STATE OF NEW YORK
SUPREME COURT NEW YORK COUNTY

DEVELOP DON'T DESTROY (BROOKLYN), INC., et al.,

Petitioners,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules,

- against -

EMPIRE STATE DEVELOPMENT CORPORATION, FOREST CITY RATNER COMPANIES, LLC,

Respondents.

Index No. 114631/09
IAS Part 57

Justice Marcy S. Friedman

PETITIONERS' REPLY MEMORANDUM OF LAW

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PRELIMINARY STATEMENT

The fundamental issue in this case is whether ESDC properly considered the new agreement between the Metropolitan Transportation Authority (MTA) and FCRC which specifically extends the scheduled acquisition of the Vanderbilt Yards, the heart of the Atlantic Yards Project, into 2030. Both ESDC and FCRC essentially admit that the ESDC Board was not aware of the new agreement. ESDC and FCRC try to confuse the issue by claiming that the term sheet is being misconstrued. However, they cannot overcome the fact that the MTA term sheet was never fully disclosed to the ESDC Board and thus the ESDC Board never had an opportunity to make a rational basis on the actual timing or likelihood of completion of the Project.

By disguising that single salient fact, the entire decision-making of the ESDC Board became fatally flawed as it had no rational basis to assume that the Project would be completed by 2019, that it was financially viable as a plan to alleviate blight and that the blight would not continue unabated for decades. By not referencing the clearly anticipated date for project completion, ESDC accepted a Technical Memorandum under SEQRA that utilized an arbitrary date and resulted in an environmental review premised on a knowingly improper timeline.

ESDC could have approved a project with an uncertain completion if it had undertaken an honest appraisal. Instead, whereas it had approved a single major project in 2006 that touted numerous benefits, in 2009, while pretending to be approving essentially the same project, it engaged in a classic bait and switch and approved a project which had so fundamentally changed its underlying financial assumptions that there was no reasonable basis to conclude that it would be completed anywhere near its claimed completion date of 2019.

ARGUMENT

POINT I

ESDC'S DENIAL OF THE MATERIALITY OF THE CHANGED MTA TERMS DOES NOT HIDE THE FACT THAT ESDC CONSCIOUSLY DETERMINED TO IGNORE THE ACTUAL TIMEFRAME FOR COMPLETION OF THE PROJECT

Throughout Respondents' papers there is a continuous theme that amounts to a claim that the ESDC Board was aware of the new MTA – FCRC deal and that the new deal would not have an impact on the schedule of completion of the project. Once it reaches that conclusion, ESDC argues that it does not change any of the analysis under the UDCA or SEQRA. It also reaches the unusual conclusion that contrary to all of its findings and determinations both in 2006 and 2009, it was not obligated under the UDCA to assure that there was a plan to eliminate blight.

A. ESDC Board was not informed about the terms of the MTA – FCRC agreement.

Despite Respondents' attempts at obfuscation, the record produced makes it abundantly clear that the ESDC Board was not informed of the material elements of the MTA deal and was not told that the project would likely take decades longer than was represented.

Petitioners alleged that at the June 23, 2009 ESDC Board meeting the directors were not fully informed about the terms of the MTA deal and that payment for the MTA rights could be extended to 2030. (Petition ¶ 30). ESDC denied that allegation (ESDC Answer ¶ 30,) and alleged that the staff memo summarized the terms of the MTA deal (ESDC Aff. Statement ¶ 26; ESDC Memorandum of Law "MOL" p. 22 footnote 5)[1]. However, ESDC's denials are simply not true.

ESDC points to the June 23rd memo from Marisa Lago as summarizing the terms of the MTA deal. However, that memo simply states that the prior agreement was for the full payment

[1] ESDC submitted a Verified Answer which included an Affirmative Statement of Facts and an Answer. Citations to the Affirmative Statement are identified as "Aff. Statement" and to the Answer as "Answer".

of $100 million and that it had been changed to $20 million for the Arena Block and that the balance of the $100 million would be paid in installments with interest. (AR 4678). There is nothing in that memo which informs in the Board that the payments would extend into 2030.

ESDC attempts to mislead the Court to believe that the Board had the MTA term sheet at its disposal at the June meeting by including it in the certified record (AR 4670). However, a careful reading of the Answer verified by Rachel Schatz, makes it clear that the term sheet was not provided to the ESDC Board as there is no allegation that it was provided to the Board. (ESDC Aff. Statement ¶ 26). ESDC also claims that the September 17, 2009 memo from Dennis Mullen to the Board contains details of the MTA agreement. (ESDC MOL p. 22). Again the cited reference simply states that there was a modified agreement between MTA and FCRC regarding the commitments for the rail yard and a phased acquisition of the MTA rights. (AR 7022). There is absolutely no mention in that document about the time frame for the acquisition.

What is strikingly absent from ESDC's papers is any affidavit from any ESDC Director or any staff person clearly stating that the Board was made fully aware of the terms of the MTA deal. Even FCRC in its responding papers makes no allegation that the ESDC Board was fully informed of the terms. At best, the Board was told there was an initial payment of $20 million and installment payments totaling $100 million with interest. They were not told that the acquisition would extend more than a decade longer than the proposed project completion date.

B. Respondents' claims that the MTA terms are only outside limits is farcical.

Respondents argue variously that Petitioners are misconstruing the terms of the MTA agreement and that FCRC will be bound to take commercially reasonable efforts to complete the project by 2019. (ESDC MOL p. 22). Alternatively, Respondents argue that there is nothing

which bars FCRC from acquiring the parcels before 2030 (ESDC MOL p. 19) and that FCRC expects and intends to purchase all of the parcels by 2019 (FCRC MOL p. 14).

Respondents' arguments miss the essential element of Petitioners' causes of action. The ESDC Board was not aware of those provisions when it made its decisions to approve the MGPP and to not require a Supplemental Environmental Impact Statement ("SEIS"). The Board was not informed of the specific terms that did not require FCRC to fully acquire the parcels until 2030. The Board was not informed of the schedule of payments and the fact that significant payments on the MTA parcel would not begin until 2016.

The simple fact is that all of the rationalizing proffered by ESDC and FCRC in its papers finds absolutely no support in the record. There is not a single reference of any discussion even remotely similar to the arguments set forth in Respondents' papers. There is no reference to the likelihood of acquisition at any particular time and there is certainly no discussion of what would occur if the acquisition was delayed or the project abandoned. The rationale offered by Respondents is completely outside of and unsupported by the record and must be disregarded.

Besides the *post hoc* nature of the rationalization, it also makes no sense. While it is true that there is no legal bar to FCRC accelerating its payments for the properties, there is no rational expectation that it will. ESDC cannot seriously contend that it was rational for it to hold to the 2019 completion date simply because it was *possible* that FCRC would not utilize the full benefit of its negotiated installment purchase plan? To condone such an analysis would be to permit the height of irrational exuberance regarding the review of the project. If ESDC had actually disclosed and discussed the terms of the MTA agreement and discussed the possibilities and consequences of a 2030 or later completion date compared to the 2019 date, there might be grounds for the Court to defer to a rational decision to choose the earlier date as the basis for the

findings. However, there was absolutely no analysis and the head-in-the-sand attitude to ignore the material terms of the MTA agreement cannot qualify as a rational determination.

It is admitted that the MGPP was modified to move from a single phase acquisition of the properties to a multi-phase acquisition and that FCRC renegotiated its agreement with MTA due to changes in market conditions and its inability to purchase and finance the full acquisition on the original schedule. This inevitably resulted in a significant extension of the time to complete the project. It was irrational to claim the delay was only for three years and that was due largely litigation. If that was the case there would be no need to phase the acquisitions or extend the payments.

C. There is no basis for ESDC to argue that there are sufficient incentives for FCRC to complete Phase II or to do so by 2019

ESDC in particular claims that FCRC has made significant investments to date in the project which would counterbalance any delay or decision to abandon the project thus justifying the blind reliance upon on the 2019 completion date. Again ESDC's argument is inconsistent with the record.

First, the argument regarding investments to date and the financial commitment of FCRC to the project were not considered by ESDC and not developed in the record and thus cannot be the basis for the a *post hoc* rationalization. Moreover, while various commenters raised the question of FCRC's financial viability and its ability to complete the project and questioned if ESDC had any contingency plans, ESDC summarily dismissed the comments by stating that "it is currently contemplated that the Project would be implemented by ESDC with FCRC as the developer, in accordance with the MGPP". (AR 7038)

FCRC and ESDC claim that FCRC has spent $277 million for acquisition and $83 million in demolition costs, relocation of utilities and construction of the temporary rail yard.

(FCRC MOL p. 14). That investment is intended to demonstrate FCRC's commitment to the Project and its incentive to proceed rapidly to completion so as to recoup a return on its investment.

However, Respondents do not explain and the record is silent on any explanation of an allocation of those expenses. What were they spent on and how much is attributable to Phase I versus Phase II? How much of that money is part of the disbursement of the $200 million provided by the State and the City?

Furthermore, Respondents do not address the fundamental changes in the both the MGPP and the MTA agreement that change the character of FCRC's commitment to complete the project by 2019 or at all. Respondents do not deny that the initial installments of $2 million provide a prime opportunity for FCRC to walk away from the project. Instead, it is argued that the $86 million letter of credit to guarantee completion of the Upgraded Rail yard is a demonstration of the commitment to the project. In fact it is the opposite. In the original MTA agreement there was no requirement for the letter of credit, nor was it included in the 2006 MGPP. (AR 3644). Instead FCRC was always required to complete the upgraded yard before it could construct the platform for Phase II. MTA obviously felt its interests were protected because it was being paid the full $100 million acquisition price up front and it was coupled with the requirement to complete the rail yard before construction could begin on the platform. In 2009, MTA obviously realized that FCRC could decide not to complete the transaction on Phase II and thus needed additional financial guarantees for completion of the yard, hence the letter of credit. That is also why the reference to the letter of credit and completion of the upgraded yard as well as the Carlton Avenue Bridge was added to the 2009 MGPP (AR 4697).

The phasing of the acquisition also diminished the exposure of FCRC to increased expenses for Phase II. Originally all properties were to be acquired at FCRC's expense upon initiation of the project. The MGPP breaks the acquisition into two phases and allows FCRC to delay the acquisition of parcels located in Phase II until it is ready to proceed. That is not a minor financial change. As of the September 17, 2009, FCRC had still not acquired many of the parcels for Phase II, including Block 1120, Lots 19 and 28; Block 1121, Lot 42; Block 1128, Lots 4, 87, 88 and 89; and Block 1129 Lots 4,5,6, 13, 21 39, 44 and 76 (AR 7074). Some of those lots include substantial buildings with ongoing businesses that will cost significant sums to acquire and two in particular, lots 19 and 28 on Block 1120 have particularly potentially expensive buildings and businesses (AR 3843-3847). By avoiding the acquisition of all of the properties for Phase II and not committing to the acquisition of the MTA property on Blocks 1120 and 1121, FCRC significantly reduced its exposure to the project and implemented a clear exit strategy by which it could minimize its losses.

D. ESDC did not update its financial analysis and did not consider the Kahr Report.

ESDC claims that despite its decision to ignore the terms of the MTA agreement, it rationally relied upon updated financial analysis provided by KPMG to determine that it was reasonable to expect that the project would be completed by 2019. Again, ESDC misstates the fundamental facts and the record does not support its arguments.

First, ESDC admits that the 2009 KPMG report does not make any mention of the new MTA agreement. (ESDC Answer ¶ 110). Nevertheless, ESDC argues that KPMG updated its 2006 financial analysis and that in 2009 it determined that the project was financially viable. That is simply not true.

In 2006 KPMG did conduct a financial viability analysis and while it found that FCRC's projections on a rate of return were overly optimistic it did conclude that the project was financially viable. However, ESDC has not included the 2006 report as part of the certified record. A copy of the 2006 KPMG report is attached as Exhibit A to the Supplemental Affirmation of Jeffrey S. Baker. The Court can easily compare that report with the 2009 KPMG Report (AR 7075) and recognize just by the introduction that the reports considered different issues. The 2009 report simply looked at the potential market absorption of residential uses and did not consider the financial feasibility of the project at all. Thus the statements in ESDC's papers and the representation to the Board (AR 7025) regarding an updated financial analysis is clearly false.

ESDC also never accurately summarized or responded to the August 2009 report from Joshua Kahr. ESDC claims it did consider and respond to the Kahr report at AR 7036, Comment 10. However that response is nothing more than a summary of the 2009 KPMG report and as noted in Petitioners' initial Memorandum of Law, there is no reference at all in the KPMG report to the Kahr report or that KPMG was even aware of the Kahr report. The response to Comment 10 is little more than a restatement that there will likely to be a demand for the project without considering the availability of financing or the overall financial viability of the project all of which are integral factors in determining whether and when the project can be completed.

While ESDC never bothered to respond or consider the August Kahr report, its Answer does provide a partial purported rebuttal to the Mr. Kahr's October 2009 Affidavit submitted in this proceeding. Curiously, however, ESDC's objections to the Kahr Affidavit are included in its Answer which is verified by its in-house counsel. There is no challenge to the Kahr Affidavit from KPMG or anyone with any actual expertise to evaluate and criticize the affidavit. Instead,

ESDC attempts to denigrate Mr. Kahr as a single individual without adequate experience compared to the supposed massive expertise of KPMG. However, ESDC ignores Mr. Kahr's extensive resume and in contrast provides no information on the individuals at KPMG who prepared its study. Moreover, ESDC cannot get past the fact that KPMG did not undertake any analysis of the actual economic feasibility of the project, that it could be constructed in a timely and cost-effective manner to compete in the marketplace and that KPMG was unaware of the new MTA terms which should have been a material element of its analysis.

POINT II

BY FAILING TO EVEN CONSIDER THE POTENTIAL OF THE DELAY OR ABANDONEMENT OF PHASE II, ESDC VIOLATED THE UDCA AND SEQRA

ESDC argues that the requirement of the UDCA (McK. Uncons. Law of NY, §6260(c)(2)) that for a Land Use Improvement Project, ESDC must make a finding that it includes a plan for the rehabilitation of a blighted area is generally aspirational and does not require a guarantee of when the project will be completed. Thus it is argued, the fact that the project may be significantly delayed or not completed does not result in a violation of §6260(c)(2) and the ESDC could still have a valid plan but simply seek another developer to complete the plan. Similarly it is argued that a long-term delay in the project and the intervening impacts from extended construction, surface parking lots and permanent blight do not require additional reviews under SEQRA.

ESDC's arguments might be valid if it actually had undertaken any of that analysis or designed and approved a project that consisted of a general plan for redevelopment. Instead, in contrast to the 42nd Street Redevelopment Project which was a multi-developer long term plan

for the revitalization of an area, the Atlantic Yards Project is a single-developer project that was not considered as long-term redevelopment strategy but as a short-term project.

As noted above, commenters questioned the alternative scenarios that ESDC contemplated if FCRC was unable to complete the project and ESDC summarily dismissed the comments by stating that it is working with FCRC. (AR 7038).

Petitioners are not claiming that the UDCA requires that a general project plan be completed in a set period of time nor is it claimed that the UDCA identify who the developer must be. But in this case, ESDC did choose the developer, before it even began drafting the GPP, it based all of its determinations regarding the existence of blight and the need for the project to alleviate blight on the assumption that the market would not alleviate blight on its plan in accordance with FCRC.

In 2006, while Petitioners believed that ESDC's projections for completion of the project in 10-years was unrealistic, there were not any clear contractual documents which indicated that the project would take considerably longer. In 2006, FCRC was committed to paying full value for the MTA property and committed to acquiring all of the properties in the project footprint, providing a clear and compelling incentive to complete the project in a timely fashion, as unrealistic as the 10-year time frame might have been.

By 2009, those fundamental elements had changed. In 2009, FCRC was contractually permitted to extend acquisition of the MTA property to at least 2030 and could postpone acquisition of the balance of the properties indefinitely. It could abandon the project or significantly delay it without any penalty.

In and of itself, there is no violation of the UDCA if ESDC had considered the prospects of delay or abandonment when it made its findings for the Land Use Improvement Project. If

ESDC had considered whether it had a viable plan for the elimination of blight for a project extending decades, that may have been a rational decision. But it did not do that. And as demonstrated, the prospects of delays significantly beyond 2019 were not unknown or even speculative – they were concrete written into the fundamental agreement with its sister agency the MTA. Instead, ESDC chose to ignore those facts and blithely determined that it had a plan for the alleviation of blight when it fact it did not.

And the consequences of the delay were well known and set forth in ESDC's own record and the basis of its initial determination that the area was blighted. ESDC had already determined that all of Blocks 1120 and 1121 as part of ATURA were blighted and the Vanderbilt Yards as a below-grade yard had a blighting influence. Yet the prospect existed for that condition to extend for decades.

ESDC had previously determined that parking lots on Blocks 1129 and 1128 were blighted because they constituted underutilized parcels. (AR. 3794, 3965-69, 3983-3985, 3989-91). Specifically, ESDC determined that Block 1129, lots 5 and 6 were blighted although they constituted a well-maintained parking lot (AR 3989-91). [2]

These are examples of the material changed circumstances that should have been considered if ESDC's Board knew about the new MTA deal and if it had rationally evaluated the potential consequences.

ESDC claims that there never are any guarantees in an MGPP and if Petitioners felt that such guarantees are required by the UDCA that claim should have been brought on the challenge to the 2006 MGPP and thus the claim is barred by res judicata. That is not true. There has been,

[2] The lot-by-lot assessments in the Blight Study do not provide a qualitative analysis of why a specific lot is deemed blighted. One must review the lot-by-lot description and then find that lot on the general map identifying all of the blighted parcels (AR 3794) to determine if a lot is deemed blighted. Thus it appears that the only reason for the blight designation on Block 1129, Lots 5 & 6 is their alleged underutilization.

as shown above, a material change in circumstances. The terms of FCRC's agreement with the MTA and the phasing of the project and acquisition of the properties have fundamentally changed. The clear failure to consider those circumstances and the likelihood that instead of alleviating blighting conditions, the conditions would be perpetuated was not an issue in 2006.

As demonstrated throughout ESDC's findings under both the UDCA and SEQRA and repeated in Respondents' papers, the benefits of this project have been touted as an integrated whole consisting of the arena, over 6,000 units of housing, at least 2,250 units of affordable housing and 8 acres of open space. In 2006 there was a reasonable expectation that the entire project would be developed. By 2009 the project had so significantly changed that the two phases should have been considered as separate projects and evaluated as to whether the goals and findings of a Land Use Improvement Project were met.

Similarly, by failing to consider the clear evidence of the delay and uncertainty in the project, ESDC violated SEQRA. This is not a question of whether a delay resulted in new adverse environmental impacts – but whether ESDC properly identified the issue before reaching the conclusion that an SEIS was not warranted. That is a threshold question. If ESDC had honestly assessed the timing and uncertainty of the project and then reached the conclusion that an SEIS was not necessary, that decision might be upheld as a rational determination. The conscious refusal to engage in an honest assessment – to deny the existence of a material fact – is to do fundamental harm to SEQRA. As the Court of Appeals recently recognized, if a lead agency has properly identified the relevant issue – the potential presence of an endangered species, then a rule of reason will be applied in assessing whether it took the requisite hard look. *Save the Pine Bush, Inc. v. Common Council of City of Albany*, __ N.Y.3d __, 2009 WL 3425317 (Oct. 27, 2009). By failing to identify the relevant fact, ESDC fails on the threshold question.

POINT III

THE RESOLUTION AUTHORIZING ESDC STAFF TO ENTER INTO AGREEMENTS WITH FCRC WAS INCONSISTENT WITH THE MGPP

Respondents seek to avoid the clear language of the terms and conditions attached to the September 17, 2009 resolution and try to argue alternatively that subsidies for affordable housing were always anticipated and that ESDC will not allow the project to be built without affordable housing. However, the Court must review the resolution and attachments as drafted and as such it permits ESDC to enter into agreements that are inconsistent with the MGPP.

Respondents argue that affordable housing subsidies were always contemplated. That is not in contention. What is in contention is an MGPP which says there will be at least 2,250 units of affordable housing which are "expected" to receive government subsidies and a term sheet for the Development Agreement which says that the affordable housing is "subject" to the availability of subsidies .

ESDC argues that it has yet to prepare the Development Agreement and it will assure that the market rate housing is not permitted unless there is the affordable housing. But the resolution authorizing the agreement, which is not subject to further review by the ESDC Board does not have the same restriction. ESDC has not explained how it will assure the provision of the affordable housing as it approves moving forward with individual buildings. FCRC could build some of the initial buildings in Phase II, show that the affordable subsidies are not available and then stop the project. Then the area is left with an incomplete project and none of the benefits touted in the MGPP.

ESDC claims that it will require FCRC to "use commercially reasonable efforts" to complete Phase I and the entire Project by 2019. However, "commercially reasonable efforts"

are not defined and since there was knowledge at the time of the adoption of the MGPP of the new MTA terms, it must be presumed that ESDC has already acquiesced to that time frame as commercially reasonable. Moreover, the ESDC term sheet includes the ground leases for all of the buildings to last for 25 years before a building is constructed, thus providing further evidence that such a time frame has already been accepted as commercially reasonable.

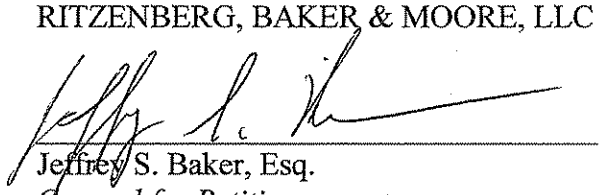
Respondents do not address how the term sheet condition which mandates only 4,470,000 sq ft of improvements, excluding the Arena, constitutes an obligation to complete the project as per the MGPP when it is 37% less than what is provided in the MGPP. The supposed obligations of FCRC which are to insure that the findings of the Land Use Improvement Project are satisfied are being undermined from the outset by permitting ESDC staff to enter into a development agreement that is already at odds with the MGPP.

CONCLUSION

For the foregoing reasons, Petitioners' respectfully request that the Petition be granted.

Dated: Albany, New York
November 24, 2009

YOUNG, SOMMER, WARD,
RITZENBERG, BAKER & MOORE, LLC

By: 

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