



1851 East First Street - Suite 1550
Santa Ana, California 92705-4067
voice 949.863.3363 - fax 949.863.3350
www.bwslaw.com

DRAFT

TO: Jim McNeill, Assistant City Attorney, City of San Diego
FROM: Burke, Williams & Sorensen, LLP
Brian A. Pierik, Esq.
Mark J. Austin, Esq.
DATE: June 17, 2020
RE: Transaction Review: 101 Ash Street Lease-to-Own Agreement

SCOPE OF ANALYSIS

The City of San Diego ("City") has asked Burke, Williams & Sorensen, LLP ("Burke"), to review and analyze the facts and documents leading to the City's decision to enter a lease-to-own agreement (the "Lease Agreement") for the office building located at 101 Ash Street in San Diego (the "Property"), effective January 3, 2017, with 101 Ash, LLC, an entity owned and controlled by Cisterra Development, Inc. ("Cisterra"), a San Diego-based development company.

This review was requested because, after the City entered into the Lease Agreement and initiated remodeling efforts for the Property, it learned that nature and extent of the asbestos on the Property was different than initially understood, particularly with respect to the susceptibility of the asbestos to sloughing and to the release of contaminants if disturbed during the remodeling work. This discovery necessitated that the City relocate any City employees working there, and delayed the City's ability to use the Property as planned. The unexpected nature of the asbestos at the Property led to questions regarding the adequacy of the City's due diligence on the transaction, such as whether the City had conducted all investigations it should have for a transaction of this nature.

The City entered into the Lease Agreement on January 3, 2017. In conducting its analysis, Burke relied on the records provided to it by the City preceding this date, including (i) the Lease Agreement itself, (ii) various City staff reports regarding the transaction, (iii) the available appraisals of the Property, and (iv) the pre-transaction "due diligence" documents that the City had received from Cisterra prior to entering into the transaction, including documents Cisterra had apparently received from the prior occupant of the Property, San Diego Gas & Electric (*i.e.*, Sempra Energy).

The City also provided Burke with additional documents that it requested after its initial review, including but not limited to (i) the contract by which Cisterra purchased the property from the former owner, (ii) certain City legal analysis relating thereto, (iii) correspondence between the City and Cisterra leading up to the transaction, and (iv) City analyses and external communications relating to alternative proposed deals. In addition, the City's Director of Real Estate Assets, Cybele Thompson, answered a number of questions from Burke, both in writing and ultimately in a series of telephonic interviews on May 21 and 22, 2020.

TABLE OF CONTENTS

This Memorandum contains the following contents:

- I. **Executive Summary:** A summary of this office's conclusions and the primary facts and documents leading thereto, including a general discussion of the adequacy of the City's due diligence.
- II. **Detailed Transaction Background:** A detailed discussion of the facts leading to the City's decision to enter into the Lease Agreement, including the City's own internal review of the transaction, based on the documents and information provided.
- III. **Analysis of Transaction History:** Commentary and analysis regarding the adequacy of the City's review of, and due diligence for, the transaction.
- IV. **Effect of Exculpatory Provisions:** Legal analysis of the likely effect of the various exculpatory provisions in the Lease Agreement, such as the "as is" clause and the release.

I.

EXECUTIVE SUMMARY

Based on this office's review of the available documents and information, we conclude that the City's due diligence on the transaction was likely deficient in a key respect—namely, its failure to follow-up on the available records concerning asbestos on the Property with a more detailed evaluation of that issue, such as a Phase II Environmental Assessment, which could have shown the full extent of the asbestos and the likely effect of disturbing the asbestos through improvements or remedial work.

A number of months before the City closed on the transaction, the City was provided documents, described in more detail below, that discussed the presence of

DRAFT MEMO

June 17, 2020

Page 3

asbestos on the Property, including but not limited to (a) an important Phase I Environmental Assessment from 2014, and (b) an appraisal obtained by Cisterra dated August of 2016. Based on its receipt and review of these records, **the City likely had sufficient information to mandate further investigation of the asbestos at the Property as a matter of reasonable prudence.**

Secondarily, this office has concerns regarding the broker-like role that Cisterra played in the City's acquisition of the Property, and the City's nearly exclusive reliance on the reports and information provided by Cisterra in conducting its due diligence, particularly in light of the fact that the Property was being sold "as is," with very strong exculpatory language in the Lease Agreement absolving Cisterra of any liability. While it is customary for a purchaser to rely on reports and disclosures provided by the seller (such as appraisals and environmental reports), a contract containing strong exculpatory provisions in favor of the seller (including, in this instance, a full release and waiver of any right to sue) increases the importance of the purchaser commissioning its own reports to investigate the property.

City staff has provided multiple justifications for structuring the transaction in this manner. These included (i) a refusal of the prior owner (Sandy Shapery) to sell the Property to the City at a reasonable price, necessitating that the City use Cisterra as a "middleman" to obtain a more reasonable price¹, (ii) an inability to obtain bond financing in time to close on a purchase from Cisterra under Cisterra's required timetable, and (iii) the fact that Cisterra's purchase agreement from the former owner could be interpreted as prohibiting an assignment of Cisterra's purchase rights.²

It is not within this office's scope of review to address the validity of those justifications, which appear to be reasonable on their face. **However, that structure underscores the importance of the City conducting its own review of any potential issues raised by Cisterra's disclosures, such as an independent investigation of the extent of any asbestos on the Property, as referenced above.**

¹ According to the City's staff reports and Ms. Thompson, although the City was approached by the former owner regarding a purchase of the Property in 2016, the City passed on this opportunity because the offered sale price was \$100 million, whereas the property only appraised (according to an appraisal obtained by Cisterra) for \$67.1 million. Although Cisterra was later able to purchase the Property for \$72.5 million, according to Ms. Thompson, it is our understanding that Mr. Shapery was not willing to offer a similar sale price to the City, instead believing that the City should be willing and able to pay more.

² This office was provided a copy of the analysis conducted by the City Attorney's Office, which determined that the language in Cisterra's purchase agreement from the prior owner could subject any assignment of Cisterra's purchase rights to legal challenge.

In this regard, Cisterra appears to have provided only two reports to the City, that Cisterra itself commissioned, regarding the condition of the Property—namely, (1) a Property Condition Report, dated March 10, 2016, and (2) a Phase I Environmental Assessment, dated March 4, 2016. However, **neither of these documents discussed the presence of asbestos on the Property, despite the fact that abundant records from the files of the prior occupant revealed that the Property had an extensive history with that substance.**³ In fact, the Phase I report expressly disclaimed any attempt to evaluate the asbestos. In light of Cisterra's limited involvement with the Property and its "as is" sale, a failure by the City to supplement these reports appears problematic.

In addition, Cisterra's position as a mere middleman in the transfer of the Property is also problematic **because it acts as a potential shield for both Cisterra and the prior owner against any liability to the City for nondisclosures**, in that (1) it strengthens Cisterra's likely argument that it was ignorant of any conditions of the Property, since it never used or occupied the Property, (2) **it disincentivized Cisterra from conducting a thorough due diligence for its own purchase (in that ignorance of the property's condition would only help it in an "as is" transfer to the City),** and (3) it prohibited the City from obtaining legally binding disclosures from the prior owner, and thus precludes the City from pursuing any legal action against that owner for issues relating to the Property.

In contrast to the Cisterra reports from 2016, there are multiple older reports in the City's files that clearly reveal the Property's lengthy history with asbestos, including (1) a Property Condition Report and a separate Phase I Environmental Assessment obtained in 2014 in conjunction with a mortgage loan on the Property, (2) a Phase I Environmental Assessment from 2004 that was attached to the Phase I assessment from 2014, and (3) a multitude of technical documents from 1993 to 2015 relating to Sempra Energy's efforts to remediate asbestos on every floor of the Property.

We were informed by Ms. Thompson that the City received these reports and documents from Cisterra from July through September of 2016, well before the City closed on the transaction in January of 2017, and that City staff reviewed them, including the historical asbestos remediation documents from Sempra. In this office's

³ Granted, in addition to these property-condition records, the above-referenced appraisal obtained by Cisterra (appraising the Property at \$67.1 million), dated August 12, 2016, does state that the Property has a history of asbestos. However, that appraisal also states that the asbestos has largely been abated or "encapsulated," and that that such encapsulation is "typically adequate if construction or maintenance work is not likely to disturb it." (Appraisal, p. 40.)

opinion, the City's possession and review of these documents, together with the August 2016 appraisal referenced above, provided adequate notice to the City, from Cisterra, regarding the condition of the Property (assuming Cisterra did not know more than it disclosed), and adequate disclosure by Cisterra regarding the presence of asbestos, to warrant the City's further investigation regarding the extent of asbestos, as well as the scope and cost of remediation of the asbestos.

With respect to the Lease Agreement itself, it contains a number of exculpatory provisions, including an "as is" clause, a release (together with a Civil Code section 1542 waiver), and specific disclaimers regarding "Hazardous Materials" (which is defined to include asbestos, amongst other materials) and the City's responsibility for determining the presence of such materials. **These provisions could prevent the City from proceeding against Cisterra based on the presence of asbestos, even if its disclosures had not been adequate.** Granted, under the law, exculpatory provisions such as "as is" clauses do not relieve a seller from liability for its failure to disclose known material facts about a property, or for any misrepresentations regarding the property. However, we have not been given any information indicating that Cisterra had information regarding the Property that it failed to provide or disclose to the City. Thus, it is unlikely that the City could take advantage of this exception to the exculpatory provisions.

In Section IIIC of this Memorandum, we list the instances in which this office believes the City did not follow best practices regarding due diligence for the subject transaction based upon our review of the documents provided by the City and our discussions with City personnel.

II. DETAILED TRANSACTION BACKGROUND

A. The City's Internal Staff Reports

The Lease Agreement was entered into by the City with 101 Ash, LLC (owned by Cisterra), effective January 3, 2017. Based on the City's meeting minutes, the ordinance approving the Lease Agreement was introduced on October 17, 2016, and finally approved on November 15, 2016.

Two primary City staff reports analyze the proposed transaction and provide its history: (1) a "Report to the City Council," dated October 13, 2016 (slightly revised from a prior version dated September 9, 2016) (the "Staff Report"), and (2) an "Office of the Independent Budget Analyst Report," dated October 12, 2016 (the "IBA Report").

According to these documents, in or about 2016, the City began to search for additional office space. This search was driven by multiple factors, including that (1) the City had reached capacity at one of its primary owned locations, the City Operations Building, and it would cost the City approximately \$94 million to complete required maintenance on that building, (2) although the City was leasing-to-own additional office space at its Civic Center Plaza location, this property would be undergoing asbestos-abatement work over the next five years that would require the temporary relocation of any employees during that period, and (3) market trends showed that office-lease rates were high, and could increase by up to 50% in the next five to eight years, such that a purchase or lease-to-own arrangement for any additional space would likely result in cost savings for the City. (IBA Report, pp. 2-3; Staff Report, pp. 1-3.)

Against this backdrop, in or about 2016, the Property's former owner (Sandy Shapery, through two related entities⁴), offered to sell the Property to the City for \$100 million. However, the City passed on this offer because the Property only appraised for \$67.1 million. (IBA Report, pp. 1-2.) This \$67.1 million value was stated in an appraisal obtained by Cisterra, dated August 12, 2016, and conducted by F. Davis Real Estate, Inc. (the "Appraisal"). The City received the Appraisal from Cisterra no later than September of 2016. It stated that the Property had the following history with asbestos:

The building contains asbestos fireproofing. Reportedly, it has been removed in all accessible areas on floors 1 and 17 through 19. On the remaining floors the asbestos below the floor decking has been removed; on the underside of the floor decking the asbestos has been encapsulated. An operations and maintenance program has been in place since the 1990s. **This is typically adequate if construction or maintenance work is not likely to disturb it.**

(Appraisal, p. 40 [emphasis added].)

After the City's rejection of the \$100 million sale price, Cisterra entered into an agreement to purchase the Property from the prior owner for \$72.5 million. (IBA Report, p. 2.) According to the IBA Report, "[d]uring Cisterra's negotiations to purchase the building," the City and Cisterra entered into a separate "non-binding agreement," which would allow the City to either (1) buy the Property directly from the prior owner via an

⁴ The Property was occupied by San Diego Gas & Electric from 1968 through 1998, and by Sempra Energy from 1998 through 2015. According to Cisterra's purchase agreement with the former owners, those owners were identified as (i) "The Gas & Electric Headquarters Building – San Diego, L.P.," and (ii) "Shapery Developers Gas & Electric Property, L.P."

assignment of Cisterra's purchase rights (for a total financing cost of \$110.6 million over 20 years), or (2) lease-to-own the Property over 20 years (for a total cost of \$127.8 million over that period). (*Ibid.* [emphasis added].) Thus, before Cisterra had secured the right to purchase the Property, the City and Cisterra had a plan for Cisterra to simply turn around and transfer the Property to the City in some fashion.

In support of Cisterra's ultimate purchase value of \$72.5, amongst the City's due diligence documents is a "Broker Opinion of Value" ("BOV"), commissioned by Cisterra, and prepared by Jones Lang LaSalle, valuing the Property between \$83.1 million and \$85.7 million. This BOV is dated September 12, 2016.

Ultimately, even though the lease-to-own option would cost approximately \$17 million more than the purchase option, the City opted not to pursue the purchase option. In speaking with Cybele Thompson, the reasons the City chose that route are (i) that Mr. Shapery refused to sell the Property to the City at a reasonable price that approximated its actual value, apparently believing it was worth more to the City than to private parties such as Cisterra⁵, (ii) that the City would be unable to secure bond financing for its purchase of the Property in time to close under Cisterra's required timetable⁶, and (iii) that Cisterra's purchase agreement from Mr. Shapery could be interpreted as prohibiting an assignment of Cisterra's purchase rights.

In addition, despite the greater cost of the lease-to-own option, according to the City's analysis, even this option would potentially save the City approximately \$44 million over 20 years compared to the simple leasing of additional office space, due to the estimated trends in office rental rates in the City, referenced above. (IBA Report, p. 1.) As stated in the IBA Report: "Entering into this 20-year lease-to-own agreement will insulate the City from the risks of rising rental costs for leased office space. It should be noted that projected savings associated with the agreement – estimated by READ [Real Estate Assets Department] at \$44.4 million over the 20-year term – rely on an estimated market rate for renting similar office space downtown." (*Ibid.*)

⁵ That said, based on information from Ms. Thompson (as well as the terms of Cisterra's purchase agreement from Mr. Shapery, discussed below), it appears that Mr. Shapery was aware, in selling the Property to Cisterra, that Cisterra intended to offload the Property to the City. As noted above, if Mr. Shapery was aware of that fact, it remains unclear why he offered such a different price to Cisterra as he did to the City.

⁶ According to Ms. Thompson, for Cisterra to secure the Property, it had to have a proposed tenant in place at the time it closed. Thus, based on the timing of Cisterra's purchase, the City did not have sufficient time to secure bond financing for its own immediate purchase.

DRAFT MEMO

June 17, 2020

Page 8

Burke reviewed a copy of the above-referenced "non-binding agreement" with Cisterra, which is dated July 21, 2016. Its terms support the characterization of that agreement as stated in the IBA Report, regarding the parties' intent to use Cisterra as a middleman for the acquisition of the Property, and the options available to the City for that purpose (i.e., to lease-to-own from Cisterra or to acquire Cisterra's purchase rights). With respect to the purchase option, the non-binding agreement indicated that the City intended to finance such a purchase through bonds, and stated: "If the City ultimately desires to buy the Property directly, using its own financing capabilities, **Cisterra is able and willing to assign its rights under the [purchase agreement] to the City.**" (Emphasis added.)

In addition, the City also provided Burke with a copy of Cisterra's purchase agreement from the former owners, which had an "effective date" of June 29, 2016 (the "Cisterra Purchase Agreement"). Based on that date, it is clear that Cisterra had secured the ability to purchase the Property well before it had finalized any deal with the City—in fact, before it had even entered the "non-binding agreement" dated July 21, 2016.⁷

With respect to the assignability of the Cisterra Purchase Agreement, it stated that the seller's consent is required for assignment, except for transfers "in connection with effecting a City Transaction" (Cisterra Purchase Agreement, § 17), which the agreement defined as "a transaction by which the City of San Diego ('City') will occupy the Building," and which the agreement acknowledged Cisterra was "currently attempting to negotiate" (*id.* § 4.6). According to a confidential memorandum prepared by the City Attorney's Office, this language was considered ambiguous as to whether the term "will occupy" would allow for the option of the City purchasing or owning the Property and thus qualify as a "City Transaction." As noted above, this ambiguity is cited by Cybele Thompson as one of the reasons the City did not pursue the assignment/purchase route. Granted, this ambiguity begs the questions as to (a) why Cisterra agreed to such language when it was contemplating an assignment of its purchase rights to the City, and (b) if the language is in fact ambiguous, why Cisterra later represented, in the non-binding agreement, that it "is able and willing to assign its rights under the [purchase agreement] to the City."

⁷ The non-binding agreement states that Cisterra had entered into two agreements with the Shapery entities for the purchase of the Property—an "Initial Purchase Agreement," which ultimately fell through for unspecified reasons, and a "New Purchase Agreement." We are informed by Ms. Thompson that the version of Cisterra's purchase agreement provided to us is the "New Purchase Agreement."

In terms of the condition of the Property, although Ms. Thompson confirms that, prior to approval of the Agreement, City staff knew there was at least some asbestos on the Property, **neither the Staff Report nor the IBA Report mention that fact**. Moreover, to the extent the City's staff reports discuss the condition of the Property at all, the only report cited is the 2016 Property Condition Report commissioned by Cisterra, which is summarized as follows in the September 9, 2016 Staff Report:

On March 10, 2016, a Property Condition Report (PCR) for 101 West Ash Street was completed by Advantage Environmental Consultants, LLC, which stated that "The Site was observed to be in good condition. Evidence of on-going maintenance was observed." **The previous occupant, Sempra Energy, was meticulous in their maintenance and care of the property over their several decades of occupancy.** In fact, the PCR estimates that "this Site's estimated remaining useful life (ERUL) should be at least an additional 40 years barring any natural disasters." The PTR summarized that **"AEC did not identify any obvious items of deferred routine maintenance that warrant mention" and their only recommendation for immediate repair was an amount of \$10,000 to clean, caulk and pressure wash the exterior of the building.**

(Staff Report, p. 4 [emphasis added].)

No other reports concerning the condition of the Property are cited, and no other comments on that subject are made, in either the Staff Report or the IBA Report. According to Ms. Thompson, however, before the City approved the Lease Agreement, **City staff had nevertheless received and had the opportunity to review the various other property-condition documents provided by Cisterra, including all prior environmental assessments and the historical abatement records from Sempra discussed below, which clearly referenced the presence of asbestos on the Property.** Despite the City's possession and review of such documents, City staff focused only on the 2016 Property Condition Report, and noted only that the prior occupant, Sempra Energy, was "meticulous in [its] maintenance and care of the property," and that the consultant "did not identify any obvious items of deferred routine maintenance that warrant mention."

Against this backdrop, both the Staff Report and the IBA Report recommended approval of the Lease Agreement, concluding that it would ultimately save the City millions of dollars in the leasing of office space, as set forth above. (Staff Report, p. 1; IBA Report, pp. 4-5.) Based on this recommendation, the City approved the agreement.

According to the City's staff reports, the City planned to do some tenant improvements to the Property after it took possession, for which the Agreement provided \$5 million from Cisterra. (Staff Report, pp. 1, 4; IBA Report, p. 3.)

B. The Available Due Diligence Documents

In contrast to the limited documents and facts referenced in the Staff Report and the IBA Report, the due diligence files provided by the City reveal a voluminous number of additional records that were, according to Ms. Thompson, in the City's possession at the time of the transaction, and reviewed by her and other City staff. Although most of those records are not relevant to the issues addressed in this Memorandum,⁸ those that are relevant, and their pertinent contents, are discussed in the following sub-sections.

The 2014 Reports

In 2014, a series of reports on the Property were issued for the purpose of securing a mortgage loan on the Property, which reports were provided to the City by Cisterra during negotiations, and reviewed by City staff.⁹ The 2014 reports included the following documents relating to the condition of the property, among others¹⁰:

1. **A Property Condition Assessment Report**, dated November 25, 2014, by AEI Consultants Environmental & Engineering Services, for Washington Capital Management, Inc.

⁸ These records include (1) the original architectural drawings for the Property (50 documents, undated); (2) the original Certificate of Occupancy for the Property, dated July 8, 1968; (3) an apparent proposal for a conversion of the Property to a hotel condominium project, dated January of 2013; (4) property tax bills for the Property from 2013-2016; (5) electrical and water bills for the Property from 2014-2015; (6) an ALTA Survey by San Diego Land Surveying and Engineering, Inc., dated November 21, 2014; (7) a "Preliminary Report," dated April 15, 2015, by Stevenson Systems, Inc., concerning building area calculations; (8) a series of undated CAD and PDF files relating to office furniture at the site; (9) approximately 650 undated photographs of the exterior and interior of the Property; and (10) a marketing video for the sale of the Property (undated), entitled "2nd cut reshoot."

⁹ Included in the City's due diligence documents are notes in Microsoft Word format purporting to relate to "Due Diligence Docs" that may shed some light on these facts, as discussed later in this Memorandum.

¹⁰ In addition to those listed below, the Property reports from 2014 also included (1) a "Scenario Expected Loss Assessment," dated November 25, 2014, by AEI Consultants Environmental & Engineering Services, for Washington Capital Management, Inc. (evaluating the Property for risk from seismic events); and (2) a Zoning and Site Requirements Summary, dated November 26, 2014, by the Planning & Zoning Corporation, for Washington Capital Management, Inc. (evaluating the Property's conformance with zoning and land-use requirements).

DRAFT MEMO

June 17, 2020

Page 11

According to this report, "[t]he purpose of the assessment was to provide an objective, independent, professional opinion of **the potential repair and deferred maintenance costs associated with the subject property**, as well as estimate the minimum ongoing capital reserves necessary to maintain the property for its current usage." (Page 1 [emphasis added].)

The report broke the building down into approximately 24 different components, and evaluated each component's need for ongoing maintenance or repairs. The vast majority of these sections ended with the phrase: "No items of deferred maintenance were observed. Routine maintenance of the [component in question] will be required over the evaluation period."

The report also contained an **express disclaimer for asbestos**, stating that "This Report **does not confirm or deny** the presence or absence of items such as mold, **asbestos**, environmental conditions or hazardous substances on this property." (App. F [emphasis added].) It also listed asbestos as an "Out of Scope Item." (Table Section 11.1.11.)

2. **A Phase I Environmental Site Assessment**, dated November 26, 2014, by AEI Consultants Environmental & Engineering Services, for Washington Capital Management, Inc.

Although this report excluded asbestos from the scope of its analysis, it nevertheless contained the following statements on that subject, including a statement that "**a thorough asbestos survey is required . . . prior to demolition or renovation activities**":

"Due to the age of the subject property building, **there is a potential that ACMs [asbestos-containing materials] are present**. According to a prior report, **an asbestos survey completed at the subject property in May 1989 identified on-site friable spray-on fireproofing, acoustical popcorn ceiling finishes and pipe elbows as asbestos containing**. Based on the presence of ACMs, AEI recommends the property owner develop and implement an Operations and Maintenance (O&M) Plan for the subject property which stipulates the identification, assessment, repair and maintenance of building materials to protect the health and safety of the building occupants, visitors to the site, and the environment. Observed suspect ACMs were in good condition and are not expected to pose a health and safety concern to the occupants of the subject

property at this time. In the event that building renovation or demolition activities are planned, a thorough asbestos survey is required in accordance with the EPA NESHAP 40 CFR Part 61 prior to demolition or renovation activities that may disturb ACMs." (Pages iii-iv, and 30-31 [emphasis added].)

In addition to these comments, this report from also contained, in its Appendix E, a separate Phase I Environmental Site Assessment, dated July 14, 2004, by IVI International, Inc., commissioned by Morgan Stanley. This 2004 report contained the following additional statement regarding asbestos:

"Friable asbestos containing spray-on fireproofing and pipe elbows are known to exist at the Subject. According to an interview with Mr. Sheldon Glady, the Facilities Manager, Floors 17-19 were renovated and all asbestos containing material including friable ACM from these floors have been abated. In addition, non-friable wallboard assemblies, built-up roofing system components and cooling tower fill may contain asbestos. These friable and non-friable materials were identified in good condition. IVI recommends that these materials be maintained in good condition under the existing Asbestos Operations and Maintenance (O&M) Program and keeping the current O&M in place at the Subject." (App. E, 2004 Phase I, p. 1 [emphasis added]; see also *id.* at pp. 26-28.)

The 2016 Reports

In addition to the 2014 documents, the City also received and reviewed reports commissioned by Cisterra in 2016. These reports are important because (i) they are the most direct embodiment of the representations made by Cisterra to the City regarding the Property, (ii) they are the closest in time to the transaction in comparison to any of the other due diligence materials in the City's files, and, (iii) to the extent the City merely relied on the due diligence conducted by Cisterra, they in effect constitute the City's own due diligence efforts.

The 2016 reports include the above-described Appraisal (August 12, 2016) and the BOV (September 12, 2016), as well as the following additional reports¹¹:

¹¹ In addition, the 2016 reports also include a Preliminary Title Report, dated August 3, 2016, by Chicago Title Company.

1. A **Phase I Environmental Site Assessment**, dated March 4, 2016, by Advantage Environmental Consultants, LLC, for Cisterra.¹²

This report states that its purpose is to "provide a professional opinion on the presence of recognized environmental conditions and other suspect environmental conditions in connection with the Site, as they existed on the date of the site inspection, and to recommend whether further investigation is required," in accordance with standard "ASTM" practice for such assessments. (Page 1.) Consistent with these standards, the report contains an **express exclusion for asbestos** (Page 4), and concludes as follows:

"This Phase I ESA has revealed no evidence of current recognized environmental conditions in connection with the Site. Additional environmental assessment at the Site is not considered to be warranted at this time. The apparent historical presence of a gas and oil facility and automotive repair facilities on portions of the Site are considered to be potential historical environmental concerns in connection with the Site that do not warrant further investigation. AEC has identified no information in regulatory records or other information sources that would lead us to believe that the above referenced historical uses of the Site have adversely impacted the Site. Such potential concerns are considered to be mitigated by the construction of the existing improvements at the Site including the subterranean parking garage" (Page 22 [emphasis added]).¹³

2. A **Property Condition Report**, dated March 10, 2016, by Advantage Environmental Consultants, LLC, for Cisterra.

This report states that its purpose is to "evaluate the general condition of the buildings, Site, and other improvements at the referenced location" and to "identify those areas that will **require remedial repair work** and . . . assign them

¹² Although the available version of this report and the following "Property Condition Report" are both marked "DRAFT," the City's staff reports refer to final such reports of the same dates.

¹³ Notwithstanding this conclusion and the asbestos exclusion, this report does provide some hints that there is asbestos on the property, including (1) a statement that the site is identified on a "HAZNET" database as containing hazardous materials, which *could* include "PCBs, asbestos and oil containing waste," and (2) a site photograph (Site Photograph # 44 (page 38)) of a pipe with an asbestos warning label, and sub-heading for the photograph stating: "View of asbestos warning label on insulated pipe." However, it is unlikely that these hints alone would constitute constructive notice of the extensive presence of asbestos on the Property.

an associated estimated remedial cost." (Page 5 [emphasis added].)

The report breaks the building down into approximately 30 different components, and evaluates each component's need for ongoing maintenance or repairs. The vast majority of these sections end with determination that the component is in good condition and requires few or no improvements or repairs. Meanwhile, **the report contains no substantive mention of asbestos.**

The Historical Asbestos-Abatement Records from Sempra Energy

In addition to the records and reports from 2014 and 2016, the City's due diligence files also contain a plethora of historical documents relating to Sempra's efforts to remediate the Property of asbestos. These documents span from 1993 to 2015 and consist primarily of technical notes for the abatement work (many of which are written by hand), such as "Daily Logs" and "Air Analyses." Generally, each set of documents relates to abatement efforts on a different set of floors, undertaken at different times, with some floors undergoing multiple remediation projects over the years. For many of the documents, however, it is only possible to determine the floors and time periods that they relate to by looking at the titles of the electronic PDFs provided by the City, for the documents themselves consist largely of disjointed notes that are difficult to decipher.

Ultimately, **for someone trying to determine the extent to which asbestos has been abated from the Property, and/or how much asbestos remains, these records are of little use.** To the extent the records can be deciphered at all, they generally contain no summary of the required abatement activities or conclusive statements regarding the condition of the Property at the conclusion of the work. At most, the reports occasionally state that the abatement efforts were completed within the "scope of work," which is not identified, and/or that results of any air analyses are within acceptable standards. Thus, to the extent City staff reviewed these documents for the purpose of determining how much asbestos remained on the Property at the time of the City's acquisition, that information would not be available from these records.

That said, someone reviewing documents would understand that the Property has a lengthy history of asbestos, and that abatement efforts have been undertaken multiple times on multiple floors of the Property for over 20 years, **such that an investigation as to the current status of abatement on the Property would be in order.** In fact, removing any doubt regarding the significance of the records, included with them is a certification by San Diego Gas & Electric, dated July 27, 2015, sent to

Sempra Energy, and entitled "Asbestos Records – Sempra Energy Headquarters." This certification states that the records enclosed therewith constitute "the current asbestos inventory and records of asbestos surveys and abatement at the Sempra Energy Headquarters Building (HQ)."¹⁴

III. ANALYSIS OF TRANSACTION HISTORY

A. Standard Due Diligence Items

One of the issues the City asked Burke to address is the extent to which the City, in entering into the Lease Agreement, followed due care under standard due diligence practices for a commercial real-estate transaction. Here, most of the standard due diligence items that a purchaser would be expected to review for a commercial purchase or lease-to-own transaction were in the City's due diligence files. Certainly, there are more potential documents that are sometimes seen in transactions that were not present here, but any such documents do not seem to be pertinent to this transaction or a concern for the City at this time.

A standard list of due diligence documents that a purchaser would be expected to review in a transaction of this nature (including what the City did and did not have here) is set forth below. In addition, as discussed as part of that list, the primary deficiencies in the City's due diligence appears to be (1) the City's failure to consider commissioning its own environmental assessments in light of the strong exculpatory provisions in the Lease Agreement and Cisterra's unique role in the transaction (discussed more in the next section of this Memorandum), and (2) the City's failure to follow up on the available information concerning asbestos with a more detailed evaluation of that issue, such as a Phase II Environmental Assessment or similar evaluation, which would have shown the full extent of asbestos on the Property and the likely effect of disturbing the Property with improvements.

With that in mind, the typical list of due diligence documents a property purchaser obtains (and whether they were included here) is as follows:

- An up-to-date title policy (see Preliminary Title Report, dated August 3, 2016, by Chicago Title Company).

¹⁴ This certification is, in turn, attached to a letter, dated July 30, 2015, from Sempra Energy to an individual at "Shapery Enterprises," stating: "Attached are the asbestos inventory records for the former Sempra Energy Headquarters Building located 101 Ash St., per your request."

- The legal description of the property (included).
- The applicable certificate of occupancy (see Certificate of Occupancy, dated July 8, 1968).
- Copies of any zoning or land-use approvals, and any available reports concerning zoning compliance (see Zoning and Site Requirements Summary, dated November 26, 2014, by the Planning & Zoning Corporation, for Washington Capital Management, Inc.).
- The most recent ALTA survey (see ALTA Survey by San Diego Land Surveying and Engineering, Inc., dated November 21, 2014).
- The available plans and drawings for the building, including architectural plans, engineering plans, construction blueprints, etc. (These appear to largely be present here, to the extent available, as part of the "architectural plans" in the City's due diligence files.)
- Property tax bills for the prior three years (included).
- The legal description of the property (included).
- Seller's third-party appraisals (see (a) the Appraisal, dated August 12, 2016, conducted by F. Davis Real Estate, for Cisterra, and (b) BOV, dated September 12, 2016, prepared by Jones Lang LaSalle, for Cisterra).
- **Seller's third-party property reports, including property-condition reports, environmental reports** (Phase I and Phase II assessments, mold or asbestos-abatement reports and tests), soils tests, engineering reports, termite studies, and similar records.

These reports are present in the City's files to the extent discussed above, and include (a) the Property Condition Reports and Phase I assessments from 2016 (commissioned by Cisterra), (b) the similar reports from 2014 (commissioned by the prior owner for a mortgage loan), (c) another Phase I assessment from 2004 (as an attachment to the 2014 Phase I assessment), and (c) the historical asbestos-abatement records from Semptra.

Although obtaining these reports from the seller/lessor was consistent with standard due-diligence practices, **the City likely should have commissioned**

its own property-condition reports in light of the strong exculpatory provisions in the Lease Agreement (including the release, the “as is” clause, and the provisions putting the responsibility on the City to determine the extent of “Hazardous Materials”). Because these provisions potentially absolved Cisterra of liability relating to the nature and extent of its disclosures, it was particularly important that the City perform its own, independent due diligence relating to issues that were of importance to the City.

Here, the City deviated from this principle by failing to conduct city-commissioned analysis to further explore the impact that remodeling the Property would have on the asbestos that existed on the Property. Because the City received and reviewed the reports from 2014 and the Sempra abatement records (and the Appraisal, which also mentioned the historical presence of asbestos on the Property) prior to the Lease Agreement, **City staff had sufficient information to mandate conducting a “Phase II Environmental Assessment” or other appropriate analysis to review the Property for the full extent of asbestos, for a prudent investigation of the transaction.** This is particularly true in light of the Phase I assessment from 2014 that stated as follows with respect to evaluating the effect of potential renovation activities on the Property, which Burke is informed the City planned here:

“Due to the age of the subject property building, **there is a potential that ACMs [asbestos-containing materials] are present.** According to a prior report, **an asbestos survey completed at the subject property in May 1989 identified on-site friable spray-on fireproofing, acoustical popcorn ceiling finishes and pipe elbows as asbestos containing.** Based on the presence of ACMs, AEI recommends the property owner develop and implement an Operations and Maintenance (O&M) Plan for the subject property which stipulates the identification, assessment, repair and maintenance of building materials to protect the health and safety of the building occupants, visitors to the site, and the environment. **Observed suspect ACMs were in good condition and are not expected to pose a health and safety concern to the occupants of the subject property at this time.** **In the event that building renovation or demolition activities are planned, a thorough asbestos survey is required in accordance with the EPA NESHAP 40 CFR Part 61 prior to demolition or renovation activities that may disturb ACMs.**” (Phase I Environmental Site Assessment, dated November 26, 2014, by AEI Consultants Environmental & Engineering Services, for Washington Capital Management, Inc., pp. iii-iv, and 30-31 [emphasis added].)

DRAFT MEMO

June 17, 2020

Page 18

- Any third-party agreements applicable to the property, including any leases or service contracts, and an accounting of any owed amounts under those contracts, either to or from the property owner, and/or a certification that there are no leases and no amounts owed. (This does not appear to have been obtained here, at least according to the City's due diligence files.)
- A copy of any pending claims relating to the property. (It is unknown whether any such claims exist, but none appear to have been provided.)

B. Analysis of City's Review of Transaction

Separate from whether the City compiled the standard due diligence documents and/or conducted the all prudent investigations, the history of the transaction gives rise to other concerns regarding the City's overall structure and review of the transaction, particularly in light of Cisterra's role as a mere "middleman."

First, there is the question of why the City chose a lease-to-own option over the purchase option, which would have saved the City at least \$17 million. The reasons provided by City staff are (i) that the original owner, Mr. Shapery, refused to sell the Property to the City at a reasonable price that approximated its actual value, apparently believing it was worth more to the City than to private parties such as Cisterra, (ii) that the City would be unable to secure bond financing for its purchase of the Property in time to close under Cisterra's required timetable, and (iii) that Cisterra's purchase agreement from Mr. Shapery could be interpreted as prohibiting an assignment of Cisterra's purchase rights (a conclusion that is supported by an analysis conducted by the City Attorney's Office).

As noted above, these explanations appear reasonable on their face, and it is not within the purview of this memorandum to analyze them. That said, there are at least some questions raised by these explanations that are not answered by the known

DRAFT MEMO

June 17, 2020

Page 19

facts.¹⁵ First, based on the terms of the Cisterra Purchase Agreement (see Section 4.6 thereof), it is clear that Mr. Shapery knew that, in selling the Property to Cisterra, Cisterra was seeking to turn around and sell or lease the Property to the City. Thus, he should have had an equal incentive to sell at an unreasonably high price to Cisterra.

Second, the bond-financing problem was merely a timing one, and the City did not appear to be under any particular time constraints that would have prohibited it from simply waiting until it could obtain bond financing before closing on the deal. On the contrary, the "early 2017" time constraint appears to have been imposed by Cisterra, based on its deal with the Shapery entities.¹⁶ However, that timing concern should not have tied the City's hands.

Third, on the issue of whether the Cisterra Purchase Agreement disallowed an assignment, while it is understandable that the City did not want to risk legal action challenging any assignment, it is unclear why the City did not push Cisterra more on this issue. Cisterra was clearly contemplating a potential assignment to the City when it entered into its purchase agreement with the Shapery entities, meaning it should not have agreed to language that was ambiguous in that respect. Moreover, after it entered into that agreement, it signed the "non-binding agreement" with the City representing that it **"is able and willing to assign its rights under the [purchase agreement] to the City."** If the Cisterra Purchase Agreement disallowed an assignment, this was, in

¹⁵ One question is whether Ms. Thompson, Deputy COO Ron Villa, COO Scott Chadwick, and a member of the City Council misrepresented the transaction to the public and other members of the City Council. According to an email from Mr. Villa on September 1, 2016, there was a belief that "we will not be able to achieve approval for a purchase at the \$72m price" and "the fact remains that the general public and policy makers may not be able to get behind paying more for the building than the 'appraised value.'" Apparently on September 16, before the revised transaction was scheduled to be presented to a City Council Committee, Ms. Thompson and Mr. Villa met with Council President Todd Gloria and two of his staff members for an "update" on the transaction; Mr. Gloria had previously been skeptical about the lease-to-own structure when it was used for a prior acquisition, but was supportive of the 101 Ash transaction when it came to the Committee and made the Council motion to approve the Lease Agreement. The discussions during the update could be informative about why the City went forward with the transaction despite the unfavorable language in the Lease Agreement, the due diligence materials available to the City, and the substantially higher cost of the lease-to-own structure. However, we were unable to obtain the City Attorney's approval to interview Mr. Gloria or his staff (all of whom are no longer in the employ of the City).

¹⁶ According to Ms. Thompson, for Cisterra to secure the Property, it had to have a proposed tenant in place at the time it closed. Thus, based on the timing of Cisterra's purchase at the end of 2016, the City did not have sufficient time to secure bond financing for its own immediate purchase.

effect, an affirmative misrepresentation on which the City could have potentially pushed Cisterra for a solution.¹⁷

Overall, these facts give rise to the potential that Cisterra received a better deal from the City than the City could have otherwise negotiated. Indeed, despite the potential for a purchase of the Property directly from the former owners, and the lack of necessity of Cisterra's involvement in the transaction, the end result was that the City leased-to-own the Property from Cisterra, and that Cisterra made a substantial profit merely by acting as a conduit. Moreover, it did so only after Cisterra agreed to purchase terms from the former owners that **precluded** the City from acquiring Cisterra's purchase rights, despite Cisterra's express representations that it could assign them.

This impression is further underscored by the "due diligence" documents obtained and reviewed by the City for the transaction itself. As noted above, all of the contemporaneous (*i.e.*, 2016) reports in the City's files were commissioned by Cisterra, presumably as part of its own due diligence to purchase the Property from the prior owner. In contrast, the City appeared to commission none of its own reports, and instead relied exclusively on those of Cisterra, which could have been deficient—and, in fact, were deficient, at least in its failure to review the Property for asbestos.

Although it is customary for a purchaser to rely on reports provided by the seller, a contract containing strong exculpatory provisions against the seller's nondisclosures (such as the Lease Agreement here) counsels towards the purchaser commissioning its own reports for confirmation, for the exculpatory provisions in the contract have the potential effect of rendering the seller's representations of little to no value. **Thus, under best practices, the City should likely have commissioned its own reports here, rather than relying exclusively on the reports commissioned by Cisterra.**

¹⁷ Although not clear-cut, the City has an argument that the "non-binding agreement" is not, in fact, non-binding, at least with respect to enforcing this representation. Although the agreement states it is non-binding, it contains mutual covenants and promises that appear to be supported by consideration. According to the agreement, it was entered into because, at the time, Cisterra was on the eve of making a non-refundable deposit to the prior owner, as a result of which Cisterra desired to bind the City to pursuing certain options for acquiring the Property. Two of those options were to either acquire Cisterra's purchase rights or lease-to-own, as discussed above. However, a third option was a "walkaway," under which, if the City chose not to acquire the Property, **it would be required to compensate Cisterra for the expenses it incurred in pursuing the Property, including the non-refundable deposit.** In light of such terms, a binding contract may have been formed. Moreover, even absent a binding contract, the non-binding agreement could nevertheless be deemed to contain binding representations of fact on which the City relied in moving forward with the Lease Agreement.

Moreover, this exclusive reliance on Cisterra, and the use of Cisterra as a "middleman" to obtain the Property from the prior owner, creates an additional problem, in that it acts as a potential liability shield for both Cisterra and the prior owner, for which Cisterra acts as an effective "buffer." For instance, if Cisterra claimed that it was ignorant of the presence of asbestos on the Property (which would likely shield Cisterra from liability for nondisclosure), there would be little the City could do to disprove that ignorance, because Cisterra never occupied the Property and may have paid little attention to the due diligence documents given its plan to simply transfer the Property "as is" to the City. Indeed, **Cisterra's limited role as a temporary transferee, together with the strong exculpatory provisions in the Lease Agreement, would have specifically dis-incentivized Cisterra from conducting a proper due diligence**, so it could remain "deliberately ignorant" of the Property's condition.

In contrast, had the City purchased the Property directly from the prior owner, the City could have known, based on the prior owner's long ownership history, that the City could obtain a full and complete picture of the Property's condition. Moreover, the City could file a lawsuit against that prior owner if any of the disclosures were inadequate or the Property was otherwise defective. In contrast, with Cisterra as a "buffer," the City has no option to seek any information or remedies from the former owner.

C. Propriety of Deal Terms

Finally, the City has asked this office to opine on whether the terms of the Lease Agreement between the City and Cisterra were consistent with what is customarily seen in real-estate transactions of this nature. The answer to that question is not straightforward, in that there is no "one size fits all" for the terms of real-estate deals, including those involving public agencies. The terms of such deals can vary widely, depending on variables such as market conditions, the parties' relative bargaining strengths, the urgency of each side's need to buy or sell, and other factors. Thus, whether deal terms are appropriate in a given instance are very much based on the facts and circumstances of that case.

Here, it is this office's opinion that the terms of the Lease Agreement were, in fact, disproportionately unfavorable to the City, on the specific issue of the exculpatory provisions in favor of Cisterra. Although such strong exculpatory provisions can be appropriate under the right circumstances, such as when the buyer has conducted a thorough review of the property as part of its due diligence, and/or is not concerned about the condition of any structures (for instance, because it plans to demolish and replace them), here such provisions were not appropriate specifically because of the

low level of independent due diligence conducted by the City, and the City's exclusive reliance on the reports and representations provided by Cisterra.

As noted above, the City did not commission any of its own reports, and likewise did not follow up on any of the information in the reports provided by Cisterra and/or Sempra, such as by conducting additional environmental review to determine the degree of asbestos on the Property. Meanwhile, although the reports provided by Cisterra put the City on notice that there was at least some asbestos on the Property, they did not provide a complete picture of that issue, which could only be obtained through further investigation. Under these circumstances, it was particularly dangerous for the City to release Cisterra from liability for any of its representations (which is what the Lease Agreement does on its face) and/or to accept the Property "as is."

As an alternative to what occurred here, this office would have recommended that either (1) the City conduct the additional due diligence investigation suggested in this report, or (2) require specific disclosures and representations on important issues (such as the Property's condition) from Cisterra, and make those representations a binding part of the contract.

D. Summary of Failures to Follow Best Practices for Due Diligence

As a summary of the above, this office has determined, based on the documents provided to us for review and this office's discussions with Cybele Thompson, that the City did not follow best practices in regard to the due diligence performed for the Lease Agreement transaction, in the following respects:

1. The City does not appear to have followed up on the available information concerning the presence of asbestos on the Property with a more detailed evaluation of that issue, such as a Phase II Environmental Assessment or similar evaluation of the full extent of that hazardous material.
2. As an example of the preceding point, it appears that the City did not follow the recommendation of at least one report in its possession regarding asbestos, which specifically recommended a "thorough asbestos survey" prior to any "demolition or renovation activities."

The report in question is the Phase I Environmental Site Assessment, dated November 26, 2014, commissioned in relation to a 2014 mortgage loan on the Property. Although it is unclear who provided this report to the

City, the City's "Due Diligence Docs" notes show that it was likely in the City's possession as of July 19, 2016. The report stated that, "[I]n the event that building renovation or demolition activities are planned, a thorough asbestos survey is required . . . prior to demolition or renovation activities that may disturb ACMs [asbestos-containing materials]." (Pages iii-iv, and 30-31 [emphasis added].)

The Staff Report and the IBA Report indicate that the City planned to make tenant improvements to the Property after acquisition—in fact, that these improvements would be paid for in part by Cisterra. (Staff Report, pp. 1, 4; IBA Report, p. 3.) Thus, the City came directly within the recommendation of the 2014 Phase I assessment, and the City should therefore have conducted the detailed asbestos survey that it suggested. The City did not do so, and, in our understanding, it was in the course of the City's remodel work that the condition and extent of the asbestos was discovered.

3. The City did not commission its own property-condition reports and environmental assessments, and instead relied exclusively on Cisterra's due diligence documents and reports, despite the strong exculpatory provisions in the Lease Agreement (including the release, the "as is" clause, and the provisions placing on the City responsibility for determining the extent of Hazardous Materials on the Property) and Cisterra's role in the transaction as a mere "middleman," which disincentivized Cisterra from conducting a thorough due diligence review.
4. As an alternative to conducting its own more thorough investigations as set forth above, the City failed to require specific disclosures and representations on important issues (such as the Property's condition) from Cisterra, and to make those representations a binding part of the contract, on which the City could take legal action if necessary.

IV.

LEGAL EFFECT OF EXCULPATORY PROVISIONS

As noted above, the Lease Agreement contains a number of exculpatory provisions, including an "as is" clause (*i.e.*, a clause stating that the Property is being

sold "as is," without any warranties or representations from Cisterra)¹⁸, a release and waiver of claims against Cisterra relating to the condition of the Property¹⁹, and specific disclaimers regarding "Hazardous Materials"²⁰ (which is defined to include asbestos) and the City's responsibility for determining the presence of such materials on the Property. In the event the City were to contemplate legal action against Cisterra

¹⁸ The "as is" clause is contained in Section 1(b), which states:

TENANT EXPRESSLY AGREES TO LEASE THE PREMISES AND EACH PART THEREOF "AS IS" AND "WHERE IS". LANDLORD SHALL NOT BE DEEMED TO HAVE MADE AS OF THE EFFECTIVE DATE, AND LANDLORD HEREBY DISCLAIMS, ANY WARRANTY OR REPRESENTATION, EXPRESS OR IMPLIED OR OTHERWISE, WITH RESPECT TO THE SAME OR THE LOCATION, USE, DESCRIPTION, DESIGN, MERCHANTABILITY, FITNESS FOR USE FOR ANY PARTICULAR PURPOSES, CONDITION OR DURABILITY THEREOF, OR AS TO THE QUALITY OF THE MATERIAL OR WORKMANSHIP THEREIN, OR AS TO LANDLORD'S TITLE THERETO OR OWNERSHIP THEREOF OR OTHERWISE, IT BEING AGREED THAT ALL RISKS INCIDENT THERETO, EXCEPT AS OTHERWISE SET FORTH HEREIN, ARE TO BE BORNE BY TENANT. IN THE EVENT OF ANY DEFECT OR DEFICIENCY OF ANY NATURE IN THE PREMISES OR ANY PROPERTY OR FIXTURE OR OTHER ITEM CONSTITUTING A PORTION THEREOF, WHETHER PATENT OR LATENT, EXCEPT AS OTHERWISE STATED HEREIN, LANDLORD SHALL HAVE NO RESPONSIBILITY OR LIABILITY WITH RESPECT THERETO. THE PROVISIONS OF THIS SECTION 1(b) HAVE BEEN NEGOTIATED AND ARE INTENDED TO BE A COMPLETE EXCLUSION AND NEGATION OF ANY WARRANTIES BY LANDLORD, EXPRESS OR IMPLIED, WITH RESPECT TO THE PREMISES OR ANY PROPERTY OR FIXTURE OR OTHER ITEM CONSTITUTING A PORTION THEREOF, WHETHER ARISING PURSUANT TO THE UNIFORM COMMERCIAL CODE OR ANOTHER LAW NOW OR HEREAFTER IN EFFECT OR OTHERWISE.

¹⁹ The release in Section 1(c) states:

As of the Commencement Date, the Tenant, and its agents, members, partners, employees, representatives, officers, directors, agents, related and affiliated entities, successors and assigns (collectively, the "Tenant Parties"), hereby **fully and irrevocably release Landlord and each person or entity acting by or on behalf of Landlord, and any member, partner, officer, director, employee, agent, affiliate, successor or assign of Landlord** (collectively, the "Landlord Parties") . . . for any cost, loss, liability, damage, expense, demand, action or cause of action ("Claims") arising from or related to any matter of any nature **relating to, and condition of, the Premises, including any latent or patent construction defects, errors or omissions, compliance with law matters, Hazardous Materials and other environmental matters within, under or upon, or in the vicinity of the Premises**, (Emphasis added.)

²⁰ Section 1(a) states:

The Premises are leased to Tenant in their present condition without representation or warranty by Landlord and subject to the rights of parties in possession, to the existing state of title and to all applicable legal requirements now or hereafter in effect. **Tenant acknowledges that it is sufficiently familiar with and knowledgeable about the physical condition of the Premises, including any elements of deferred maintenance or the presence of any Hazardous Materials and is not relying on any representation or warranty by Landlord with regard to the condition of the Premises, and Tenant finds all of the same satisfactory for all purposes.** (Emphasis added.)

regarding the adequacy of the disclosures made by it prior to the Lease Agreement (e.g., the adequacy of its disclosures regarding the nature or extent of asbestos on the Property), these exculpatory provisions would likely preclude such action given their strong terms.

With respect to the “as is” clause, its protections would only extend so far. Despite such a provision, Cisterra had a common-law obligation to disclose any facts within its knowledge that materially affected the value or desirability of the property to the City, if Cisterra was aware that those facts were not known to the City or within reach of the City’s “diligent attention and observation.” (*Lingsch v. Savage* (1963) 213 Cal.App.2d 729, 735; *Stevenson v. Baum* (1998) 65 Cal.App.4th 159, 165.)

Under this rule, an as-is provision will only immunize a seller (here, Cisterra) from defects to real property that are visible to or observable by the buyer (here, the City). (*Lingsch, supra*, (1963) 213 Cal.App.2d at p. 742.) In contrast, however, an as-is provision does not immunize a seller who, **through fraud or misrepresentation**, intentionally conceals material defects not otherwise visible or observable to the buyer. (*Shapiro v. Hu* (1986) 188 Cal.App.3d 324, 333-334.) Similarly, “where the seller knows of facts materially affecting the value or desirability of the property which are known or accessible **only to him** and also knows that such facts are not known to, or within the reach of the diligent attention and observation of the buyer, the seller is under a duty to disclose them to the buyer.” (*Lingsch, supra*, (1963) 213 Cal.App.2d at p. 735 [emphasis added].)

Granted, this office has been given no evidence that Cisterra failed to provide any known information to the City regarding the Property or its condition, such as on the issue of the nature and extent of the asbestos on the Property. On the contrary, Cisterra appears to have provided to the City all of the documents it received from the prior owners on that issue. Thus, at least under the facts as currently known to this office, it appears that the City would not be able to make use of the above “exceptions” to the “as is” clause.

Similar rules apply to the release, under which the City purported to waive any claims against Cisterra that relate in any manner to the condition of the Property. “As a general rule, a release, indemnity, or other exculpatory provision is binding on the parties and enforceable as long as it is clear, explicit, and comprehensible in the essential details.” (Contractual provision against fraud liability—Exculpatory clauses generally, 1 Cal. Real Est. § 1:172 (4th ed.).)

Again, however, the City would have an argument that this release could **not** be enforced as against a claim of **fraud or nondisclosure** relating to the Lease Agreement. Under California law, "[a]ll contracts which have for their objective, directly or indirectly, to except anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law." (Civ. Code § 1668.) In this regard, Civil Code section 1668 "negates a contractual clause exempting a party from responsibility for fraud or a statutory violation only when all or some of the elements of the tort are **concurrent** or future events at the time the contract is signed." (*SI 59 LLC v. Variel Warner Ventures, LLC* (2018) 29 Cal.App.5th 146, 148 [emphasis added].)

Thus, Cisterra could not rely upon the release to shield it from fraudulent statements or negligent nondisclosures that it made to induce the City to enter into the Lease Agreement itself. (Contractual provision against fraud liability—Exculpatory clauses generally, 1 Cal. Real Est. § 1:172 (4th ed.).) However, noted above, this office has been given no evidence to support such a claim of misrepresentations or nondisclosures by Cisterra in relation to this transaction.

* * *

Should the City have any follow-up questions concerning the foregoing, please do not hesitate to contact us.