining the circumstances under which confidential information may be disclosed.

Of particular interest, the R2C2 rejected a suggestion that a **government lawyer** should be able to disclose confidential information as a whistle blower, based upon an argument that the

[33] Rule 1.5 Report, p 22.
[34] Rule 1.5.1 Report, p 11.

government lawyer should be viewed as owing duties to both the **governmental entity** as well as the public. However, the R2C2 rejected this notion, fearing that **governmental lawyer** would not be able to establish the trust necessary to have an effective relationship with client **governmental entities** with such an exception in place. The R2C2 also noted that attempts to create such an exception have failed three times in the last fifteen years.[35]

Rule 1.7 Conflict of Interest: Current Clients

(AKA Conflicts, more or less.)

This rule—along with three others (1.8(f), 1.8(g) and 1.9) replaces the current 3-310. The rule moves California to the ABA Model format and language. There was debate at the R2C2 level about whether to include a "hybrid" of the ABA and California rules—somehow incorporating the checklist format found in 3-310 into the ABA language, but this was rejected as too confusing[36]. Of note, the Model Rule has 35 interpretive comments, and the first R2C2 proposed a rule with 41 interpretive comments. Ultimately the court approved rule only includes 11 comments—so more (4 rules instead of one) and less (11 comments, as opposed to 35) than what this could have been.

Rule 1.8.1 Business Transactions with a Client and Pecuniary Interests Adverse to a Client

(AKA Hollywood here I come.)

This rule did not change significantly in substance, although the numbering is intended to track the ABA rule. However, the R2C2 did reject the portion of the ABA rule that prohibited champerty[37] and negotiating for media and print rights to your client's story during the representation[38]. The R2C2 felt that an absolute disciplinary prohibition in that regard was counter to existing California law and policy.[39]

Rule 1.8.2 Use of Current Client's Information

(AKA Don't stab your client in the back without their consent.)

This rule adopts the substance of ABA model rule 1.8(b). There was some discussion in the R2C2 report about whether this rule was actually necessary, given that the duty to protect client confidentiality (B&P Section 6068(e)) arguably encompasses this rule[40]. But the R2C2 felt that for consistency with other jurisdictions, there should be an express California rule that prohibits use of a client's confidential information (beyond just a prohibition on disclosure of

[35] Rule 1.6 Report at p. 49, discussing a failed attempt to modify rule 3-600, and the veto of AB363 and AB 2713.
[36] Rule 1.7 Report, pp. 46-48.
[37] Yeah, I had to look it up too.
[38] Rule 1.8.1 Report Executive Summary, pp. 2-3.
[39] So when you are writing a brief for a client, you might also want to think about how it would read as a screenplay.
[40] Rule 1.8.2 Report Executive Summary, p. 2.

confidential information). The new rule prohibits use of client confidential information to the disadvantage of a client, unless the client gives informed consent.[41]

Rule 1.8.3 Gifts From Client

(AKA "For me? You shouldn't have. Does it come with a certificate of independent review?")

The rule tracks the prior California rule (4-400) and the comments make clear that a lawyer can still accept a gift from a client subject to general standards of fairness and absence of undue influence.[42] The new rule also adds language from the ABA Model Rule, requiring a certificate of independent review[43] before a lawyer can prepare an instrument giving him or herself a substantial gift from a client.

Rule 1.8.5 Payment of Personal or Business Expenses Incurred by or for a Client

(AKA Sign here, then we can talk about who pays for what.)

This rule modifies slightly existing rule 4-210. It is intended to restrict lawyers from inducing a potential client into representation by promising financial assistance.

Rule 1.8.6 Compensation from One Other Than Client

(AKA Put it on Mr. Underhill's tab.)

This rule does not alter the substance of former rule 3-310(f), although, as a reminder to **government lawyers**, this rule still does not apply to a lawyer rendering legal services on behalf of any public agency (and now--nonprofit organization) that provides legal services to other public agencies or the public.

Rule 1.8.7 Aggregate Settlements

(AKA You get a car, and you get a car, and you also get a car.)

This rule modifies the old rule (3-310(D)) to add a prohibition on entering into aggregate plea arrangements in criminal matters. The new rule also moves the exception for class action settlements from the discussion/comments up into the substantive provisions of the rule.

[41] ?!
[42] And isn't that what holidays and birthdays are all about?
[43] Probate Code section 21384.

Rule 1.8.8 Limiting Liability to Client

(AKA Can't we keep this just between us?)

This rule preserves the substance of rule 3-400. The new rule adds a comment that specifically refers to B&P section 6090.5—which prohibits a settlement of a malpractice claim where the client agrees not to report the malpractice to a disciplinary agency (ala the State Bar) or requires the withdrawal of or non-cooperation in a disciplinary complaint.

Rule 1.8.9 Purchasing Property at a Foreclosure or a Sale Subject to Judicial Review

(AKA The Art of the (self) Deal.)

As proposed by the R2C2, this rule does not change the existing rule 4-300, which generally prohibits self-dealing in foreclosure and similar sales.[44] The R2C2 wrestled with whether or not to address certain provisions of the Probate Code, which arguably are inconsistent with the rule, but opted not to. The Supreme Court, in approving the new rule, modified it to add language addressing the Probate Code exception to participation in foreclosure and similar sales.

Rule 1.8.10 Sexual Relations With Current Client

(AKA Abstinence is the best form of protection.)

This rule revises the current prohibition on sex with clients under certain circumstances to be a flat out prohibition on sex with clients.[45] The ABA has a similar prohibition and for ease of enforcement and integrity of the profession, the R2C2 has revised the rule to be a straightforward prohibition. And for those who represent an organization (in house or outside counsel), the prohibition extends to sex with a constituent of the organization who supervises, directs or regularly consults with the lawyer concerning the organization's legal matters.[46]

Rule 1.8.11 Imputation of Prohibitions Under Rules 1.8.1 to 1.8.9

(AKA Guilt by association.)

While lawyers are associated in a firm, a prohibition that applies to one of them under 1.8.1 to 1.8.9, applies to all of them. Note the imputation does not encompass Rule 1.8.10.

[44] The existing and new rules have no ABA Model counterpart.
[45] With the exception of spouses, domestic partners, and pre-existing relationships.
[46] I'm going to opt to refrain from comment on this one.

Rule 1.9 Duties to Former Clients

(AKA Don't forget to check the rearview mirror.)

This is the companion rule to 1.7 concerning current clients. This rule expands former 3-310(E) and covers three concepts: not being adverse to a former client in the same or related matter; not being adverse to a former client from a prior firm; not using or revealing confidential information to the detriment of a former client. Of note, the last comment to the rule expressly requires compliance by **government lawyers** to the extent required by rule 1.11.[47]

Rule 1.10 Imputation of Conflicts of Interest: General Rule

(AKA A screen you can't see through.)

First, this rule does not apply to **government lawyers** (see rule 1.11). This rule imputes conflicts arising out of rules 1.7 and 1.9 to other members of a firm. Of note, for the first time in California, the rule expressly allows the use of an ethical screen for lateral lawyers who join a firm, with written notice to the affected former client[48]. However, unlike the ABA Model Rule, which allows the use of such screens broadly, this new rule limits the use to instances where the lawyer joining a new firm did not substantially participate in the same or a substantially related matter. Screens can also only be used for conflicts arising out of the representation of clients at a former firm—"a law firm could not erect a screen around those firm lawyers who had represented a former client when the lawyers were associated in the same firm in order to represent a new client against that former client."[49]

Rule 1.11 Special Conflicts of Interest for Former and Current Government Officials and Employees

(AKA Government to private, government to government, but not private to government.)

This rule sets forth the general conflict rules for **government lawyers**. It allows for screening of a lawyer who comes from **government employment** to a private firm (without client consent), whether or not the lawyer practiced law in the public employment. There is no limit to the screening based upon the degree of involvement (as with rule 1.10). Two twists on the application of this rule are mentioned in the comments. First, a lawyer moving from one **governmental agency** to another may have to be screened.[50] Second, when a lawyer moves from the private sector to a **governmental agency**, the extent to which any conflicts may be

[47] No, I'm not going to tell you what that means—you'll have to see below under 1.11.
[48] Consent is not required—but the former client can object to the screening procedures and the firm is required to respond.
[49] Rule 1.10 Report, p. 3.
[50] Comment 6.

imputed to the other lawyers in that **governmental agency** is governed by caselaw, rather than this rule.[51]

Rule 1.12 Former Judge, Arbitrator, Mediator or Other Third-Party Neutral

(AKA Leave that resume in your back pocket.)

This rule provides for imputation and screening when judges or other third party neutrals, or their staffs, move into private practice. It also limits the circumstances under which such a person can negotiate for employment with a private firm that is appearing before the court or neutral.

Rule 1.13 Organization as Client

(AKA I'm going to tell on you.)

This rule modifies current rule 3-600 by mandating that a lawyer "report up" the actions of constituents within an organization under certain circumstances. More specifically, when a lawyer knows a constituent is acting[52] in a manner that 1) violates the law or a legal obligation and 2) that action is likely to result in substantial injury to the organization, the lawyer must report those actions up the food chain within the organization.[53] If the highest authority within the organization refuses to change course, the lawyer cannot report outside of the organization, as that would violate B&P section 6068(e). The lawyer can continue to act in the best lawful interests of the organization, or resign if appropriate. The comments indicate that this rule applies to both public and private organizations, but also recognizes that defining precisely the identity of the client in a **governmental organization** is beyond the scope of the rule. Further, the rule is not intended to preclude specific reporting duties and procedures that may exist within **governmental organizations**, provided that they comply with B&P section 6068(e).

Rule 1.15 Safekeeping Funds and Property of Clients and Other Persons

(AKA Trust me.)

This rule makes two substantive changes to existing rule 4-100. First, for lawyers who receive an up front payment for work, that money must be deposited into a client trust account unless the client agrees in writing that the money can be deposited into the lawyer's operating account. Second, the language "client or other person" in section (a) and the first comment to the rule indicate that a lawyer might have a duty to third parties (such as lienholders) with regard to any funds held in a client trust account. The rule does not affirmatively state such a duty exists in all instances, rather it points to caselaw that a lawyer might need to consult before disbursing funds from the account.

[51] Comment 10. See also *Kirk v. First American Title Ins. Co.*, 183 Cal.App.4th 776, p. 806 n. 24.
[52] Or intends to act or is refraining from acting.
[53] If only one of the factors is present, then the lawyer "may" report up.

Rule 1.16 Declining or Terminating Representation

(AKA Wait…you're firing me?)

This rule largely tracks existing Rule 3-700, which governs the circumstances under which a lawyer MUST terminate representation and under which a lawyer MAY terminate representation. The rule clarifies that a lawyer must terminate representation when the client fires the lawyer—so resisting being fired could be grounds for discipline.

Rule 1.17 Sale of a Law Practice

(AKA Original owner, new tires, purrs like a kitten.)

The rule tracks current rule 2-300. The R2C2 opted not to track the ABA Model Rule provision that would allow sales of a portion of a practice, instead retaining the California rule requirement that the sale of a practice apply to "all or substantially all" of a law practice. The R2C2 was worried that selling off pieces of a practice could operate as an end run to referral fee rules, add to the commercialization of the practice of law and make client representation for less lucrative matters scarce.[54]

Rule 1.18 Duties to Prospective Client

(AKA Yet another screen.)

This rule tracks and expands upon the evidence code provisions governing attorney-client privilege. Under those statutes, privileged communications of even a potential client are protected from disclosure. The new rule would prohibit disclosure of confidential information obtained from a potential client and prohibit representation of other clients adverse to the potential client, unless informed written consent is obtained, or unless the lawyer with whom the potential client consulted is screened. This is, once again, unconsented screening with notice to the prospective client to ascertain compliance with the rule. A dissent on the R2C2 raised a concern about too much confidential information being obtained prior to an effective screen being established, but the majority of the R2C2 felt that the rules requirement that the lawyer take "reasonable" measures to limit the amount of information learned, and the burden on the firm to demonstrate timely imposition of adequate screening strikes the right balance.[55]

[54] Rule 1.17 Report, p. 19.
[55] Dissent by Robert Kehr to Rule 1.18(d)(2), p. 4.

Counselor (Rules 2.1-2.4.1)

Rule 2.1 Advisor

(AKA How do you think I should vote on this agenda item?)

"In representing a client, a lawyer shall exercise independent professional judgment and render candid advice." This rule is a new rule for California, but the R2C2 describes the rule as a core duty of every lawyer.[56] Two short comments describe the scope of the rule, and even indicate that the rule does not preclude a lawyer from referring to considerations other than the law, such as moral, economic, social and political factors.[57] So for **government lawyers**, apparently political advice is not out of bounds.

Criticism from the State Bar Court Review Department and the State Bar Chief Trial Counsel suggests the rule is already covered by the duty of competence, and that the comments to this rule may actually misstate the scope of the duty.[58] Of note, the R2C2 declined to define independent professional judgment.

Rule 2.4 Lawyer as Third-Party Neutral

(AKA Are you my Momma?)

This new rule for California requires a lawyer acting as a third-party neutral to inform unrepresented parties that the lawyer is not representing them. Further, if the lawyer knows or reasonably should know that a party does not understand the lawyer's role in the matter, the lawyer must explain the difference between acting as a third party neutral versus acting as one who represents a client.

Rule 2.4.1 Lawyer as a Temporary Judge, Referee, or Court-Appointed Arbitrator

(AKA The bootstrap.)

This rule restates current rule 1-710, which states that a lawyer who is serving as a temporary judge and is subject to the terms of Judicial Ethics Canon 6D shall comply with that canon. Canon 6D describes which of the canons in the Code of Judicial Ethics cover temporary judges. The new State Bar rule is intended to permit the State Bar to discipline lawyers who violate applicable portions of the Code of Judicial Ethics while acting in a judicial capacity. The enforcement jurisdiction of the Code of Judicial Ethics relates to sitting judges only, so this rule bootstraps those rules into the Rules of Professional Conduct, to capture lawyers who are not "sitting" judges.

[56] Rule 2.1 Report, p. 1.
[57] Comment 2.
[58] Rule 2.1 Report, pp. 6, 7.

Advocate (Rules 3.1-3.10)

Rule 3.1 Meritorious Claims and Contentions

(AKA I knew this was a bad idea.)

This rule is the first of 9 rules, brought together to mirror chapter 3 of the ABA Model Rules entitled "Advocate." This rule carries forward the substance of existing rule 3-200, but makes one significant change. The existing rule prohibits a lawyer's conduct where the lawyer "knows or should know that the objective of such employment" is to pursue an unmeritorious or malicious course of action. The new rule eliminates the "knowledge of the objective" requirement and simply prohibits 1) actions that lack probable cause and are intended to harass or maliciously injure, or 2) claims or defenses that are unwarranted under existing law without a good faith argument for a change in the law.

Rule 3.2 Delay of Litigation

(AKA The four corner stall.)

This new to California rule prohibits delaying a proceeding without substantial purpose, or causing needless expense. This rule is modeled on the New York rule, rather than the ABA Model Rule—the Model Rule is worded aspirationally, requiring reasonable efforts to expedite litigation. The R2C2 Report includes a quote from the Chief Justice of the U.S. Supreme Court to support adoption of the rule:

"As for the lawyers, most will readily agree—in the abstract—that they have an obligation to their clients, and to the justice system, to avoid antagonistic tactics, wasteful procedural maneuvers, and teetering brinksmanship. I cannot believe that many members of the bar went to law school because of a burning desire to spend their professional life wearing down opponents with creatively burdensome discovery requests or evading legitimate requests through dilatory tactics. The test for plaintiffs' and defendants' counsel alike is whether they will affirmatively search out cooperative solutions, chart a cost-effective course of litigation, and assume shared responsibility with opposing counsel to achieve just results."[59]

It will be interesting to see whether in fact there is a sea change in litigation tactics as a result of this rule. The Office of Chief Trial Counsel, who included lengthy concerns about the enforceability of many of the other proposed rules, simply indicated support for this draft rule.[60]

[59] Rule 3.2 Report, p. 6, quoting *2015 Year-End Report on the Federal Judiciary* at page 11.
[60] Rule 3.2 Report, p. 4.

3.3 Candor Toward the Tribunal

(AKA Don't hide the ball—unless you have to.)

This rule follows the ABA Model Rule and elaborates on current rule 5-200. The current rule prohibits misleading the court through a false statement of fact or law, or citing authority that is no longer valid. Rule 3.3 expands on the types of prohibited conduct and then imposes a cure obligation when a lawyer knows or becomes aware of the issue in a proceeding. Unlike the Model Rule, however, the duty of confidentiality is not qualified by the lawyer's duty of candor to the court. Thus, when presented with a question from the court that would disclose client confidential information, the lawyer must indicate an inability to answer based upon applicable ethics rules and statutes (absent consent to disclose from the client).[61]

Also unlike the Model Rule, where the substantive duties of the rule expire upon conclusion of the matter, R2C2 recommended that the duty to correct should expire upon the conclusion of the matter or the representation, whichever comes first—so a lawyer fired mid-litigation would have no further substantive duty under the rule.[62] But the question of whether a lawyer who knows of a misstatement of law or fact and fails to correct it before being fired by the Client could still be subject to discipline was not addressed. The Supreme Court, in approving the rule, altered the language duty to conform to the Model Rule, so the duty extends to the conclusion of the proceeding. Thus a lawyer fired during a matter would still theoretically have an obligation to correct a misstatement of law or fact when he or she becomes aware of such until the proceeding concluded.[63]

Rule 3.4 Fairness to Opposing Party and Counsel

(AKA Play nice in the sandbox.)

This rule incorporates provisions from three current rules concerning evidence, witnesses, discovery and asserting personal opinions (when not a witness) in trial. The rule does not make any substantive additions to existing rules.

Rule 3.5 Contact with Judges, Officials, Employees and Jurors

(AKA There's no party like an ex parte.)

This rule combines into one the current rules governing contact with jurors and contact with judicial officers. The R2C2 preferred the more detailed California language from those rules to that of the ABA Model Rule. Of note, the rule prohibits ex parte contacts with judges absent a rule allowing for such contact. Trustees Michael Colantuono and Sean SeLegue

[61] Rule 3.3 Report, pp. 17-18.
[62] See discussion in Rule 3.3 Report at pp. 23-24 and Dissent pp. 1-2.
[63] That would seem to make for an awkward ex parte.

submitted a memo[64] expressing concern that the inclusion of administrative bodies acting in an adjudicatory capacity within the definition of "judge" could create confusion in, for example, a city council setting where the council has not adopted ex parte contact rules. In that setting, a lawyer could not have ex parte contact with city councilmembers—but a non-lawyer could. Further, a lawyer must ascertain whether or not the particular proceeding before the council was adjudicatory or not before attempting any contact. And all of this even though that Rule 4.2 would allow a lawyer to speak to councilmembers, due to First Amendment concerns. Rule 3.5 was adopted without change by the Supreme Court.

Rule 3.6 Trial Publicity

(AKA Meet the press.)

This rule carries over the substance of existing rule 5-120 which already largely tracked the ABA Model Rule. The rule operates as a limitation on statements that can be made publicly about an investigation or litigation matter. The standard of care was changed from that of a reasonable person to instead be when a lawyer "knows or reasonably should know." The Office of Chief Trial Counsel was critical of the use of the word "knows," believing it may make enforcement difficult, but the R2C2 disagreed, based upon the definition in 1.0.1(f) and a conclusion that knowledge can be inferred from the specific circumstances.[65]

Rule 3.7 Lawyer as Witness

(AKA How to cross-examine yourself.)

This rule expands existing rule 5-120 to include not only proceedings before a jury, but also a trial before a judge, administrative law judge or arbitrator. The rule also addresses use of lawyers from the same firm as witnesses. Finally, for **government lawyers**, before a lawyer may act as a witness in a contested matter, informed written consent must be obtained from the head of the office (or his/her designee) in which the lawyer is employed.

Rule 3.8 Special Responsibilities of a Prosecutor

(AKA How to be a Minister of Justice.)

This rule dramatically expanded the scope of a prosecutor's responsibilities under former former[66] rule 5-110. That rule was one short paragraph long. However, during the pendency of the comprehensive rule update process, the Supreme Court approved a new rule 5-110 on an expedited basis, in December 2017. That "former" rule is now being replaced by rule 3.8—

[64] The Rule 3.5 Report references the memo as attached, but it was not. I obtained a copy from Mr. Colantuono.
[65] The knowledge requirement is raised as a concern by OCTC in several of the new rules, and the response from the Commission in this instance is the typical response asserted. Rule 3.6 Report, p.9.
[66] Not a typo—read on.

which effectively represents a renumbering of the current "former" rule 5-110 (not the former former rule 5-110).

Bottom line, the expanded duties of prosecutors as "ministers of justice"[67] have been in place since December 2017, so for those that serve as prosecutors, you are already subject to and should already be familiar with the expanded scope of responsibilities. The expanded rule language addresses sharing of evidence, advising accused of certain rights, and an obligation to undertake cure efforts when a lawyer becomes aware of evidence indicating a defendant has been wrongly accused or convicted—even in another jurisdiction. Of further note, a prosecutor can be disciplined for insufficiently supervising other lawyers who violate Rule 3.6 (Trial Publicity).

Rule 3.9 Advocate in Nonadjudicative Proceedings

(AKA Please fill out a speaker card.)

This rule is new for California and is modeled on the New York rule, rather than the ABA Model Rule. It applies to a lawyer appearing before a legislative body or administrative agency. It requires that the lawyer indicate they are appearing in a representative capacity (but the lawyer does not have to disclose the client's identity), unless the lawyer is merely seeking information that is available to the public. The purpose for the rule is to identify for the legislative body or administrative agency whether the lawyer is appearing as a concerned citizen, or on behalf of someone. In terms of the necessity for such a rule, the commentary in support of the New York rule cites to Monty Python in support.[68]

Rule 3.10 Threatening Criminal, Administrative, or Disciplinary Charges

(AKA Extortion's still bad.)

This rule is unusual in that there is no equivalent ABA Model Rule. The body of this rule makes non-substantive changes to existing rule 5-100, which prohibits threatening criminal action to gain a civil advantage. Most helpfully, however, the new rule includes several comments that clarify the rule's scope, and even authorize some activity that contradicts prior State Bar Ethics opinions. Specifically, the State Bar has previously opined that "release-dismissal" agreements, where a prosecution is dismissed in exchange for a civil release, violate this rule. The new comments indicate such a practice is permitted.[69] The comments also clarify that a threat to bring a civil action, or a statement that a lawyer will pursue "all available legal remedies" does not violate the rule.

[67] See Comment 1 to Rule 3.8.
[68] Rule 3.9 Report at p. 4.
[69] Rule 3.10 Report at p. 8 and 11-12.

Transactions with Persons Other than Clients (Rules 4.1-4.4)

Rule 4.1 Truthfulness in Statements to Others

(AKA I cannot tell a lie—I mean a "material" lie.)

This new rule to California prohibits a lawyer from making a false statement of fact or law to a third person and also requires a lawyer to disclose a material fact to avoid assisting a client in a criminal or fraudulent act. The concepts covered by this rule are already covered in statutes and caselaw, and arguably even some other rules, but now would also be a clearly articulable standard of discipline.[70] The rule also ties into Rule 3.9, tempering the types of statements that can be made before a legislative or administrative body.[71]

Rule 4.2 Communication With a Represented Person

(AKA Leave my date alone.)

This rule carries over the substance of existing Rule 2-100, but then adds a definition for "public official" for purposes of making a distinction as to who can be communicated with in a **governmental organization.** As a result, the rule now clarifies that when a public entity is one of the parties, opposing counsel may communicate with public officials, but not other employees of the public entity in connection with the matter. Unfortunately, "public official" is defined as a public officer with the comparable decision-making authority and responsibilities of an "officer, director, partner, or managing agent of the organization." So you will have to ascertain within your own organization how far down the management structure this definition goes.

Rule 4.3 Communicating with an Unrepresented Person

(AKA Help me, help you.)

Rule 4.3 has no equivalent in the current rules. This rule prohibits three activities when a lawyer communicates with an unrepresented party on behalf of a client: 1) stating or implying the lawyer is disinterested; 2) failing to correct the person's misconception if the lawyer knows or reasonably should know the person incorrectly believes the lawyer is disinterested; and 3) providing legal advice, other than to obtain counsel, if the interests of the person are in conflict with the client's interests. Unlike the ABA Model Rule, this version of the rule also prohibits a lawyer from seeking to obtain privileged or confidential information that the lawyer knows or reasonably should know the person may not reveal without violating a duty to another. So it would appear that for that type of information, your client would have to speak to the unrepresented person directly.[72]

[70] Rule 4.1 Executive Summary, pp. 1-2; Report p. 7.
[71] Rule 4.1 Report, p. 7-8.
[72] Rule 4.3 Report, p. 8.

Law Firms and Associations (Rules 5.1-5.6)

Rule 5.1 Responsibilities of Managerial and Supervisory Lawyers

(AKA Have I got your attention, City Attorney?)

The R2C2 has taken one sentence from rule 3-110 that referenced a duty to supervise the work of subordinates and expanded it to three rules (5.1, 5.2 and 5.3), taken from the ABA Model Rules. This rule speaks primarily to the obligations of the lawyers with managerial authority in a law firm[73] to make reasonable efforts to ensure that the firm has in place measures that give reasonable assurance that all lawyers in the firm comply with the rules. Such measures include conflict check systems, calendar/litigation deadline systems, accounting systems, distribution of workload and supervision of less experienced lawyers.

The rule identifies the circumstances under which a supervising lawyer may be subject to discipline for the actions of a subordinate, which include a failure to take remedial action to correct a potential rule violation when the supervisor becomes aware of the issue. As proposed, the rule included a comment 6, that would exculpate a supervisor where a decision to ratify a course of action was a reasonable resolution of an arguable question of professional responsibility. The Supreme Court struck that comment from the rule.

Rule 5.2 Responsibilities of a Subordinate Lawyer

(AKA The anti-Nuremberg rule.)

This rule is the flipside of 5.1, requiring adherence to the rules, notwithstanding directions from a supervisor. That said, this rule does include the caveat that was deleted from 5.1—a subordinate does not violate the rules where the lawyer acts in accordance with a supervisory lawyer's reasonable resolution of an arguable question of professional duty.[74]

Rule 5.3 Responsibilities Regarding Nonlawyer Assistants

(AKA The buck still stops here.)

This rule tracks the obligations of rule 5.1, but applies the duties to the supervision of secretaries, investigators, law student interns and paraprofessionals. As a managing lawyer in a firm or a lawyer who supervises the activities of nonlawyers, you can still be disciplined for their actions under certain circumstances. But note that here there is no caveat concerning resolution of an arguable question of professional duty.[75]

[73] The definition of firm includes lawyers working in a **governmental office** (see Rule 1.0.1).

[74] So if you are on the fence about a course of action, best to consult with another attorney in your office—and refer to them as your "supervisor" during the conversation.

[75] But I guess you could still wander down the hall and ask a fellow lawyer "Hey, Supervisor, my secretary is about to…"

Rule 5.3.1 Employment of Disbarred, Suspended, Resigned, or Involuntarily Inactive Lawyer

(AKA The Slytherin[76] Rule.)

This rule carries over the substance of rule 1-311, for which there is no ABA Model Rule counterpart. It still prohibits hiring lawyers who have been disbarred, suspended, resigned (in the face of pending discipline), or been made involuntarily inactive (based upon incapacity) for certain legal work, and allows other work only with the written consent of a client and notification to the State Bar. Now, however, such persons are referred to as "ineligible persons." The rule is intended to provide a vocational rehab opportunity for ineligible persons, but as noted in the dissent "a disciplinary rule, the violation of which may lead to punishment of the employing attorney, is an odd place to set out a purported rehabilitating mechanism that gives no positive incentive to the employing attorney to help the wayward, sidelined attorney."[77]

Rule 5.4 Financial and Similar Arrangements with Nonlawyers

(AKA No Peanut Butter in your Chocolate.)

This rule, based upon the ABA Model Rule, combines three former California rules: 1-310 (Forming a Partnership With a Non-lawyer), 1-320 (Financial Arrangements with Non-Lawyers), and 1-600 (Legal Service Programs). The rule generally prohibits sharing fees with non-lawyers (with some exceptions), prohibits forming partnerships with non-lawyers if the partnership includes the practice of law; and limits the authority of non-lawyers in a law practice. The rule also governs referrals from non-lawyers, and practice with nonprofit legal aid type entities. The substance of the rule remains unchanged, and the thrust of the rule continues to be to protect a lawyer's independent judgment.[78]

Rule 5.5 Unauthorized Practice of Law; Multijurisdictional Practice of Law

(AKA Not without a Golden Ticket.)

This rule continues the prohibition on aiding someone in the unauthorized practice of law, and against a member of the California bar practicing in another jurisdiction in violation of that jurisdiction's regulations. The rule has been expanded to include the ABA Model Rule provisions that prohibit persons not admitted to practice in California from maintaining an office in California and holding him or herself out as authorized to practice in California.

[76] OK, so some of you may quibble with this because Harry Potter, who was consistently good, could have chosen to be Slytherin-but he actually chose Gryffindor. Snape, on the other hand, was not good, but was ultimately rehabilitated, Q.E.D.
[77] Commission Member Daniel Eaton Dissent, p. 3.
[78] Rule 5.4 Report at pp. 18-19.

Rule 5.6 Restrictions on a Lawyer's Right to Practice

(AKA You can't always get what you want.)

This rule continues the restrictions on provisions in partnership agreements and settlement agreements that would 1) restrict the practice of law after leaving a partnership[79]; 2) prohibit a report of a violation of the rules; or 3) restrict a lawyer from representing another client concerning the same or similar claims. Of note, the R2C2 considered inclusion of a restriction that would prohibit confidential settlement agreements, given that with the existence of confidential settlement agreements, there is no way to tell if the provisions of this rule governing prohibited content in settlement agreements have been violated. However, the R2C2 chose to reject such language given that resulting policy implications are beyond the scope of the Commission's Charter.[80]

Public Service (Rules 6.1-6.5)

Rule 6.3 Membership in Legal Services Organization

(AKA A good deed goes unpunished.)

This new rule to California is based upon the ABA Model Rule and is intended to provide assurances to lawyers that they will not disqualify themselves or their firm from participating as officers or members of a legal services organization. "Such service is important and should be encouraged as long as it does not interfere with the lawyer's duties to his or her clients."[81] The rule describes the prohibited circumstances under which a lawyer should not participate in decisions or actions of the organization.

Rule 6.5 Limited Legal Services Programs

(AKA Rules for speed dating.)

This rule carries forward the substance of current rule 1-650, describing the scope of a lawyer's duties with regard to conflicts in connection with short term representation of a client, such as a pro bono clinic. Given the limited interaction, insufficient time exists to undertake a thorough conflict analysis, so a lawyer only has a conflict if the lawyer knows that a conflict exists. Subsequent to the representation, neither the lawyer nor others at his/her firm are conflicted based upon the prior representation, although the lawyer would still owe a duty of confidentiality to the short term client.[82]

[79] Although an agreement can include financial consequences for practice after leaving a partnership. Rule 5.6 Report at pp. 7 and 9.
[80] Rule 5.6 Report, p. 12.
[81] Rule 6.3 Report Executive Summary, p. 1.
[82] Rule 6.5 Report, p. 13.

Information About Legal Services (Rules 7.1-7.5)

Rule 7.1 Communications Concerning a Lawyer's Services

(AKA Se Habla Espanol.)

The R2C2 has taken rule 1-400 (Advertising and Solicitation) and converted it into five rules (7.1 – 7.5) to track the ABA Model Rules. Substantively, the requirements of rule 1-400 remain intact, so discussion of this and the next four rules will simply highlight a few updates to the language. Rule 7.1 covers communications generally, the format of which are covered in rules 7.2 through 7.5. Rule 7.1 also retains the right for the State Bar Governing Board to adopt standards for communications that are presumed to violate the rules.

El comentario 5 a esta regla requiere que cuando un abogado represente que puede proporcionar servicios legales en un idioma que no sea el inglés, pero que personalmente no puede hacerlo, también debe indicar en ese otro idioma el título de empleo de la persona que habla dicho idioma.[83]

Rule 7.2 Advertising

(AKA Mad Men (or Women))

This rule allows advertising, under certain circumstances. It also allows for payments or gifts for referrals, under certain circumstances. Of note, the previous requirement to retain copies of all advertisements for two years has been removed. The rule now contemplates advertising via electronic means, and the R2C2 felt that retaining copies of a fluid website would be cumbersome.[84]

Rule 7.3 Solicitation of Clients

(AKA Would you like to buy a Girl Scout Cookie?)

This rule addresses "real-time" solicitation of clients. "The concern is the ability of lawyers to employ their 'skills in the persuasive arts' to overreach and convince a person in need of legal services to retain the lawyer without the person having had time to reflect on this important decision."[85] The R2C2 discussed whether or not a savings clause found in the prior rule should be retained, based upon constitutional concerns. The First Commission believed that Supreme Court precedent invalidating a prohibition on accountants cold-calling customers may invalidate the prohibition for lawyers. But the R2C2 pointed out that the Court drew a

[83] Comment 5 to this rule requires that where a lawyer represents they can provide legal services in a language other than English, but they personally cannot, they must also state in that other language the employment title of the person who speaks such language.
[84] Rule 7.2 Report, p. 15.
[85] Rule 7.3 Report, p. 12.

distinction between accountants and lawyers, the former not being "skilled in the persuasive arts."[86]

The rule also addresses solicitation via written and electronic communication.

Rule 7.4 Communication of Fields of Practice and Specialization

(AKA Certifiable.)

This rule prohibits communicating that a lawyer is a certified specialist in a particular area of law, unless he or she actually is certified by the Board of Legal Specialization, or an entity accredited by the State Bar to designate specialties. Interestingly, however, the rule now includes language that indicates a lawyer may communicate that his or her practice "specializes in" a particular field of law.[87]

Rule 7.5 Firm Names and Trade Names

(AKA Well you can call me Ray…)

Substantively, no change to this rule. Of note for cities, the rule carries over the language that prohibits use of a firm name, trade name or other professional designation that states or implies a relationship with a **government agency**.

Maintaining the Integrity of the Profession (Rules 8.1-8.5)

Rule 8.1 False Statement Regarding Application for Admission to Practice Law

(AKA The wrong type of bar for lies.)

This rule largely tracks the current rule. A person submitting an application cannot make a false statement or make a statement "with reckless disregard as to its truth or falsity." In contrast, a lawyer, in connection with another person's application for admission to practice law, is prohibited from making a statement of material fact that the lawyer knows to be false. This distinction is made in recognition that many people seeking admission to practice solicit support from persons such as law professors and judges who are not in a position to undertake an investigation of facts and the process is better with the participation of those individuals.[88]

[86] Wow—we needed the U.S. Supreme Court to tell us that. See Rule 7.3 Report at p. 17-18 and Edenfield v. Fane, (1993) 507 U.S. 761, pp. 774-775.
[87] Not sure a potential client can appreciate the distinction when he sees it driving by a billboard or bus bench ad.
[88] Rule 8.1 Report, p. 11.

Rule 8.1.1 Compliance with Conditions of Discipline and Agreements in Lieu of Discipline

(AKA Fool me once…)

This rule carries forward the substance of rule 1-110 with slight modifications. Essentially the rule makes non-compliance with imposed discipline or the conditions in an agreement in lieu of discipline a disciplinable offense.

Rule 8.2 Judicial Officials

(AKA Bootstrap from the other boot.)

Like rule 2.4, where reference to the Canons of the Code of Judicial Ethics were referenced as a way of gaining State Bar jurisdiction to enforce the referenced canons, here a candidate for judicial office or a lawyer seeking appointment to judicial office are required to comport with identified canons, and are thereby subject to discipline by the State Bar for their violation. Of note for those not desiring to wear the robes, a lawyer can now be disciplined for making false statements of fact, or statements with reckless disregard as to its truth or falsity concerning the qualifications or integrity of a judge or judicial candidate. However, note that the rule only addresses false statements of fact—the R2C2 recognizes that a lawyer has a right to criticize the judiciary if the criticisms are supported by a reasonable factual basis.[89]

Rule 8.4 Misconduct

(AKA The 6 Commandments)

This rule collects in one place various rules "intended to facilitate compliance and enforcement by clearly stating these principles in a single rule where lawyers, judges and the public can identify basic standards of conduct addressing honesty, trustworthiness and fitness to practice with which a lawyer must comply."[90] The principle debate over this rule was whether or not to include "attempt" to violate the rules as a violation. The R2C2 opted not to include attempt in this general rule, as discipline for an attempted violation works with the language of certain rules, but not others.[91] The R2C2 feels that this rule is not a substantive change to the existing rules, as it aggregates concepts taken from existing rules, statutes and caselaw.[92]

[89] Rule 8.2 Report, p. 4, referencing *Standing Committee on Discipline of the United States District Court for the Central District of California v. Yagman* (9th Cir. 1995) 55 F.3d 1430, 1438.
[90] So why do we need the other 68?
[91] Rule 8.4 Report, pp. 10-12.
[92] Rule 8.4 Report, p. 16.

Rule 8.4.1 Prohibited Discrimination, Harassment and Retaliation

(AKA The State Bar FEHA Policy.)

This rule updates rule 2-400, an anti-harassment, anti-discrimination rule from 1994. The rule is updated to more current language/standards that would be seen in similar policies and statutes adopted more recently.

The major change to the rule, however, is the elimination of the former threshold requirement that a court of competent jurisdiction must have already found that the alleged unlawful conduct occurred. That elimination results in original jurisdiction for the State Bar to pursue a violation. The State Bar Court raised concerns regarding the limited discovery, differing burden of proof, inapplicability of the Evidence Code and lack of jury trials in a proceeding for violation of a rule that could simultaneously be pursued by other government agencies specifically authorized to investigate and prosecute similar conduct.[93] A dissent by Commissioner Robert Kerr raises similar concerns, as well as the potential that this rule could result in a wave of State Bar complaints for conduct better handled, at least in the first instance, by other governmental entities.[94]

The R2C2's response indicates that because the new rule requires a lawyer who is the subject of an OCTC investigation for violation of this rule to notify the State Bar of any criminal, civil or administrative action premised on the same conduct, the State Bar and OCTC will have access to related proceedings that might weigh in favor of abating, or deferring a State Bar proceeding. Additionally, the rule also requires a lawyer who receives a notice of a disciplinary charge under this rule to provide a copy to the State and Federal agencies tasked with primary responsibility for coordinating enforcement of laws and regulations prohibiting unlawful discrimination. If those agencies initiate their own proceedings, the OCTC and State Bar Court can defer to those proceedings.[95]

Rule 8.5 Disciplinary Authority; Choice of Law

(AKA Home Field Advantage.)

This rule replaces existing rule 1-100(D) and conforms the substance to that of the ABA Model Rule. Specifically, lawyers admitted to practice in California are subject to discipline in California, regardless of where the conduct occurs. Lawyers not admitted in California are subject to discipline for legal services performed in California. A lawyer may be subject to discipline in more than one jurisdiction, depending upon where the violation occurs.

[93] Rule 8.4.1 Report, pp. 12-13.
[94] Rule 8.4.1 Report, Robert Kerr Dissent, pp. 1-8.
[95] Rule 8.4.1 Report, Robert Kerr Dissent, pp. 9-11.

Conclusion

The new rules go into effect November 1, 2018 and all lawyers practicing in California are subject to them. As you become familiar with the new rules, hopefully the substance of this paper has provided some focus or insight into issues that may be of particular interest to you.[96]

[96] So you won't have to read all of the reports and back up materials!

Speaker Biographies

Janna Aldrete

Janna Aldrete has been involved with commercial real estate for the past 21 years. Her career started with Spieker Properties, a former REIT, as a Building Manager which lead to a Project Director position with a commercial real estate developer in a 200-acre office park. Janna has developed multi-tenant office buildings from the conceptual drawing phase through construction, lease-up and property management functions. She is the Property Manager for the City of Monterey focusing on a commercial leasing and management portfolio of ground leases, single-tenant building leases and multi-tenant retail leases. Janna is a former Monterey Peninsula Chamber of Commerce Board Member where she co-chaired the Economic Vitality Committee and was a member of the Government Affairs Committee. She is a past president of the Monterey Commercial Property Owners Association and is licensed through the California Bureau of Real Estate.

David Bruce

David Bruce has practiced law in Seattle for over 20 years. After more than a decade in private practice and public service, he teamed with Jim Savitt in 1999 to found the firm that eventually became Savitt Bruce & Willey LLP. Dave's 20 years of experience in representing public entities have given him a unique ability to defend government entities and managers against all manner of challenges. He is a graduate of American University, summa cum laude, and Cornell Law School, magna cum laude. Dave began his career with the Perkins Coie firm.

Timothy Coates

Tim Coates is a partner at the appellate firm of Greines, Martin, Stein & Richland LLP in Los Angeles, and over the past 34 years he has briefed and argued more than 250 matters in the state and federal appellate courts, including successfully arguing five cases in the United States Supreme Court, and obtaining a per curiam reversal in a sixth case. Tim's Supreme Court victories have addressed absolute and qualified immunity (*Van de Kamp v. Goldstein*, 555 U.S. 335 (2009), *Messerschmidt v. Millender*, 565 U.S. 535 (2012), *Stanton v. Sims*, 571 U.S. 3 (2013)), Monell liability (*Los Angeles County v. Humphries*, 562 U.S. 29 (2010)) and warrantless arrests (*County of Riverside v. McLaughlin*, 500 U.S. 44 (1991)). He has been named a Southern California Super Lawyer in the area of appellate practice from 2007-2018, and has also been named in The Best Lawyers In America (Appellate Law) (2014-2018). The Los Angeles Daily Journal has repeatedly recognized Tim as one of the Top 100 Attorneys in California, he has received a California Lawyer Attorney of the Year award for his United States Supreme Court work, and Reuters News Service named him one of the "Top Petitioners" in the United States Supreme Court. Tim lectures widely on issues related to appellate practice, as well as section 1983 liability. He is also co-author of the chapter on federal civil rights liability in the CEB publication California Government Tort Liability Practice.

Michael Conneran

Michael N. Conneran is a partner is the San Francisco law firm Hanson Bridgett LLP. He specializes in the representation of public agencies in a variety of matters involving transportation, real estate and environmental law. Michael serves as General Counsel for the Livermore Amador Valley Transit Authority, the Tri-Valley San Joaquin Valley Regional Rail Authority, the Western Contra Costa Transit Authority, and the Measure J Traffic Congestion Relief Agency. Michael led the legal effort for the acquisition of real property required for the extension of the BART system to the San Francisco International Airport. Michael received his A.B. degree from the Woodrow Wilson School of Public and International Affairs at Princeton University and his J.D. from Hastings College of the Law where he was Note Editor of the Hastings Law Journal.

Paul Glassman

Paul R. Glassman is a Shareholder with Stradling Yocca Carlson & Rauth, P.C. where he chairs the Bankruptcy and Restructuring Practice. Mr. Glassman is one of the country's leading practitioners in the municipal insolvency area. He represents the City of San Bernardino, in their chapter 9 case, and the City of Ponce in the Commonwealth of Puerto Rico PROMESA proceedings. He also represented the official committee of Orange County cities and the City of Irvine in the Orange County chapter 9 case, and the largest unsecured creditor and chair of the creditors committee in the Valley Health Systems chapter 9 case. Listed as one of the "Top Bankruptcy Lawyers" by The Deal Magazine, a "Top Lawyer" by Super Lawyers magazine and a "Top 20 California Municipal Law Attorney" by The Daily Journal, Mr. Glassman has also lectured extensively including to the National Conference of Bankruptcy Judges, American Bankruptcy Institute, California Bankruptcy Forum, UCLA Law School, and various law school symposia, as well as to California City Attorney and County Counsel associations. Mr. Glassman has authored numerous articles in such publications as the American Bankruptcy Law Journal, the American Bankruptcy Institute Journal, the Business Lawyer and the Norton Bankruptcy Law Advisor, as well as the Thomson Reuters/Aspatore publication, "Chapter 9 Bankruptcy Strategies." Mr. Glassman is a graduate of Stanford Law School where he was a member of the Law Review. He also has Masters and Bachelors degrees in Economics from the University of Pennsylvania where he was Phi Beta Kappa.

Glen Hansen

Glen Hansen is a Senior Counsel at Abbott & Kindermann, Inc., in Sacramento, CA, and primarily represents local municipalities and property owners in the areas of land use, real estate law, local government law and takings law. He was counsel of record in numerous reported decisions, including most recently *Harrington v. City of Davis* (2017) 16 Cal.App.5th 420. Previously, Mr. Hansen was an attorney with the law firm of Knox, Lemmon & Anapolsky, LLP, in Sacramento, California, where he represented the California Secretary of State, the California District Attorneys Association, trade associations, businesses and individuals in administrative and rule-making proceedings and civil litigation involving election law disputes, real estate law, contract disputes, governmental immunities, and business torts. Before that, Mr. Hansen was an attorney with the law firm of Freeman, Brown, Sperry & D'Aiuto, LLP, in Stockton, California, where he represented local governments, developers and businesses in the areas of land use, real estate contracts, eminent domain, environmental compliance, business torts and commercial transactions. Mr. Hansen is a member of the Board of Directors for the Sacramento County Bar Association, and the Agribusiness Committee of the Business Law Section of the California Lawyers Assn. He is a Dispute Resolution Conference pro-tem judge for the El Dorado County Superior Court. Mr. Hansen publishes updates on legislation, case law, regulations and regulatory guidance in the areas of real property, environmental and municipal law at http://blog.aklandlaw.com. Mr. Hansen obtained his law degree from the University of the Pacific, McGeorge School of Law, and a Bachelor of Arts in American Studies from Biola University in La Mirada, California. He is married with 11 children, is on the Board of Directors for xHope Missions and is an Elder at Reflect Church in Elk Grove, California.

Whitman Manley

Whit Manley is of counsel at Remy Moose and Manley LLP in Sacramento. RMM provides consulting services and trial and appellate litigation representation to clients throughout California in both the public and private sector. A substantial portion of the firm's practice involves CEQA. Mr. Manley is co-author of Solano Press's Guide to CEQA (11th ed., 2007); the 12th edition will be published in 2019. Mr. Manley received his A.B. in Philosophy from UC Berkeley, and his J.D. from Cornell Law School, where he was editor in chief of the Cornell Law Review. Before going into private practice, he served as law clerk to the late Robert F. Peckham, Chief Judge of the Federal District Court for the Northern District of California.

Michael Maurer

Michael Maurer is a public law attorney at Best Best & Krieger LLP and serves as City Attorney for San Jacinto and La Habra Heights. Mike guides clients through the public procurement process, assisting on everything from basic purchase orders to nine-figure deals. He has prepared and negotiated contracts for major public infrastructure projects, including projects utilizing alternative procurement methods, and has developed and implemented RFPs for a variety of critical public services. Mike has also successfully defended public clients in court against challenges to purchase and contract awards, and he regularly comments on new and developing laws relating to public contracting.

Russell McGlothlin

Russell McGlothlin is a water resources attorney with Brownstein Hyatt Farber Schreck. He possesses extensive expertise concerning water use and management in California and the western United States. His practice particularly specializes in the management of groundwater. He was highly involved in the development of the Sustainable Groundwater Management Act and laws to reform the judicial procedure for adjudicating groundwater basins. He is now engaged in numerous basins across the state assisting with the implementation of these new laws. Russell frequently publishes and speaks on water law topics. His writings include several law journal articles and two chapters of California Groundwater Management published by the Groundwater Resources Association. He is also a member of the Council of Legal Advisors to the Bren School of Environmental Science & Management at the University of California at Santa Barbara where he guest lectures regularly.

Joseph Montes

Joseph Montes is the City Attorney for the cities of Alhambra and Santa Clarita. He is a partner at Burke, Williams & Sorensen, LLP, where he has been for 24 years. In past years he has participated as a Policy Committee Representative, as a member of the Public Records Act Committee, the Legal Advocacy Committee, the City Attorney's Section Board Selection Committee, and has spoken at past conferences. He is a survivor of 19 years of Catholic education, 11 of them Jesuit. And while he does not profess to be an Ethics Expert, he generally knows when other people are wrong.

Traci Park

Traci Park exclusively advises and assists employers and management in labor and employment law and civil rights litigation. Her wide-ranging practice includes representing clients in FEHA, Title VII, wrongful termination, employee compensation, and civil rights matters. Traci has extensive trial and appellate experience, and she regularly handles grievance arbitrations, disciplinary appeals, administrative hearings, and agency investigations. She is a member of the Association of Workplace Investigators and frequently serves as a personnel investigator and neutral fact-finder. Traci regularly advises employers about issues and policies related to cyber-security, social media, and on-line conduct of employees and elected officials, and she regularly writes for the California Lawyer Magazine Social Media Column. She recently authored articles on use of social media by police, social media policies for public entities, defining on-line threats, social media and the First Amendment, and litigating sexual harassment in the #MeToo environment. Traci is an experienced trainer who has conducted hundreds of seminars on all aspects of employment law and civil litigation. Her recent presentations include Facebook and the First Amendment, hacking and cyber-misconduct, privacy and privilege in litigation, harassment prevention, social media in the workplace, managing difficult employees, HR boot camp for managers, strategies to prevent lawsuits arising from terminations, disability discrimination, conducting lawful workplace investigations, and effective discipline and workplace documentation. Traci likes surfing, Facebook, and the Los Angeles Chargers.

Nancy Park

Nancy Park has a varied real estate, finance and business background, which includes serving as CEO for a private developer, giving her a unique insider's perspective that allows her to relate to her clients. Her practice includes real estate leasing, acquisitions, finance, development and joint ventures. Nancy is a partner at Best Best & Krieger LLP where she works with clients in both the private and public sector, focusing on real estate transactions, leasing, finance and business contracts. Nancy represents real estate entities, lenders and borrowers, landlords and tenants, and large and small businesses. Public clients include cities, counties, special districts, JPAs and hospital districts, among others. Prior to joining BB&K, Nancy was the CEO of The Evergreen Company, a veteran Northern California developer of retail and office projects. Nancy was also an attorney with McDonough Holland & Allen PC from 2000 to 2006. Prior to that, she was an investment officer for the California Public Employees' Retirement System (CalPERS). In that capacity, she was responsible for investing $1.8 billion in real estate assets. Additionally, she started her career with more than 10 years of experience as a commercial real estate lender for several community banks. Nancy is very involved in the Sacramento community as a volunteer leader for both Girl Scouts and Boy Scouts. Nancy has a BS in Business Administration/Finance from California State University, Sacramento and her JD from University of the Pacific, McGeorge School of Law.

Charles Parkin

Charles Parkin began working for the City of Long Beach in 1985 in the Department of Oil Properties. In 1995, Charlie was hired as a Deputy City Attorney. Through the years, he was promoted to Principal Deputy City Attorney, Assistant City Attorney and in August of 2013 the City Council appointed Charlie as the City Attorney. In 2014, Charlie was elected Long Beach City Attorney for a four-year term and re-elected in April of this year.

Javan Rad

Javan Rad is the Chief Assistant City Attorney for the City of Pasadena, and has been with Pasadena since 2005. Javan oversees the Civil Division of the City Attorney's office, and also handles a variety of litigation and advisory matters in the areas of constitutional, tort, and telecommunications law. Javan has been active in a variety of capacities for the League of California Cities' City Attorney's Department. Javan has previously served as President of the City Attorney's Association of Los Angeles County, and is currently on the Board of Directors of SCAN NATOA (the States of California and Nevada Chapter of the National Association of Telecommunications Officers and Advisors). Javan graduated in from Purdue University with a bachelor's degree in Quantitative Agricultural Economics and from Pepperdine University School of Law.

Gary Saenz

Gary Saenz was elected as City Attorney for San Bernardino, California, on November 5, 2013, and was re-elected on November 3, 2015. Prior to his election, he was a general Civil Attorney in private practice, specializing in Real Estate Law. Being a life-long resident of San Bernardino, Mr. Saenz wanted to become involved in helping San Bernardino recover from its financial challenges by playing a vital role in helping to unite its many positive resources and residents. Working cohesively with the Mayor and City Council, Mr. Saenz's commitment and dedication to San Bernardino has advanced the City through bankruptcy confirmation, which was a significant milestone for the City. Mr. Saenz received a BA in Philosophy from San Diego State University, and a JD from University of California, Los Angeles, J.D. Mr. Saenz is a member of the State Bar of California and the San Bernardino County Bar Association.

Stacey Sheston

Stacey N. Sheston is a partner in the Labor & Employment practice group of Best Best & Krieger LLP. She is also a member of the firm's Executive Committee. Prior to joining BB&K, she was a shareholder, practice group leader and chief talent officer on the management committee of McDonough Holland & Allen in Sacramento. Stacey's practice includes day-to-day employment advice, such as dealing with problem employees (including discipline and terminations), handling harassment complaints and investigations, responding to requests for disability accommodations, addressing wage and hour and leave of absence questions, responding to grievances and unfair practice charges, and drafting employment agreements, handbooks and policies. On the litigation side, Stacey represents employers in mediations, arbitrations, administrative hearings and court proceedings (including jury and nonjury trials) arising out of employment matters, including wrongful termination, breach of contract, unpaid wages, harassment, discrimination and retaliation. Stacey is a member of the State Bar of California, the Employee Relations harassment, discrimination and retaliation. Stacey is a member of the State Bar of California, the Employee Relations Policy Committee of the League of California Cities, the Sacramento County Bar Association Labor & Employment Section, Women Lawyers of Sacramento, and the California Public Employers Labor Relations Association. She is also former editorial chair of, and contributor to, the Personnel Chapter of the Municipal Law Handbook (CEB 2010). From 2012 to 2017, Stacey was named by her peers as a Northern California Super Lawyer for employment and labor law. She is admitted to the U.S. District Court for the Central & Eastern districts of California and the Ninth Circuit U.S. Court Appeals. She is licensed to practice in the State of California.

David Silberman

David Silberman is a Chief Deputy County Counsel for San Mateo County. David joined the County Counsel's Office in 2004. He currently is assigned to: the Sheriff, the Narcotics Task Force, the Office of Emergency Services, the Northern California Regional Intelligence Center, the Office of Sustainability, supervises the Child Protective Services, Litigation and Public Guardian and Public Administrator Teams and serves as General Counsel to Peninsula Clean Energy. In the past, he has also worked in the areas of health, community services and school law. He graduated from the UCLA School of Law with honors in 2000 and clerked in the Central District of California and Fifth Circuit Court of Appeals. In the community, David serves as Chair of the San Carlos Planning Commission, and formerly chaired the Residential Design Review Committee and as a grader for the California Bar Exam. He has been a member of the San Mateo County Bar Association Board since 2010 and is the Vice President.

Daniel Sodergren

Dan Sodergren is the City Attorney for the City of Pleasanton. Dan previously served as City Attorney for the cities of Tracy and Livermore. He is a graduate of U.C. Berkeley and Santa Clara University School of Law.

Megan Somogyi

Megan Somogyi has regulatory, transactional, and appellate experience in matters relating to public utilities, with a focus on energy, transportation, and water. She represents clients in administrative compliance and litigation proceedings before the California Public Utilities Commission and other regulatory agencies. Ms. Somogyi has represented local government entities and utility clients in electric transmission line siting proceedings, ratemaking litigation, sale and transfer of electric utility property, and utility certification proceedings. She has also represented clients in appellate litigation before the California Courts of Appeal and Supreme Court. Before joining Goodin MacBride, Ms. Somogyi was a Civil Staff Attorney at the Supreme Court of California, where she previously served as a judicial extern to Justice Marvin R. Baxter. After receiving her B.A. from the University of California, Berkeley, Ms. Somogyi obtained her J.D. from the University of San Francisco School of Law, where she served on the Editorial Board of the University of San Francisco Law Review as an Articles Editor. Ms. Somogyi was named one of the Top Women Attorneys in Northern California for 2017 by Super Lawyers, and has been named a Super Lawyers Rising Star for Northern California each year from 2015 to 2018. Ms. Somogyi co-founded Women In Public Utilities, a professional association, in 2017. She teaches Advanced Legal Writing at the University of California, Berkeley School of Law. Ms. Somogyi served as the 2016–2017 co-chair of the Young Utility Lawyers section of the Conference of California Public Utility Counsel. Ms. Somogyi is a member of the California State Bar.

Kelly Trainer

Kelly Trainer is a partner in Burke, Williams and Sorensen, LLP's Orange County office, representing employers in labor and employment law matters. Ms. Trainer has represented and advised employers on matters involving numerous federal and state law claims, including discrimination, harassment, retaliation, wrongful termination, leaves of absence, wage and hour, freedom of speech and association, and privacy. In addition, Ms. Trainer's practice includes representation of public employers in areas unique to public employment such as due process, disciplinary procedures, the MMBA, CalPERS, and the Public Safety Officers Procedural Bill of Rights, and the Firefighters Procedural Bill of Rights. Ms. Trainer has an extensive counseling practice, concentrating on preventive measures of employment and labor law. In this regard, her practice has focused on revising personnel rules, employee handbooks, and personnel ordinances, updating specific policies, and advising employers on the handling of a variety of employment matters. Ms. Trainer has acted as lead negotiator during labor negotiations for public agencies, and has negotiated many labor agreements. In addition to labor negotiations, Ms. Trainer has experience in handling related labor relations issues such as grievances and PERB proceedings, and she regularly advises employers on such matters. Ms. Trainer is a member of AWI and has served as a neutral investigator for internal investigations of employment complaints involving discrimination, harassment, retaliation, and workplace misconduct. She also conducts a variety of seminars and workplace trainings for employees on matters such as harassment prevention, disability discrimination, workplace investigations, managing difficult employees, workplace violence, discipline and termination, social media, performance evaluation, creating effective documentation, and leaves of absence.

Kevin Wang

Kevin Wang is an associate in Best Best & Krieger's Sacramento office. Kevin's practice concentrates on all aspects of public contracting with a focus on public works construction and infrastructure construction law. Kevin guides clients through the process of procuring public works construction projects including advising on drafting contract documents, bidding procedures and disputes, construction claims resolution, state and federal prevailing wage law compliance and construction defect.

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