Reducing Development Agreement Risks in Municipal Bankruptcies

As part of a bankruptcy, a city can assume or reject "executory contracts" — contracts under which material performance obligations remain such that a breach by a party would entitle the other party to terminate. However, if an executory contract, such as a Development Agreement, is rejected by a city, the developer has no ability to enforce its terms and conditions. Instead, the developer has a breach of contract claim against the city, which then becomes a part of the bankruptcy, meaning that the developer is usually able to recover a fraction of the investment.

Similarly, if the Development Agreement is non-executory, meaning the city has no remaining material obligations to perform, a developer's damages for a breach of such an agreement by the city, again, gives rise to a similar limited claim.

Whether the Development Agreement is executory or non-executory, the bankruptcy of a city will likely require the developer to renegotiate its Development Agreement to continue its project. The resulting renegotiated Development Agreement will almost certainly be more costly and onerous to the developer and the completion date of the project. **In the bankruptcy context, the developer can press the city to seek the court's approval of the Development Agreement in a renegotiated form.** Once a Development Agreement is assumed, any subsequent breach of it by the city should give rise to administrative claim expenses within the bankruptcy. Under these circumstances, the developer could recover its actual damages for the city's breach, as opposed to being able to recover only pennies on the dollar.

The benefits to a developer stemming from a court-approved Development Agreement are obvious: there is more certainty in terms of time and money.

Cities facing bankruptcy must generate additional revenue so it is prudent for developers to keep a low profile. The developer and the project may risk being seen as a prime target for generating additional revenue, which could be in the form of expedited fees. **Instead, developers should play a limited, behind-the-scenes role that impresses upon the city that the project is critical to the financial survival of the community.**

Although the prospect of city bankruptcies is increasing, developers can mitigate the impact of such bankruptcies. Indeed, strained local budgets may even offer opportunities for developers to invest. Cities in financial crisis often own undeveloped properties that can be sold to developers to increase revenues and to stave off bankruptcy.

Although Farella Braun + Martel is unaware of any renegotiated Development Agreements, the coastal city of Half Moon Bay, CA threatened bankruptcy to avoid having to pay a 2008 $36.8 million judgment against it to a developer for a regulatory taking. This occurred after the city essentially reneged on approval of a development and then prevented the development from taking place. In the shadow of a bankruptcy threat, Half Moon Bay worked out a settlement, *after* the developer obtained the judgment, and avoided bankruptcy by buying the disputed property for $18 million by issuing tax-exempt bonds. ■

By **B. Scott Douglass**, **Dean Gloster**, attorneys and partners at Farella Braun + Martel, and **Gary Kaplan**, attorney and special counsel at Farella Braun + Martel.

B. Scott Douglass