MEMORANDUM

TO:            Board of Supervisors
FROM:          Stephen Kristovich
                Paul Watford
CC:            Ronald Reitz
                Charles Scolastico
                Mitchell Norton
DATE:          April 4, 2005
RE:            Proposed Settlement of Claims Brought by Colonies Partners, L.P.

On March 25, 2005, we attended what was expected to be a preliminary meeting with representatives of Colonies Partners, L.P. ("Colonies") aimed at determining whether, in the wake of the Court of Appeal's tentative decision, the parties' respective positions had changed enough to warrant the resumption of in-depth settlement negotiations. Present at the meeting were Jeff Burum and Dan Richards, principals of Colonies; Scott Sommer and Heidi Timken, counsel for Colonies; Jim Brulte, a consultant for Colonies; Supervisors Postums and Biane; and, as counsel for the Flood Control District, Deputy County Counsel Mitchell Norton and ourselves.

From approximately 1:30 p.m. when the meeting began to approximately 3:45 p.m., the parties and their counsel discussed their respective views regarding the impact of the Court of Appeal's tentative decision on the scope of Colonies' claim for damages in its pending inverse condemnation action against the Flood Control District. The parties made progress in laying out their differing views of the case, but did not engage in settlement negotiations and did not discuss any specific settlement proposals.

At approximately 3:45 p.m., Supervisors Postums and Biane asked the lawyers for both parties to leave the room so that they could speak with Messrs. Burum and Richards alone. We left the room along with counsel for Colonies and waited outside while Supervisors Postums and Biane continued discussions with Messrs. Burum, Richards and Brulte. Following approximately one and one-quarter hours, Supervisor Biane advised us that a tentative settlement with Colonies had been reached, subject to approval by the full Board.

Supervisor Biane advised us that the terms of the tentative settlement would require the Flood Control District:
(1) to assume the cost of completing construction of Basin A;

(2) to pay Colonies approximately $22 million as reimbursement for the Basin A construction and related costs Colonies claims to have incurred to date; and

(3) to compensate Colonies for a "taking" of 37 acres of its land at the value now claimed by Colonies of $1.5 million per acre for a total of approximately $55.5 million.

We understand that a portion of the amount owed to Colonies under the settlement may be satisfied through the transfer of land the Flood Control District owns rather than the payment of cash. It is unclear to us what land may be involved in such a transfer, the value of the land, or how the value of this land is to be determined.

It is also our understanding that the settlement is not contingent upon any of the other potentially responsible entities (i.e., Caltrans, SANBAG, and the City of Upland) contributing funds toward payment of the settlement.

The very broad, preliminary terms communicated to us by Supervisor Biane set forth above raise numerous related issues (concerning, among other things, the parties' respective future obligations, Basin maintenance, and property title) that we are not aware have been addressed and resolved. Setting aside how all these and other related issues that must be resolved as part of any settlement will be resolved, we have serious concerns about whether it is in the Flood Control District's best interests at this time to accept the settlement on the terms proposed.

Our concerns fall into two general categories: (1) the risk that the terms of the settlement will later be deemed unreasonable by a court or jury, thereby jeopardizing the Flood Control District's ability to recover on its claims for contribution and indemnity against Caltrans, SANBAG, and the City of Upland; and (2) the timing of the proposed settlement.

I. Risk That the Settlement Will Be Deemed Unreasonable

As we have previously discussed with you, we believe the Flood Control District has strong claims for contribution and indemnity against Caltrans, SANBAG, and the City of Upland for any damages the Flood Control District is forced to pay Colonies in the inverse condemnation case. If the Flood Control District settles with Colonies rather than litigating the inverse condemnation action to judgment, the Flood Control District may still pursue its pending
contribution and indemnity claims against the other entities, but it will then bear
the burden of proving that the settlement is reasonable. If a judge or jury later
determines that the settlement reached with Colonies is unreasonable, the Flood
Control District may be precluded from recovering on its contribution and
indemnity claims against the other entities. In that event, the Flood Control
District would be forced to bear 100% of the settlement cost, even though we
believe that the Flood Control District has strong arguments that Caltrans,
SANBAG, and the City of Upland are responsible for the vast majority of any
damages Colonies has suffered.

In our view, there is a significant risk that a judge or jury will find the
tentative settlement unreasonable in at least two respects. First, the settlement
would require the Flood Control District to compensate Colonies for the “taking”
of 37 acres of Colonies’ property, representing the difference between the 67
acres Colonies has set aside for Basin A and the 30 acres of Colonies’ property
over which the Flood Control District holds easement rights under the terms of
the Court of Appeal’s tentative decision. We have been advised by the Flood
Control District’s engineering staff that a basin adequate to control the flows from
the 19th and 20th Street Storm Drains can be constructed in an area that lies
within the 30 acres for which the Flood Control District holds valid easement
rights under the terms of the Court of Appeal’s tentative decision. The area
needed for the construction of Basin A has been reduced from the original 67
acres to less than 30 acres because in October 2003 the Army Corps of Engineers
significantly increased the volume of water authorized to flow from the 19th and
20th Street Storm Drains into the Cucamonga Channel. The increase in that
outflow figure (from 658 cfs to approximately 2400 cfs) reduces the size of the
land area needed for Basin A. In November 2003 and again in December 2003,
the Flood Control District advised the City of Upland, the public entity
responsible for permitting Colonies’ development, of the Army Corps of
Engineers’ actions in connection with Upland’s permitting of the Colonies
project.

The tentative settlement appears to require the Flood Control District to
compensate Colonies for the permanent taking of 37 acres of land that is not now
needed for flood-control purposes. Although Colonies contends that the Flood
Control District could not obtain the necessary approvals to reduce the size of
Basin A from 67 acres to less than 30 acres, we have been provided with no
evidence to substantiate that claim. We have also been told that the Flood Control
District’s engineering staff believes the requisite approvals for a basin less than 30
acres in size could be obtained.

As a result, a strong argument could be made that a settlement that
includes compensation for 37 acres not now needed for Basin A is not a
reasonable settlement.
Second, the tentative settlement could also be deemed unreasonable based on the $1.5 million valuation assigned to each acre of land for which Colonies will receive compensation. As discussed in our memorandum to the Board dated January 4, 2005, Colonies' $1.5 million per acre valuation assumes that the land in question has been entitled for the construction of residential housing. The 67 acres Colonies has set aside for Basin A, however, have been zoned by the City of Upland as open space and thus cannot currently be used for the construction of homes. Colonies also may not be able to develop this land because of obligations that Colonies has to the Department of Fish and Game and various water companies, but because pre-trial discovery has not yet occurred, we have not yet seen, and Colonies has not provided, all the documents that show this land may be encumbered in ways to prevent development. For example, the CC&Rs adopted in connection with the homes built in Phase 1 of the Colonies project may also require Colonies to preserve the area earmarked for Basin A as open space.

For the foregoing reasons, it is uncertain whether Colonies would be able to establish at trial that there is a reasonable probability the City of Upland will change the current zoning designation to allow construction of residential housing. We have seen no evidence thus far indicating that Colonies would be successful in obtaining such a change. As a result, even if Colonies were entitled to compensation for a taking of 37 acres of its land, that land would likely be valued as open space, in the range of perhaps $1 million for all 37 acres, and not as land that could be used for residential housing.

Moreover, we understand that the $1.5 million/acre amount is not based on an independent appraisal of the property, but rather solely on selective information provided by Colonies.

In sum, we believe there is a significant risk that a settlement on the terms that have been proposed will later be deemed unreasonable, as to both the number of acres for which Colonies should receive compensation and the amount Colonies is paid for each acre. Therefore, if the Board approves the settlement as proposed, we believe there is a significant risk that the Flood Control District will lose its ability to recover contribution or indemnity from Caltrans, SANBAG, and the City of Upland.

II. Timing of the Proposed Settlement

In addition to the concerns expressed above regarding the risk that the proposed settlement will later be deemed unreasonable, we also have significant concerns about whether it is in the Flood Control District's best interests to enter into the proposed settlement now.

As you know, the Court of Appeal has scheduled oral argument for May 4, 2005, and is expected to issue a final ruling within one to three months thereafter. We continue to believe, as we have advised you before, that the Flood Control
District has strong arguments that the District’s rights under the 1939 easement cover a land area large enough to accommodate a flood-control basin 67 acres in size, and that Colonies has lost the right to argue otherwise under the doctrine of equitable estoppel. The Court of Appeal’s tentative decision does not explicitly reject either of these arguments. To the contrary, the tentative decision at page 4 expressly states that “[t]he 1939 easement encompassed the whole Cucamonga Wash,” and at page 18 states “[w]e acknowledge Colonies waited far too long to assert its rights as a property owner and allowed the District, SANBAG, and Upland to proceed with and complete the construction of the $15 million 20th Street storm drain with an outlet structure on Colonies’ property and which is currently receiving drainage waters... These problems might have been avoided had Colonies raised its claims much earlier in the process.” We intend at oral argument to explain why the Court of Appeal should rule in the Flood Control District’s favor on both points. A ruling in the Flood Control District’s favor on either of these two points would eliminate the basis for Colonies’ claim to compensation for the 37 acres, potentially saving the Flood Control District $55 million under the terms of the proposed settlement.

Although it is unlikely that either of the parties would be able to persuade the Court of Appeal to change the substance of the tentative decision in their favor, we believe the Flood Control District would be substantially more likely to do so than Colonies. That is particularly true with respect to the equitable estoppel argument because the Court of Appeal’s tentative decision already includes a paragraph largely adopting the Flood Control District’s view of the issue. In our view, it would be prudent for the Board to delay consideration of the proposed settlement until after oral argument is held and the Court of Appeal issues its final decision, a delay of only a few months.

Delaying consideration of a settlement on the terms proposed would also be prudent to allow us adequate time to gather the evidence necessary to assess the validity of some of the key assumptions underlying the terms of the proposed settlement. As noted above, for example, Colonies has raised questions about whether the Flood Control District could obtain the approvals necessary to reduce the size of Basin A below 36 acres. In effect, the proposed settlement assumes that such approvals could not be obtained, despite the fact that we have seen no evidence supporting that assumption and we have been informed that the Flood Control District’s engineering staff believes such approvals could be obtained. Similarly, we have not been provided with evidence to support the $1.5 million per acre valuation that the proposed settlement assumes to be accurate. Again, we would need an opportunity to gather additional facts before we could determine the validity of that assumption and advise the Board whether that assumption is reasonable.
Delaying consideration would also allow time to collect relevant information regarding what non-flood control obligations, if any, Colonies has to maintain as open space the 37 acres that is the subject of the alleged taking.

Finally, before the Board approves any settlement, it should be determined whether or not insurance is available to pay for some or all of the settlement and, if insurance is available, that the Flood Control District has satisfied whatever obligations it has to the insurer and obtained whatever consent, if any, is required before entering into the settlement.

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Given the concerns expressed above, we recommend that the Board at this time not approve the settlement on what we understand are the terms that have been proposed.