

PRESCOTT, ARIZONA
SPECIAL COUNCIL MEETING
OCTOBER 23, 2007

A SPECIAL COUNCIL MEETING OF THE PRESCOTT CITY COUNCIL WAS HELD ON TUESDAY, October 23, 2007, in the Council Chambers at the Prescott Municipal Building, 201 Cortez Street, Prescott, Arizona.

I. Call to Order.

Mayor Simmons called the meeting to order at 2:05 p.m.

II. Roll Call.

MAYOR AND CITY COUNCIL:

Mayor Simmons

Councilman Bell

Councilman Blair

Councilman Lamerson

Councilman Luzius

Councilman Roecker

Councilwoman Suttles

III. Presentation and discussion by Scott Ruby, Gust Rosenfeld, concerning legal issues and other considerations for municipalities in drafting and approving development agreements.

City Attorney Kidd said that there have been some discussions over the last few weeks regarding developments and one of the things he had intended to do awhile back was bring up Scott Ruby to talk about them. Back in March they worked on the Storm Development Agreement and Scott commented and looked at that agreement, as did his firm, and as a result of those discussions Scott had some insights on things that he believes the Council, as well as the public, needs to be aware of.

Mr. Kidd said that Scott is the city attorney for Buckeye, Parker and Tolleson. His law firm, Gust Rosenfeld, is also the attorney for Avondale and Fountain Hills. Scott has also been involved with doing development agreements for the City of Goodyear and Coolidge.

Mr. Ruby said that development agreements in Arizona have been around since 1988, so there is not a great deal of law involving them and there is not a great deal of law in the country involving them. He said they have to view each one in a distinct way but for the most part they have a development agreement statute not too dissimilar to what most states have. The statute came about because of a desire by the development community to get some certainty in municipal conduct with regard to multiphase, long-term projects. They found themselves in a predicament where they would engage in a 20 year project, and in the middle of the stream rules changed that caused them to either abandon the project or lose an extraordinary amount of money. The Legislature responded and adopted

a vested development right statute which attempted to deal with the problem. It says that when there is a master planned project, it is vested with that project for least three years. They have to go through some statutory process to make that happen, but there is that remedy. The statute goes on to say, because of the concern for multiphase projects, that they can vest a multiphase project for up to five years and have the ability to extend for an additional two.

When looking at this, they have to first ask themselves why they want to do a development agreement and if it is a policy they want to make available for everyone that comes in. A lot of developers assume that is the normal course of business and when they go to some jurisdictions in the State it appears to be an entitlement. He has that in Buckeye; they have a template development agreement that says that if they have a big project that they have a master plan for, they will sign the development agreement. They do that because their development book happens to say that they'll only approve a master plan through a development agreement.

Mr. Ruby said that in some jurisdictions, like Chandler, they won't do development agreements for residential projects, and today he is speaking primarily in a residential context. If they were in a commercial context, sometimes the rules and interests are radically different.

He said that the development agreements, generally as presented by developers, suffer in his opinion from traditional problems. First, they attempt to take the legislative conduct of the council in general and take it away and make that a binding obligation, whatever the issue is. An example is legislative acts involve the police power such as zoning, health and safety, and oftentimes development agreements attempt to take away some of those police powers from future councils and put it into contract terms. The courts frown on that; they don't like legislative acts being contracted away. Contract zoning is illegal and cannot be done.

Mr. Ruby said that if they contract away the ability to deal with health and safety, the courts will normally overthrow that. The constant debate is what an administrative act is and what a legislative act is. Where the line is between the two is not a bright line. For example, one case in California says that the decision as to how wide the streets are is a legislative act and they cannot contract that away.

He said that he has looked at the Fann development agreement, and he doesn't want to pick on it, because it is certainly indicative in many ways of what they see routinely. Development agreements suffer from that attempt to take away the legislative act authority.

Also, development agreements suffer from violating the budget laws. As a municipality, they are not allowed to bind themselves beyond the current fiscal

year, and there are very few exceptions. They can enter into a construction contract for construction projects that may take two years, but they have to have all of the money upfront, unencumbered. Bonding is one of the exceptions and before that can happen, as is the case with most exceptions to the budget law, it has to be voted on by the people. When they get into an agreement that says “the City shall” they have to look and question whether it binds future councils, which also is illegal, or if it is binding future budgets.

Mr. Ruby said that development agreements typically establish a priority, or special treatment, for whomever is in the agreement. The uniformity by which they are bound as a municipality to treat all of the residents is lost in a development agreement. If they tell someone they will expeditiously review their plans, or promptly drop whatever they have going on and deal with their issues, they have prioritized their needs over and above anyone else. That is a dangerous scenario, not only from a uniformity clause, but from a breach of contract clause; when they start agreeing to expeditiously do anything that is a term that is going to be defined later on by a court, and in context with 20/20 hindsight. There is a case in Avondale where they entered into a development agreement that suffered from that type of terminology. Over the course of time, there were delays, and the developers brought a law suit against the City and said the aggregation of all of those times where they didn’t expeditiously process as required, made them miss the market, and they either lost profits, or their costs went up. Either way it is going to cost money. It cost them \$7.2 million. A significant amount, over \$1 million, was for attorneys fees.

Councilman Roecker said he is confused with what he said that they can’t bind future councils, and it appears that a development agreement has those obligations in it. Now, he is saying that a City spent \$7.2 million because that clause was enforceable. Mr. Ruby said that they cannot bind future councils with respect to legislative conduct by the council. They can bind the City with respect to its administrative processes, its day-to-day business operations. Review of plans is an administrative process and therefore permissible to be included in an agreement.

Councilman Luzius asked Mr. Ruby if the Fann development agreement was an agreement for one of his cities, if he would recommend its approval. Mr. Ruby said he would not. Mr. Ruby said that the other thing that development agreements suffer from is the City guaranteeing certain services, and in this case the City is guaranteeing water. That is a scenario where as a City they can’t guarantee quality or quantity. They have an obligation according to the law to serve everyone in their municipal boundary. He doesn’t know that it would be enforced by a court because it is so much outside the scope of what they are supposed to do as a municipality. By guaranteeing them, it could disadvantage those that want water. There is a case in Phoenix where Phoenix had a sewer line that was sized a certain size in order to accommodate the development in and around the area and the development which happened to pay for the sewer

line. They were sued because they denied access to the sewer line to someone that was approximate to it, and the City said they could not because someone else paid for it. The court said the City is obligated to serve municipal services to everyone within their jurisdiction on a fair and equitable basis.

Mr. Ruby said that development agreements take normal City processes and turn them into contractual obligations and the significance of that is they now have a contractual obligation which is typically outside their insurance coverage.

He said that remedies are always an issue in development agreements. He cannot say that every development agreements he ever did didn't have remedies in it that were things he didn't like. He can't say that he's very proud of every development agreement he's ever done. The remedy clause is a big issue because they are outside their insurance coverage and it is also about a developer and City entering into a relationship that should not be from a remedial standpoint, one that is so one-sided. The City isn't going to sue the developer for cash if they don't develop in time; they are not going to demand specific performance. It would probably be a meaningless remedy as (1) he suspects that it is a single asset, so the remedies would be limited to a LLC, that wouldn't be there even if they wanted to sue them, and (2) when they start getting specific performance on an obligation they will find themselves in a bankruptcy court.

Mr. Ruby said that in his last five or six years he has tried to limit the remedies to specific performance. Mayor Simmons said that the 900 pound gorilla in the Fann issue is narrowed down to remedies. He said that the way it has been explained to him is that on a specific performance, if they get a makeup of a council and all of a sudden they decide that there is something they're supposed to do that is going to be \$1.5 million, and for whatever reason they would like to stall that, the contractor could sue for specific performance, but they could be tied up for months and then just have a judge tell the City to perform. The contractor has lost a lot of money and is hurt by it, and yet they get nothing. The bottom line is there is not much incentive under specific performance.

Mr. Ruby said that in specific performances they always try to put in expedited processes so they can get it quickly. In the Mayor's example, they have already violated budget law, so if there is specific performance or not, or normal consequential damages, he's hopeful that a court will not uphold any obligation to spend money beyond the budget year. That is a tough scenario to deal with. If specific performance causes delay and delay costs money, then there's no question that the developer's remedy is somewhat a problem. For the failure to do that which is the decision of the elected officials, and they think it is in the best interests of the community to not live up to that obligation, that is their feeling and the liability is shifted. He would not disagree with the Mayor in all of those cases.

Councilman Lamerson said that he appreciated Mr. Ruby coming up. He appreciated Mr. Luzius' question. He said that he understood that Mr. Ruby has

had time to read the agreement. He said that they have 1,142 acres right outside the City limits that they are subject to see developed on exempt wells and septic tanks that no one really wants to see. They also have assured water in the City limits of Prescott and the ability to do certain things with infrastructure. One of the reasons to have someone outside the picture to look at this is to know if there are areas of the agreement that they can get over to allow this to come into the City without putting the screws to the developer.

Mr. Ruby said that like any contract negotiation, it is always a matter of compromise. He said that from the developer standpoint, it is a matter of lot yield. In his development agreements he vests and gives them a contractual right to enforce density in land use, not zoning or annexation. He also says, like was done in the Fann development agreement, that they freeze the rules and regulations for the term of the agreement, although the Fann agreement has no term, so he doesn't know how long that is. That is an issue where they basically say that on the day it is signed, put aside all of the Code sections as they exist that day and all the policies and that is what applies. He has tried to get away from that because then they have to know what the rules and regulations were on each and every day a development agreement is effective. He does say that they will not change the rules and regulations if it materially and adversely affects the density, intensity or land use. So the developer can go into a project and know what the lot yield will be and that the City is bound by that.

If he, as a developer, knows what his lot density is, he knows from any prudent application of engineering standards what his infrastructure needs are. Most of them will have community master plans already developed when they come forward. They will have a right to develop according to that plan, unless it is changed. That gives the City some flexibility, and gives the developer some certainty. That isn't to say that they cannot change a setback, but if it has a material adverse affect on density, then they cannot do it, unless they can show a health or safety reason.

Mr. Ruby said that the difficulty they have in the Fann agreement that he would struggle with is the water issue; that is outside the authority of a City to do. How to do that is a difficult scenario to wrestle with. They could have the developer build the infrastructure and then give them credits, or agree to reimburse them from regional folks that may hook onto the line. All of those types of things can be done and bind future councils, because in his mind those are administrative functions. They have the authority under the development agreement statute to deal with land use, density, infrastructure, intensity, etc.

He said that it is a pure policy decision on whether they want to agree to expeditiously review things. If they do, they will be bound by it. They may want to define what *expeditiously* means. All that being said, they probably won't get them where they want to be with the Fann development agreement.

Councilman Lamerson said that they are in a management area for water purposes; allocated so much water a year that they can distribute. If he's hearing correctly, he is suggesting that while they may be able to allocate up to a certain amount of acre feet a year for the development, they cannot guarantee to which part of the development it is going to be delivered to. Mr. Ruby said that they have so many acre feet to serve all of the residents of Prescott.

Councilman Blair said that when they start talking about annexations and development agreements, he asked Mr. Ruby how flexible he would make it in the development agreement, annexation versus master plan phase, and if he thinks that all of the things are going to be in an annexation agreement. They have so many different levels of seeing a master plan, phases, etc.; they all come later on. Mr. Ruby said that he is not familiar with the City's development code, but clearly the agreements typically deal with the big master plan concepts, but the Fann development is more of a general concept plan.

Mayor Simmons said that one thing he was hoping for during the process is that on one hand they have specific performance and the other hand they have more extensive remedies. He asked Mr. Ruby if he has seen any development agreements where they take the King Solomon approach and split the baby. He nearly begged all of the attorneys to see the middle ground where neither is totally happy, but both feel that they are sufficiently covered to where they can walk down the path. Mr. Ruby said that he has seen varying degrees of remedies from specific performance to sky's the limit. He has seen them waive lost profits, waive consequential damages, and waive 1983 actions. He suggests that they waive any cause of action under Section 1983 which is basically someone saying their civil rights are violated.

He said that they don't have a right to expeditiously have plans reviewed that the courts would protect under Section 1983, but the minute they turn it into a contract right, and they have egregious conduct, then they have a 1983 action based on their failure to perform. Mr. Kidd said that the only deletion in the development agreement so far is the developer has requested a full range of remedies and has deleted lost profits. The other change made since the last Council meeting is the developer has agreed to limit attorneys' fees to the arbitration process.

Mr. Ruby said that the other issue within the Fann agreement, which is beyond what he has normally seen, is that this agreement states that if a court states that the City cannot do something because it is illegal, an example being the budget law, it is a breach of contract.

Councilman Blair asked Mr. Ruby if arbitration was standard and a quicker remedy than going through court. Mr. Ruby said that more and more are going to it because it is cheap, although he is not quite sure who it favors. Councilman

Blair said that he would also think it is would be quicker. Mr. Ruby said that if they end up in the court system, they could be there for years.

Councilman Roecker asked Mr. Ruby how many agreements out of 100 violate the budget law. Mr. Ruby said that he didn't know, but some do. He said that he can show them many that do not violate the budget law because all they are doing is binding themselves with respect to their administrative acts. They are not binding themselves to a future financial obligation.

Councilman Roecker asked if Mr. Ruby had said it was difficult to hold a developer to specific performances because they can go behind their LLC or declare bankruptcy. Mr. Ruby said that has been his experience. Generally, when they go bad from the developer's standpoint, it has gone bad because the market has gone bad or the developer hit some rough time.

Councilman Roecker asked Mr. Ruby if he has ever represented a developer. Mr. Ruby replied that he did. He said that he represented U.S. Homes in Marana and they kicked the crud out of the city and the city ultimately ended up hiring him. He is asked all the time, but his firm's hallmark since 1921 has been public finance and representing public entities, although they do represent Wal-Mart in the entire western United States.

Councilman Lamerson and others on the Council thanked Mr. Ruby for coming up.

IV. Discussion concerning legal issues/concerns pertaining to Granite Dells Estates I and II development agreement.

Mr. Kidd noted that both agenda items were discussed under the first.

V. Adjournment

There being no further business to be discussed, the Special Meeting of the Prescott City Council held October 23, 2007, adjourned at 2:53 p.m.

ROWLE P. SIMMONS, Mayor

ATTEST:

ELIZABETH A. BURKE, City Clerk