MEMORANDUM

Date: November 16, 2016

To: Board of Directors

From: Darlene Thiel, General Manager

Subject: Claim under the Government Claims Act from M&R Investment One Company, Inc.

RECOMMENDED ACTION

Move to return the claim by M&R Investment One Company, Inc. as untimely to the extent it relates to causes of action that accrued prior to one year before the claim submittal, to deny the claim to the extent that it's timely, and to direct District counsel to send a claim rejection letter.

BACKGROUND

In the early 1990s, developer SHF Acquisition Corporation constructed houses in a Rancho Murieta subdivision known as Unit 6 or the Fairways. In 1995, the District entered into a Reimbursement Agreement with SHF concerning the reimbursement of a portion of the costs of improvements SHF constructed. In September 2015, the Board authorized a one-year extension of the 1995 agreement.

On August 12, 2016, the Board evaluated and rejected a demand by M&R, the claimed successor to SHF, for a 19-year extension of the 1995 agreement.

DISCUSSION

On October 19, 2016, attorneys for M&R presented the District with a claim regarding the District's performance under the 1995 agreement. A copy of the claim is attached. M&R states the amount of damages caused to M&R is $1.1 million.

The District's attorneys have reviewed M&R's claim. It appears that portions of M&R's claim may be barred by the 1-year claim presentation deadline under the Government Claims Act. Staff recommends that the District return the claim as untimely to the extent it relates to causes of action that accrued prior to one year before the claim submittal and deny the claim to the extent that it's timely.

ATTORNEYS AT LAW
333 BUSH STREET, 30TH FLOOR SAN FRANCISCO, CALIFORNIA 94104-2834
www.sedgwicklaw.com 415.781.7900 *phone* 415.781.2635 *fax*

Sedgwick LLP

Steven D. Roland
415.781.7900
steven.roland@sedgwicklaw.com

October 19, 2016

Via E-mail and FedEx

Ms. Darlene J. Gillum
General Manager
Rancho Murieta Community Service District
P.O. Box 1050
Rancho Murieta, CA 95683
E-Mail: *dgillum@rmcsd.com*

Re: **Claim against Rancho Murieta Community Service District (Government Claims Act, Govt. Code § 810 et seq.)**

Dear Ms. Gillum:

As you know, we represent M&R Investment One Company, Inc., successor by merger to SHF Acquisition Corporation. Pursuant to the California Government Claims Act (Govt. Code § 810 et seq.), notice is hereby given that M&R is making a claim against the Rancho Murieta Community Services District.

M&R fully incorporates our letter to you dated August 12, 2016, a copy of which is also attached. In that letter, M&R suggested and requested an extension of the term of the Reimbursement Agreement between SHF and the District. On August 17, 2016, the District refused M&R's request for an extension of the term of the Agreement. The alternative is payment by the District of a money claim for the value of the Agreement, which we now make.

The August 12 letter sets forth the date, place, and other circumstances which give rise to this claim, as well as a general description of the obligations, injury, and damages incurred by M&R. The names of any employees causing these injuries and damages are unknown to M&R. The amount of damage caused to M&R is excess of $1.1 million, as delineated in the attached,

less credit received. If M&R is compelled to file a lawsuit, the claim would be an unlimited jurisdiction civil case.

Any communication with M&R, including notices regarding this claim, should be directed to Steven D. Roland, 333 Bush Street, 30th Floor, San Francisco, CA 94104.

Sincerely,

Steven D. Roland
Kara L. Dibiasio
Sedgwick LLP

Enclosure

cc: Andrew Ramos (via email to *ajr@bkslawfirm.com*)

ATTORNEYS AT LAW

333 BUSH STREET, 30TH FLOOR SAN FRANCISCO, CALIFORNIA 94104-2834

www.sedgwicklaw.com 415.781.7900 *phone* 415.781.2635 *fax*

Sedgwick LLP

Steven D. Roland
415.627.1498
steven.roland@sedgwicklaw.com

August 12, 2016

Via E-mail (dgillum@rmcsd.com)

Ms. Darlene J. Gillum
General Manager
Rancho Murieta Community Service District
P.O. Box 1050
Rancho Murieta, CA 95683
E-Mail: dgillum@rmcsd.com

Re: Extension of Term of Reimbursement Agreement between Rancho Murieta Community Service District and SHF Acquisition Corporation

Dear Ms. Gillum:

As you know, we have been retained as litigation counsel by M&R Investment One Company, Inc., successor by merger to SHF Acquisition Corporation. As successor, M&R is a party to the Reimbursement Agreement with Rancho Murieta Community Services District, dated as of September 20, 1995. The purpose of the Agreement is to obtain reimbursement for M&R for certain water, sewer, and drainage facilities M&R was required to construct for the benefit of the District and certain other developers in Rancho Murieta. The amount owing under the Agreement is $1,190,612.31. The District is required to use its "***best efforts***" to ensure that M&R is reimbursed this amount. To date, M&R has received nothing by way of the Agreement and there is no indication that the District has made "best" or, indeed, any effort to assure compliance with its contractual obligations. Even after a one year extension authorized by the District in September 2015, the District has still done nothing to assure compliance. We incorporate all materials submitted in connection with the September 2015 hearing by reference.

1. M&R's Request for Extension and Grounds Therefor

By letter dated July 29, 2015, M&R through its counsel James Wiley asked the District to join in an amendment to extend the term of the Agreement to ensure that M&R receives the benefit of its bargain, including reimbursement for the additional facilities M&R was required to construct. Instead of granting the extension as requested, the District agreed to extend the Agreement for one year to allow the parties to further address resolution. The parties have had discussions which, to M&R's knowledge, have resulted in offers and counteroffers, but no final resolution. We have attached a copy of M&R's proposed resolution to this letter. We respectfully urge the District to grant M&R's request to extend the Agreement as proposed.

M&R is not in a position to walk away from the approximately $1.2 million it is owed. M&R has received no reimbursement at all under the Agreement. Indeed, M&R is unaware of any steps taken by the District in

furtherance of its obligations under the Agreement. Had the District been using its best efforts to ensure that M&R received reimbursement, we are confident at least some reimbursement would have been, or will be, forthcoming.

2. A Matter of Fairness

One of the subdivisions that is responsible for reimbursement, Retreats West, is moving forward with development and a major development proposal for most of the rest of the property is just underway. A decision by the District now to undermine M&R's right to reimbursement would be manifestly unfair, particularly in light of the Water Board's cease and desist order against the District, which resulted in a de facto moratorium on construction from at least 2006-2008, thereby reducing the effective term of the Agreement.

In addition, M&R understands that the District was willing to extend the term of an agreement in favor of Reynen & Bardis. If that is true, there is an even more compelling reason to extend the Agreement with M&R, whose efforts have unquestionably served both the District and the Rancho Murieta community. Refusal to extend the M&R Agreement would constitute unequal treatment and would be fundamentally unfair.

3. Litigation Will Be Expensive, Time Consuming, and Ultimately Unproductive

Failure to extend the Agreement will undoubtedly lead to litigation. We have seen that the District has not fared well in past litigation and had difficulty paying a judgment against it. A lawsuit here will prove to be unproductive and costly for both M&R and the District, particularly where the problem is so easily remedied. By contrast, there appears to be no downside for the District to grant M&R's request and extend the Agreement.

If the District chooses litigation over an extension of the Agreement, a preliminary review of this matter shows that M&R has claims for the District's failure to use best efforts, breach of the covenant of good faith and fair dealing, unjust enrichment, constructive fraud, and unconscionability. We are continuing to review the legal and factual bases for a successful lawsuit against the District. We note there is a legal fee provision in the Agreement, such that the District will be liable not only for its own legal fees, but for M&R's legal fees as well.

4. Claims Against The District

(a) The District Has Failed to Use Its Best Efforts

The District has plainly failed to use its best efforts to ensure that M&R is reimbursed for the amounts expended for the benefit of the District and other developers. "Best efforts" clauses are, of course, enforceable in California. *Midland Pacific Building Corp. v. King* (2007) 157 Cal.App.4th 264, 274; *Gilmore v. Hoffman* (1954) 123 Cal.App.2d 313, 319. What constitutes a party's "best efforts" is construed in the context of the circumstances of a particular case. *Id.* at 320. Whether a party has exercised its best efforts is a factual question to be decided by the trier of fact. *Id.* Whatever else is true about the District's actions over the past 20 years, one thing is undeniable: While there has been various development within the Rancho

Murieta community over the past 20 years, none of that has resulted in reimbursement of the amounts expended by M&R for the benefit of the District and other developers. As we review the facts in greater detail, we anticipate M&R will be able to state a strong claim that the District has failed to use its best efforts to ensure that M&R receives the benefit of its bargain.

(b) The District Will Have Breached Its Covenant of Good Faith and Fair Dealing

There is also a compelling argument that the District, by refusing to extend the term of the Agreement, will be in breach of the covenant of good faith and fair dealing. It is well established the covenant of good faith and fair dealing is implied in all contracts. *Carma Developers (Cal.), Inc. v. Marathon Development California, Inc.* (1992) 2 Ca1.4th 342, 371- 72; *Fairchild v. Park* (2001) 109 Cal.App.4th 919, 927. That covenant requires a promisor to do everything required to ensure that the promissee receives the benefit of its bargain, and not to do anything that would deprive the promissee thereof. *Comunale v. Traders & General Ins. Co.* (1958) 50 Ca1.2d 654, 658 (implied covenant means "neither party will do anything which will injure the right of the other to receive the benefits of the agreement"). Plainly, the purpose of the Agreement is to secure for M&R reimbursement of the amounts M&R expended for the benefit of others. To date, M&R has received nothing by way of the Agreement. Again, we believe, as we learn more facts, that the District will be shown to have failed to do everything the Agreement requires to ensure that M&R in fact received the benefit of its bargain.

(c) The District and Future Developers Are Unjustly Enriched

By retaining the use of the improvements without assisting M&R to obtain any reimbursement, the District is liable for unjust enrichment. "An individual is required to make restitution if he or she is unjustly enriched at the expense of another. [Citations.] A person is enriched if the person receives a benefit at another's expense. [Citation.] Benefit means any type of advantage." *First Nationwide Savings v. Perry* (1992) 11 Cal.App.4th 1657, 1662; *see also Turpin v. Sortini* (1982) 31 Ca1.3d 220, 237-239; *Andalon v. Superior Court* (1984) 162 Cal.App.3d 600, 612-613; *Call v. Kezirian* (1982) 135 Cal.App.3d 189, 194. It is beyond dispute that the District and other developers have received a huge benefit as a result of M&R's construction of the water, sewer, and drainage facilities. Indeed, the benefit is even greater than the reimbursement amount inasmuch as the reimbursement amount is stated in 1995 dollars rather than the cost or value of those improvements today. Should the Agreement expire without reimbursement to M&R, the District (and other developers) will have received this huge benefit at M&R's expense. M&R will plainly have resort to a claim for unjust enrichment, possibly well in excess of $1.2 million.

(d) The District Could Be Liable for Constructive Fraud

The District may also be liable for constructive fraud. Constructive fraud consists of any breach of duty which, without an actually fraudulent intent, gains an advantage to the person in fault or anyone claiming under him by misleading another to his prejudice. Civ. Code §1573. "Fraud assumes so many shapes that courts and authors have ever been cautious in attempting to define. ... Constructive fraud exists in cases in which conduct, although not actually fraudulent, ought to be so treated," that is, where a party's conduct has the legal and actual consequences of fraud. *Estate of Arbuckle* (1950) 98 Cal.App.2d 562. To the extent the District had no reasonable basis for believing it could obtain reimbursement for M&R after M&R was

compelled to construct the oversized public facilities, there is a strong argument for constructive fraud. And, with development right around the corner, there is the suggestion that the District is scuttling the Agreement to keep the benefits of M&R's construction for itself or to otherwise attract developers with the benefits conferred by M&R.

(e) The 20-year Limitation Is Unenforceable

Finally, it is likely that the 20-year limitation on enforceability of the Agreement, even if not considered fraudulent, is unenforceable under the circumstances. For example, if "the court finds the contract or any clause of the contract to have been unconscionable at the time it was made, ... the court may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result." Civ. Code §1670.5; *see also Little v. Auto Stiegler* (2003) 29 Ca1.4th 1064, 1074 (unconscionable arbitration appeal provision was severable). Here, the limitation on enforceability was unconscionable, particularly to the extent that the District had no reasonable expectation that M&R could be paid back in the timeframe the Agreement contemplated.

At a minimum, there will be equitable tolling for the length of time that the Water Board's cease and desist order was in place against the District. Although the Agreement was for a term of 20 years, development was not possible as a practical matter for at least some of those years.

5. There Is a Ready Solution

Although M&R would prefer not to file a lawsuit, it cannot in good conscience allow the District and other developers to accept the benefit of the additional public improvements constructed by M&R without paying for them. There is, however, a ready solution at hand. For reasons explained to the District's counsel in prior correspondence, the District's offer of a five year extension is not realistic. It is quite clear that the current proposals for development of the "Benefitted Properties" will not result in approvals within the five year time limitation given the length of time it takes for such approvals and the absorption rates for home sales in the area.

Attached is M&R's proposed amendment of the Reimbursement Agreement. We believe our proposed amendment is simple, straightforward, and fair. It is designed only to secure to M&R reimbursement for infrastructure which Rancho Murieta demanded beyond that which would serve M&R's development.

We strongly encourage the District to take the fair and proper path and enter into the attached extension of the Agreement.

Regards,

S. Roland

Steven D. Roland
Sedgwick LLP

SDR/cjs

cc: Andrew Ramos (via email to *ajr@bkslawfirm.com*)
Gerald Pasek (via email to *jpasek@rmcsd.com*)
Betty Ferraro (via email to *bferraro@rmcsd.com*)
Morrison Graf (via email to *mgraf@rmcsd.com*)
Michael Martel (via email to *mmartel@rmcsd.com*)
Mark Pecotich (via email to *mpecotich@rmcsd.com*)