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CITY OF OAKLAND



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July 22, 2014

HONORABLE CITY COUNCIL
COMMUNITY ECONOMIC DEVELOPMENT COMMITTEE
Oakland, California

Re: Informational Report from the City Attorney Addressing Questions Raised by Gene Hazzard regarding a Lawsuit Entitled *Faulkner v. Rotunda Partners II* and *Len Epstein*, arising out of the Chapter 11 Bankruptcy Proceeding of R.E. Loans, LLC, and Whether that Lawsuit Impacts the City's Legal Rights against Rotunda Partners II under the Disposition and Development Agreement for the Rotunda Building and Related Parcels

Dear Chairperson Reid and Members of the Community Economic Development Committee:

I. PURPOSE OF REPORT

The Rules and Legislation Committee scheduled this item and requested that the City Attorney provide an informational report addressing legal questions Oakland resident Gene Hazzard raised regarding the lawsuit against Rotunda Partners II ("Rotunda Partners"), *Faulkner v. Rotunda Partners II* and *Len Epstein*, and whether that lawsuit impacts the City's legal rights against Rotunda Partners under the Disposition and Development Agreement ("DDA") to develop the Rotunda Building. This report responds to the Committee's request.

II. BACKGROUND

Mr. Hazzard contends that Rotunda Partners has defaulted under the DDA. Mr. Hazzard asserts that: (1) a bankruptcy trustee has sued Rotunda Partners for fraud in a Texas bankruptcy proceeding; and (2) the Rotunda Partners' involvement in the Texas litigation constitutes a default under the DDA.

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COMMUNITY AND ECONOMIC
DEVELOPMENT COMMITTEE
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We have analyzed this matter and conclude the bankruptcy litigation does not currently give rise to a breach under the DDA.

III. ANALYSIS

A. TEXAS LITIGATION

1. Bankruptcy Case

On September 13, 2011, R.E. Loans, LLC, a real estate investment fund, and related entities ("REL") filed a Chapter 11 bankruptcy petition in the U.S. Bankruptcy Court for the Northern District of Texas ("Bankruptcy Action"). Rotunda Partners is not a debtor in this bankruptcy proceeding.

2. Federal Fraud Action

On September 13, 2013, Dennis S. Faulkner, a trustee appointed by the bankruptcy court to identify and liquidate REL's assets, filed a complaint in the U.S. District Court for the Northern District of Texas against Rotunda Partners and Leonard Epstein, a Rotunda Partners' principal (the "Texas Litigation").

The Trustee alleges that Rotunda Partners: (1) invested in REL; (2) was an "REL insider"; and (3) intentionally concealed this information so that Rotunda Partners would continue to receive millions of dollars in personal transfers from REL before an inevitable bankruptcy filing. The Trustee seeks to recover these alleged fraudulent transfers from REL to Rotunda Partners.

On March 31, 2014, Rotunda Partners denied all material allegations in the complaint. On April 14, 2014, Rotunda Partners demanded a jury trial. Based on our most recent review of the court's docket calendar, the court has not yet set a trial date.

B. IMPACT OF LITIGATION ON DDA

1. Alleged DDA Default re Bankruptcy Filing

DDA Section 14.2 defines DDA defaults. Under Subsections 14.2(e) and (f), Rotunda Partners' filing of a voluntary bankruptcy, or filing by a third part of an involuntary bankruptcy, constitutes a default. Rotunda Partners is not a bankruptcy debtor in the Texas proceeding. Accordingly, the Texas Litigation fails to give rise to a default by Rotunda Partners under DDA Section 14.2(e) or (f).

2. Alleged Breach of Representation

Under DDA Section 14.2(d), Rotunda Partners commits a default if it makes a material false or misleading representation: (1) in the DDA; (2) in the City's loan documents¹; or (3) in any written statement Rotunda Partners gives to the City *at any time* in connection with the DDA (emphasis added).

DDA Article 10 delineates Rotunda Partners' warranties and representations to the City. Under DDA Section 10.3, Rotunda Partners represented that it was not a party to any litigation nor was it threatened with litigation that might adversely affect the City's rights or remedies under the DDA or payment of the City loan (the "Litigation Representation"). The question arises whether the Rotunda Partners has committed a breach of representation for failing to advise the City that the Trustee has sued it in the Texas Litigation and that such lawsuit might adversely affect the City's rights.²

Representations regarding litigation generally apply as of the date the parties actually execute the agreement. In fact, the DDA does not specifically require that Rotunda Partners' Litigation Representation continue beyond the date that the parties executed the DDA.³ In other words, the Developer has no obligation to advise the City of potentially adverse litigation filed after the parties execute the DDA or loan documents. Section 14.2(d) supports this conclusion by limiting a breach for a misrepresentation "at any time" to a written statement or certificate the Developer gives to the City in a document other than the DDA or loan documents. Accordingly, because the trustee filed the Texas Litigation after DDA execution, the Developer did not breach its Litigation Representation.

¹ The City loaned the Developer approximately \$12M to help construct seismic upgrades and other improvements.

² A similar question arises under the guaranty securing the \$12M loan ("Guaranty") executed by Len Epstein, a named defendant in the Texas Litigation, and other guarantors. In the Guaranty, guarantors represent that there is no threat of litigation that, *if adversely determined*, would materially impair or affect the financial condition of any guarantor. Guaranty, Section 3(g)(emphasis added). Such representation "shall remain true" as long as the \$12M loan is outstanding. Guaranty, Section 11. It is unclear if Len Epstein's financial condition would be materially impaired or affected by an adverse ruling in the Texas Litigation.

³ Even if Section 13.04 could be interpreted as imposing on Rotunda Partners a continuing obligation under its Litigation Representation, the Texas litigation does not currently actually adversely affect the City's rights or remedies under the DDA and given the current status of the litigation it is not clear that the litigation "might" adversely affect the City's rights or remedies under the DDA or payment of the City's loan. The Trustee has not filed a lien or attachment on the DDA property.

**Re: Informational Report Analyzing Texas Bankruptcy Litigation Impact on Rotunda
Garage Transaction**

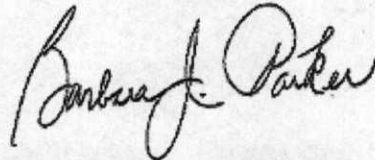
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Under Section 10.4, Rotunda Partners represented that Rotunda Partners and its general partners provided true, correct and complete financial statements, and accurately reflected their respective financial positions as of the DDA's execution date, (June 29, 1998). Because the Texas Litigation is pending, and the Texas court has not yet ruled on the trustee's allegations, there is currently no evidence that the Texas Litigation has established that the foregoing representation is materially false under the DDA's default provisions.

IV. CONCLUSION

Based on the foregoing, we find that the REL bankruptcy filing or the Trustee's initiation of an action against Rotunda Partners in the Texas Litigation currently does not constitute an Event of Default under the DDA.

Respectfully submitted,



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cc: Members of the City Council
Mayor Jean Quan
Henry Gardner, Interim City Administrator

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