

testimony

From: Anne Stevens [Astevens@scd.hawaii.gov]
Sent: Thursday, February 21, 2008 2:19 PM
To: testimony
Subject: FW: Testimony for SCR 54, Senate Committee on Water and Land

Amended testimony. Please see additions in blue.

From: Anne Stevens
Sent: Thursday, February 21, 2008 9:52 AM
To: 'testimony@capitol.hawaii.gov'
Subject: Testimony for SCR 54, Senate Committee on Water and Land

Please accept the below testimony in support of SCR54, hearing before Senate Committees on Water and Land, Tourism and Government Operations. Hearing to be held on Tuesday, February 26, 2008

February 21, 2008

The Honorable Clayton Hee, Chair
Senate Committee on Water and Land

The Honorable Clarence Nishihara, Chair
Senate Committee on Tourism and Government Operations

Dear Senators Hee and Nishihara:

Thank you for hearing this concurrent resolution in your committees. I would like to express my strong support for an audit of the Aloha Tower Development Corporation (ATDC) by the State Auditor. As the resolution states, ATDC has responsibility for an important part of maritime property and surrounding lands. In each of the development agreements ATDC has entered, maritime interests have taken a back seat. For example, Piers 7 & 8 around Aloha Tower were developed for the Marketplace with no serviceable potable water lines for visiting ships and no electrical power hook ups. In another example, ATDC wished to develop an important cargo section of Pier 2C into a parking structure. This plan would decrease the available pier space for working cargo, in a harbor already lacking usable piers.

Also ATDC and contracted developers seem to disregard the importance of Homeland Security concerns when approving harbor development projects. In today's heightened security environment, there are some activities that should remain separate for the protection of both our citizens and the maritime assets. For example ATDC seemed to express support for building condos with balconies directly above Pier 10 where both cruise and cargo ships dock. It would be impossible to adequately secure a cruise or cargo ship operations, when residents have access to parking, balconies etc. directly above the ship. No Captain of the Port responsible for security would support this plan, yet ATDC was willing to allow Hughes Development LP to include this design in their plans.

Over the years, ATDC has claimed to evolve into an agency with more focus on the important maritime issues facing Honolulu Harbor. The Administration has planned to use the development arm of ATDC to advance Harbor redevelopment plan. House Bill 3406 seeks to expand the size of the ATDC board for this purpose. I truly support this change of focus, to support Hawaii's harbor. However, before moving ahead with expanding ATDC, I believe an audit would serve to delve into this change of focus and perhaps suggest reorganization and/or renaming of ATDC to reflect this change. Additionally, it is my hope that an audit would uncover the reasons behind the various lawsuits and suggest preventative measures for the future.

I appreciate the opportunity to provide testimony on this measure.

Sincerely,
Anne V. Stevens
1350 Ala Moana Blvd. #1004
Honolulu, HI 96814
(808) 591-0899

2/21/2008

February 22, 2008

Jeffrey S. Portnoy
Direct Line: (808) 521-9221
Direct Fax: (808) 540-5040
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Hawaii State Senate
Committee on Water and Land
Senator Clayton Hee, Chair
Senator Russell S. Kokubun, Vice-Chair

Hawaii State Senate
Committee on Governmental Operations
Senator Clarence K. Nishihara, Chair
Senator Donna Mercado Kim, Vice-Chair

Re: Senate Concurrent Resolution No. 54
Requesting the Auditor to Conduct an Audit
of the Aloha Tower Development Corporation,
Particularly With Regard to Lawsuits Relating
to Development Projects

Dear Senators:

Our office is litigation counsel for Kenneth H. Hughes, Inc., the developer named in that certain Development Agreement with the Aloha Tower Development Corporation ("ATDC") dated October 12, 2004.

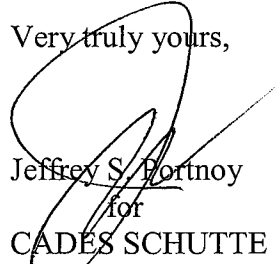
Please be advised that we, and our client, fully support Senate Concurrent Resolution No. 54.

The ATDC is in material breach of the Development Agreement. As a result, our client has filed an arbitration proceeding against the ATDC seeking, among other things, specific performance, damages and attorney's fees. The arbitration is being conducted at Dispute Prevention and Resolution, Inc. and is presently in the discovery phase. The arbitration hearing is set for May 12, 2008.

Attached hereto is the developer's Arbitration Statement of Claims against the ATDC which I am sure you will find supports Senate Concurrent Resolution No. 54.

If you have any questions, please contact me.

Very truly yours,

A handwritten signature in black ink, appearing to read "Jeffrey S. Portnoy", is written over the typed name and the word "for".

Jeffrey S. Portnoy
for

CADES SCHUTTE
A Limited Liability Law Partnership

JSP/lss

ImanageDB:840026.1



DISPUTE PREVENTION & RESOLUTION, INC.

DEMAND FOR ARBITRATION®

This Demand is Made Upon: Name(s) of the Party(s) _____

Respondent: Aloha Tower Development Corporation
 Address: 600 Fort Street Mall, Pier 10 Terminal
 2nd Floor, Honolulu, Hawaii 96813
 Phone: (808)586-2530 Fax (808)586-3046

Respondent: _____
 Address: _____
 Phone: _____ Fax _____

Attorney: Gregg J. Kinkley, Deputy Attorney General
 Firm: Commerce & Economic Development Division
 Address: 425 Queen Street, 3rd Floor
 Honolulu, HI 96813
 Phone: 808 586-1180 Fax: 808 586-1205

Attorney: _____
 Firm: _____
 Address: _____
 Phone: _____ Fax: _____

The below-named Claimant, a party to an arbitration provision contained in a written contract/agreement, dated October 12, 2004, hereby demands arbitration pursuant thereto.

Respondent(s) are hereby notified that copies of our arbitration agreement and this Demand for Arbitration are being filed with Dispute Prevention & Resolution, Inc. in Honolulu, Hawaii, along with a request to commence administration of an Arbitration proceeding.

Claimant's Signature: _____ Title _____
 (May be Signed by Claimant's Attorney)

Claimant: Kenneth H. Hughes, Inc.
 Address: 7001 Preston Road, Suite 500
 Dallas, Texas 75205
 Phone: (214)224-4640 Fax: (214)219-2080

Claimant: _____
 Address: _____
 Phone: _____ Fax: _____

Attorney: Jeffrey S. Portnoy
 Firm: Cades Schutte LLP
 Address: 1000 Bishop Street, Suite 1200
 Honolulu, Hawaii 96813
 Phone: 808-521-9221 Fax: 808-540-5040

Attorney: _____
 Firm: _____
 Address: _____
 Phone: _____ Fax: _____

- The arbitration provision in this matter is governed by Hawaii Revised State Section 658A.
- We request an administrative conference with Dispute Prevention & Resolution, Inc. to discuss:
- Settlement Procedures Discovery Issues Form and Scope of Award of Arbitrator Other Issues

To initiate arbitration proceedings: Claimant should send an original demand, a copy of the complete contract or agreement containing the arbitration provision, and a copy of the relevant pleadings and/or a statement of claims to each Respondent(s) by hand delivery or by U.S. Mail First Class, Certified/Return Receipt Requested. In addition, please send 2 copies of this Demand, the Contract or Agreement, and the pleadings/statement of claims to: Dispute Prevention & Resolution, Inc., 1155 Pauahi Tower, 1001 Bishop Street, Honolulu, HI 96813 (Phone: (808) 523-1234, Fax: (808) 537-1377, E-mail: keithhunter@dpr4adr.com). No filing fees are charged by DPR.

If you would like DPR to contact the other parties to ascertain whether they wish to **MEDIATE** this matter, please check this box (there is no administrative fee for this service). Mediation is a non-binding process.

COPY

STATEMENT OF CLAIMS

I. INTRODUCTORY STATEMENT

This arbitration filing represents the unfortunate and wholly avoidable culmination of over five years of mismanagement -- or worse -- by a public agency of the State of Hawaii of the bidding and award of a private development project to build a luxury mixed use complex on a vacant piece of land on the Honolulu harbor. After literally years of effort to get the State to deliver on its contractual obligations and representations, and after yet another reversal by the State of a material aspect of the approved development plan, the developer is left with no choice but to bring this action to compel the State to either (i) deliver the property in a financeable form consistent with the parties' contract and State-approved development plan so that development may proceed; or (ii) admit that it is unable or unwilling to do so and compensate the developer for its substantial losses and lost opportunity suffered at the hands of a dysfunctional public agency.

II. SUMMARY OF THE DISPUTE AND RELIEF SOUGHT

Claimant Kenneth H. Hughes, Inc. ("Hughes") is a Texas-based real estate development company whose Chairman and namesake, Ken Hughes, has more than forty years' experience developing award winning mixed use urban development projects throughout the country. Hughes and Aloha Tower Development Corporation ("ATDC"), a public agency of the State of Hawaii, are the parties to an October 12, 2004, Development Agreement that provides for the private development by Hughes of a mid-rise residential condominium and retail complex on Piers 5 and 6 in Honolulu Harbor. This project, referred to as "Pacific Quay," originally was the subject of a public Request for Proposal ("RFP") issued by ATDC in 2002. Hughes responded to the RFP and the ATDC decided to move forward with Hughes. Accordingly, the parties entered into a 2003 Pre-Development Agreement, which ultimately culminated in the 2004 Development Agreement and a subsequent Board-approved detailed project plan, the operative agreements at issue in this arbitration.

Sadly, in the three years since execution of the Development Agreement, Hughes' ability to move forward with the Pacific Quay development has been stymied first by bureaucratic delays, and ultimately ATDC's inability or refusal, *inter alia*, to deliver the public infrastructure components that it contracted to provide pursuant to the Development Agreement; to negotiate in good faith and enter into component agreements consistent with the Development Agreement and approved project plans to allow Hughes to move forward with the project; and to deliver the property free of encumbrances that would otherwise destroy the developers ability to finance and complete the project.

Most recently, for reasons not fully understood by Hughes, ATDC has proposed substantial changes to the structure, mutual responsibilities, finances, and other material terms of the arrangement contemplated by the RFP and Hughes proposal, the Development Agreement and subsequently approved project plans. ATDC's recently proposed changes, together with its prior delays and failures to deliver the public infrastructure components necessary for Hughes to proceed, essentially render the project economically unfeasible and are in direct contravention of the parties'

agreements. Hughes does not know why those entrusted to carry out ATDC's mission apparently have determined to scuttle this deal, which undeniably would result in substantial benefits to the State. Regardless of whether ATDC's intransigence is motivated by changed political winds, private conflicts of interest, inconsistent commitments to third parties, or simple incompetence or inexperience, it has resulted in a breach of the Development Agreement by ATDC and a denial of Hughes' vested right to develop the Pacific Quay project.

Left with no alternative, Hughes brings this action (i) to compel ATDC to comply with its obligations under the Development Agreement and enter into project component agreements fairly reflecting the terms and conditions of the parties' undertakings, taking into account the delays, expenses, and increased costs already incurred as a result of ATDC's conduct; or, alternatively, (ii) to be compensated for the substantial damages and losses arising from ATDC's conduct and the resulting deprivation of Hughes' property and contract rights.

III. FACTUAL BACKGROUND

A. THE MEETING OF THE PARTIES

1. The Offeror - ATDC

The Aloha Tower Development Corporation ("ATDC") is a State of Hawaii agency that was created by the Legislature in 1981 for the express purpose of undertaking the redevelopment of the Aloha Tower Complex in Honolulu Harbor. It generally has jurisdiction over Piers 4 through 11 in the harbor pursuant to HRS Chapter 206J and by way of a Master Lease with the Hawaii Department of Transportation. The ATDC does not own fee simple title to any of the lands in its jurisdiction, but is charged with the mission to procure appropriate private development of those lands through long-term ground subleases. Since its inception, ATDC has completed only one private development project within its jurisdiction.

In 1993, ATDC entered into a sublease with Aloha Tower Associates, as a lessee, pursuant to which the lessee constructed and operates the Aloha Tower Market Place ("Aloha Market Place"). The ATDC and the Market Place also entered into a Parking Agreement in September 1993, which has been the subject of litigation between those two parties for at least ten years. Pursuant to the Parking Agreement, ATDC was required to supply a certain number of parking spaces to the Aloha Market Place within a designated zone. Although that parking originally was located on Piers 5 and 6, ATDC reserved the right to relocate that parking anywhere within the parking zone on thirty days' notice. Whether because of the dispute with the Aloha Market Place or for other reasons, following the construction of the Market Place and the ensuing lawsuits, ATDC apparently did not pursue any further developments within its jurisdiction for another ten years.

2. The Offer -- RFP

In late 2002, ATDC issued a Request for Proposal ("RFP") for the purpose of soliciting proposals "...from qualified developers to undertake the redevelopment of Piers 5 and

6.” A copy of the RFP is attached hereto as Exhibit A. The RFP was specifically written and designed for a private development and not a public project or joint venture with ATDC. The RFP provided that “the land would be made available on a [ground] lease basis for a maximum term of 65 years.” Since the RFP contemplated a privately-financed project, it was implicit that the ground lease be in a financeable form. The RFP further provided that the rent for the ground lease would be based on what the developer determined to be appropriate for the project. One of the proposed elements of the RFP that was not initially significant but has become of particular relevance to the current dispute was the request that the proposal commit to supply replacement parking for the Aloha Market Place, presumably in an effort to fulfill ATDC’s obligation to the Aloha Market Place pursuant to their parking agreement. Unfortunately, there initially were no takers for the RFP.

3. The Sole Bidder - Ken Hughes

In an effort to locate a developer willing to bid on the RFP, Bill Whitney, a development consultant to ATDC who helped draft the RFP, approached Hughes. Hughes is an experienced urban developer who has developed many award winning projects across the country. He has a national reputation as a developer of first-class urban projects including mixed-use urban projects with a transportation component. Hughes is a member of the Board of Governors of the Urban Land Institute (the “ULI”), a guest lecturer at Harvard University, and the developer of Mockingbird Station in Dallas, Texas, which was listed by the ULI as one of the 40 best projects in the world for 2006.

At Mr. Whitney’s urging, Hughes reviewed the Aloha Tower site and the RFP. Hughes submitted a comprehensive written response to the RFP that included a general development plan not just for Piers 5 and 6, but also for the entire harbor front, modeled after Circular Quay and Darling Harbor on the Sydney, Australia waterfront. With respect to Piers 5 and 6, Hughes’ proposal specified a single mixed-use building with residential, retail and parking components on a 65-year ground lease. It also responded in detail to each of the components of the RFP, specifying how Hughes proposed to address each of the requirements of the RFP or, if Hughes did not propose to meet any proposed elements of the RFP, expressly so stating. Importantly, Hughes’ response to the RFP expressly specified, *inter alia*, that Hughes would not be financially responsible to build additional parking for the Market Place as proposed by the RFP and that any such parking would not be located on Piers 5 and 6. However, Hughes did offer to oversee development and construction of parking facilities elsewhere on ATDC’s jurisdiction at their expense. A copy of Hughes’ Proposal in response to the RFP is attached hereto as “Exhibit B.”

B. ATDC’S ACCEPTANCE AND THE OPERATIVE CONTRACTS

1. The Pre-Development Agreement

ATDC quickly and enthusiastically accepted Hughes’ proposal and agreed to fund \$200,000 for Hughes to commission certain development and feasibility studies. This funding was part of a Pre-Development Agreement between the ATDC and Developer dated September 1, 2003. In that document, a copy of which is attached hereto as “Exhibit C,” ATDC’s Board of Directors (the “ATDC Board”) authorized commencement of discussions with Hughes

towards completion of a development agreement and eventual lease pursuant to which Hughes would develop Piers 5 and 6 as proposed in Hughes' response to the RFP. The express purpose of the Pre-Development Agreement was to permit the parties to determine to their mutual satisfaction whether the certain issues identified by Hughes as interfering with the commercial feasibility of the project could be alleviated, including (1) the existence of a power plant blocking the view plane; (2) poor traffic patterns in the area; and (3) the lack of adequate parking spaces. Importantly, this agreement and funding specifically covered the commission of a parking study by Hughes to address the location of construction parking for the project, as well as temporary and permanent replacement parking for the Aloha Market Place, in recognition of the fact that such parking was not proposed by Hughes and would not be included within the Pacific Quay development.

2. The Development Agreement

Following extensive discussions and negotiations between Hughes and ATDC, and following successful completion by Hughes of the agreed upon studies pursuant to the Pre-Development Agreement, the parties negotiated and entered into the October 12, 2004, Development Agreement (the "Development Agreement"), a copy of which is attached hereto as "Exhibit D."

The Development Agreement is the controlling contract between the parties and attaches and expressly incorporates by reference the RFP, Hughes' Response, and the Pre-Development Agreement. The Development Agreement lists eleven (11) specific projects in Schedule 1, all but one of which are public infrastructure projects that are to be financed with public funding. Those public projects expressly include two separate parking facilities, not located on Piers 5 and 6, that would supply replacement parking for the Aloha Market Place as proposed by Hughes, validated by the parking study, and agreed by ATDC. With respect to these and the other public elements of the plan, the Development Agreement specifies that the Developer's sole involvement with respect to those project is to serve as the "project coordinator" if selected by ATDC.

The sole private development specified in the Development Agreement is the Pacific Quay project on Piers 5 and 6. With respect to the Pacific Quay project, the Development Agreement, among many other things:

- a. specifically incorporates and refers to the RFP and the Developer's proposal, wherein the Developer described the Pacific Quay project as a mixed-use private development consisting of residential units, retail and parking which would be privately financed;
- b. states "... this Agreement provides for the private development by KH of a private condominium/retail project on Piers 5 and 6....";
- c. expressly provides that "ATDC hereby grants to KH the exclusive right to develop, and KH agrees to develop, ... Piers 5 and 6....";

- d. expressly incorporates by reference the RFP, Hughes' Response, the Pre-Development Agreement;
- e. clearly recognizes that the issue of "adequate parking spaces serving the development area" had to be resolved or else the project "would be neither financeable nor viable," and recites that the parties had in fact determined to their mutual satisfaction that this issue had been resolved during the course of the Pre-Development Agreement, which included the parking study;
- f. recites that the ATDC Board had voted on October 12, 2004, to proceed with the project subject only to the enactment of certain legislation and the express contingencies set forth in the Agreement;
- g. provides that the Developer has the right to hypothecate the development rights in order to provide financing for the project;
- h. confirms that "it is the intent of the ATDC to effectuate all the public improvement project components in Schedule 1 ... and that it is the "intent of KH to effectuate all the private improvement project components, including without limitation, the establishment of Pacific Quay....";
- i. notes that no joint venture or partnership is created between the ATDC and the Developer; and
- j. agrees that all disputes or claims are to be resolved by mediation and/or arbitration pursuant to Section 21 of the Agreement.

Section 7 of the Development Agreement also specified that each of the projects described would require more definitive agreements in order to memorialize and effectuate the particulars of each such project. The Development Agreement therefore requires that the parties "negotiate in good faith to enter into such Project Component Agreements and along the parameters set forth in this Agreement, including all requirements inherent and explicit in Schedule 1, in order that the Project may be completed." Importantly, the Development Agreement nowhere provides for or otherwise allows the parties to fail to complete Project Component Agreement, nor does it condition either party's performance on their ability to negotiate Project Component Agreements. To the contrary, the Development Agreement is quite specific regarding the conditions to each side's obligations, and does not include ATDC's failure to negotiate Project Component Agreements as a basis for eliminating Hughes' development rights.

The RFP, the Developer's proposal and the Board's acceptance thereof all clearly state that the Pacific Quay project is to be developed as a private development on a 65-year ground lease. The Development Agreement also makes clear in multiple places that this is a purely private development for which Hughes is exclusively required to arrange funding. The definitive

project component agreement for Pacific Quay, therefore, is necessarily the ground lease itself. With respect to the public infrastructure projects, the definitive project component agreements would be in the nature of specific project management agreements, as the Development Agreement specifies.

In addition to the specific language in the Development Agreement requiring that the parties negotiate in good faith to enter into the ground lease (the specific project component agreement pertaining to the Pacific Quay project), the development contract "...contains an implied covenant of *good faith* and *fair dealing* that neither party will do anything that will deprive the other of the benefits of the agreement." See Simmons v. Puu, 105 Haw. 112 (2004). In Simmons, the court emphasized:

"The obligation to deal in good faith is now a well-established principle of contract law. Restatement (2nd) Contracts, Section 205 (1979) provides that "every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."

C. PERFORMANCE OF THE DEVELOPMENT AGREEMENT

1. The ATDC's Failed Legislative Attempt

Commencing in late 2004, the ATDC decided to attempt to convince the legislature to allow it to sell the land to the Developer so that the Developer could sell the condominium units in fee simple. This was done with the full concurrence of Hughes, as it would enhance the value of the project. The ATDC also sought funding from the legislature for the public projects infrastructure described in the Development Agreement. The ATDC prepared proposed legislation and actively lobbied during the legislative session of 2005.

a. The ATDC Approval of the Detailed Project Plan

The ATDC was unsuccessful in obtaining legislation either to sell the land or to obtain funding. Accordingly, at the request of the Board, the developer prepared a detailed description of the proposed Pacific Quay development and submitted it to the ATDC Board in early 2006. This was consistent with the Development Agreement, which expressly provided that if the legislation, funding or other governmental action necessary to accomplish the project was not authorized, the parties would reassess the project and consider alternative approaches. If the parties determined that a proposed alternative plan was feasible and desirable, they would proceed with the project as amended. In accordance with this process, Hughes provided to the ATDC a detailed project plan ("Detailed Project Plan"), limited to the development of Piers 5 and 6 and excluding any other portions of the overall Harbor public infrastructure, as the proposed alternative.

Importantly, Hughes' Detailed Project Plan did not provide for the Pacific Quay development to assume any or all of ATDC's parking obligations to the Market Place

or otherwise dedicate any parking spaces to that site. Rather, it provided for parking for residents and guests of Pacific Quay, plus a number of additional fee parking spaces to be available to the general public.

The ATDC responded by forming a 3-member committee to review the Pacific Quay Detailed Project Plan. After review, the committee unanimously recommended approval to the Board, and the Board approved it in June of 2006. The sub-committee approval recommendation for the project stated that it was conditioned upon the Developer's commitment to the improvement of the parking situation in the development area. At a meeting with the sub-committee, Hughes noted that the Detailed Project Plan would increase by 50% the parking available to the public and, therefore, he was improving the parking situation in the development area. There was never any discussion concerning any obligation on the part of Hughes to solve the Market Place parking situation, nor was there ever any discussion concerning an "obligation" that Hughes might owe the Market Place operator to supply parking.

In connection with ATDC's approval of the Detailed Project Plan, the ATDC staff was also directed to employ outside counsel to work with the Developer in drafting a ground lease. Hughes also immediately started on the development process, including the arranging of financing.

b. The ATDC Permits

The ATDC is a "one-stop" redevelopment agency and has its own zoning rules. It is not subject to City zoning. The zoning rules are contained in the ATDC Project Area Rules.

The Project Area Rules ("Rules") require only two permits, which are nondiscretionary, in connection with any development. The first is called a Project Eligibility Review (Rule Section 15-26-59). This review is essentially a sign off from various City and State agencies concerning the availability of utilities and other offsite infrastructure to the project. Hughes applied for the Project Eligibility Review in November 2006, and it was satisfactorily completed in January 2007. As part of that process, the developer requested a change in the ATDC zoning rules that would permit the construction of the specific building which had been proposed by the developer since the original response to the RFP. The public hearing was conducted, and the ATDC Board of Directors approved the zoning change in January 2007.

The other permit under the Rules is a Development Permit (Rule 15-26-60). This is a nondiscretionary permit which simply confirms that the project sought to be built conforms to the zoning rules. Since the zoning rules had already been changed to fit the project, this was not a major undertaking. Hughes submitted the Application for the Development Permit on March 20, 2007. The ATDC did not respond to the application and thus, pursuant to the Rules, the application was deemed accepted.

Under the Rules, there are no discretionary permits required to be obtained from the ATDC.

2. The ATDC Delays

Initially, the ATDC staff failed to promptly secure outside counsel. Five months passed from the date that they were directed to secure outside counsel before that selection was made. Despite constant prodding by Hughes and his counsel, another two months passed before any documents were generated by the outside counsel and the ATDC staff.

3. The ATDC's Bad Faith Attempt to Change the Deal

When ATDC finally did provided draft Project Component Agreements in January 2007, they were woefully inadequate and represented a dramatic departure from the terms of the Development Agreement and the subsequently approved Detailed Project Plan. Moreover, the ATDC refused to submit a draft Ground Lease (although the developer had submitted a draft to the Attorney General's office for review at least 1-1/2 years prior). Instead, in an act of extreme bad faith, the ATDC sought to create an entirely new development agreement which, among other things:

- a. Created a new "feasibility and viability" review process not sanctioned by the Rules;
- b. Completely stripped the developer of any of its rights under the Development Agreement;
- c. Restricted the developer to a 10% profit interest;
- d. Gave the ATDC complete control over construction, marketing and operation of the project;
- e. Required onerous financial conditions despite the fact that this matter only concerns a ground lease with single-payment rent;
- f. Gave the ATDC complete approval rights over the private financing;
- g. Saddled Hughes with certain of ATDC's parking obligations to the Market Place; and,
- h. Provided for strangely punitive remedies bearing no resemblance to the developer's proposal, the Development Agreement and the approval by the ATDC Board of the Detailed Project Plan.

In sum, the document was a poorly drafted, unsynchronized menage of provisions taken from loan agreements, security agreements, mortgages and leases. It attempted to create a situation in which the ATDC would be in complete control of the entire project, from beginning to end. Perhaps most fundamentally, it was not even remotely financeable under any

scenario. To make matters worse, the ATDC's outside counsel informed the developer's counsel that he was "not authorized to discuss the ground lease."

As noted above, the ATDC's document for the first time purported to require Hughes to solve the ATDC's longstanding parking problems with the Market Place. The ATDC's document made Hughes' rights contingent upon a resolution of the Market Place parking dispute with the Market Place operator on terms acceptable to the ATDC. It also required that Hughes provide replacement parking for the Market Place, at no cost to either the ATDC or the Market Place operator. In other words, Hughes would have to absorb over \$20 million in additional construction costs, with absolutely no return on the money. Of course, neither Hughes nor ATDC agreed to make the Pacific Quay project contingent upon the ATDC resolving its issues with the Market Place operator. Nor did the Pre-Development Agreement, Development Agreement, or the Detailed Project Plan require Hughes to supply this parking. As such, ATDC's draft document was nothing more than an attempt by the ATDC to "hijack" the Pacific Quay project in order to solve its problems.

D. HUGHES' EFFORTS TO SALVAGE THE DEAL

Notwithstanding ATDC's dramatic departure from the parties' prior agreements, Hughes was determined to complete the Project Component Agreements so that the parties could move forward with the development, to both of their substantial anticipated benefit. Yet for reasons unknown to Hughes, the ATDC and/or its staff has continued to demonstrate a determination to stymie his efforts in that regard.

1. The Option Agreement and Ground Lease

In March 2007, in response to ATDC's shocking display of bad faith, Hughes threatened to submit this matter to arbitration. In response, the ATDC appeared to change its position and the drafting of the documentation appeared to be heading in the right direction. In addition to the ground lease, the parties agreed to use an option to lease in order to facilitate the development process. Hughes' counsel took the lead in drafting the Project Component Agreements.

By August 2007, Hughes' counsel had submitted forms of the option and the ground lease which were acceptable to Hughes and were consistent with the spirit and substance of the Development Agreement and the Detailed Project Plan, as well as industry standards for private developments of this type. After more than a month without comment, the ATDC responded with numerous substantive revisions that, among other things, again attempted to strip away Hughes' rights, granted essential overall control of the private development process to the ATDC, and reinstated the Market Place parking issue. ATDC did not respond at all to Hughes' draft of the ground lease.

2. The Ground Lease Rent

Although ATDC had failed altogether to propose a form of ground lease, Hughes attempted to negotiate with ATDC an appropriate rent figure. With respect to the determination of rent, Hughes has made three proposals. With respect to the first two proposals, the ATDC has simply rejected the proposals without any proposal of its own. The ATDC's counsel responded to the third proposal with a meaningless counter-proposal. As such, Hughes has never received a good faith proposal.

The parties did agree to a single payment of rent. That single payment of rent is not deductible by Hughes as a project cost, and thus it has to be paid by each individual buyer as a component of the purchase price for a unit. The amount of the single payment of rent has to be specifically spelled out on the face of the contract and has to be paid by the buyer to the ATDC.

There is obviously a limit to what a buyer will pay for lease rent. Hughes made a proposal based upon the advice of experts as to what would be acceptable to buyers. It is not possible for Hughes to pay for any more than what the buyers themselves are willing to pay, as any such amounts are not deductible as project costs. Hughes also offered to pay for \$12.5 million in infrastructure costs to make the site ready for development. This work is primarily shoreline bulkhead and pier work, all of which will belong to the State, is for the benefit of the State, and will not be owned or operated by the project. By virtue of the RFP, the developer was led to believe that this contribution would be taken into account with respect to the determination of rent.

3. The Revised Option Agreement and Subsequent Negotiations

In August 2007, ATDC's counsel provided its "markup" of Hughes' proposed Option Agreement. As mentioned above, that document again represented a seismic shift from the Development Agreement and Detailed Project Plan, granting significant approval and other rights to ATDC and imposing substantial obligations on Hughes that were inconsistent with any financeable or commercially feasible private development agreement and incongruous with the four years of the parties previous dealings.

In response, Hughes prepared yet another revised draft of the Option Agreement and Ground Lease, acceding to as many of ATDC's proposals as possible, while remaining true to the underlying agreements and, perhaps most importantly, ensuring the financeability of the project. A copy of Hughes' final proposals, provided to ATDC in September 2007, are attached as Exhibits E and F.

In October 2007, still without receiving approval of or comments on the draft documents from ATDC, counsel for Hughes and ATDC met by teleconference to discuss the draft documents and the material issues remaining.

In that call, counsel for ATDC identified three substantive issues upon which there remained material differences:

- a. Financial issues such as option fees, extension fees and rent

- b. Remedies available to either party
 - c. Aloha Tower Market Place Parking
4. ATDC's Parking Bombshell

Following the call with ATDC, and in an effort to correct what Hughes believed to be a breach of the underlying agreement, James Stubenberg, counsel for Hughes, communicated with counsel for ATDC, Gregg Kinkley of the Attorney General's office, regarding the issue of parking, which they had discussed at length in the past. In those communications, which are attached hereto as Exhibit G, Mr. Kinkley made clear for the first time ATDC's new position that it sought to obligate Hughes, for the 65+ year duration of the project, to "help [ATDC] solve its parking problems with [the Market Place]. As Mr. Kinkley emphasized, if ATDC could not find a solution to its "sole satisfaction," then Piers 5 and 6 could be used for the Market Place parking. Most importantly, Mr. Kinkley admitted that it was ATDC's intention to strip Hughes of the "legal availability of development rights" if he would not accede to ATDC's demands.

5. Hughes' Good Faith

Since the RFP was issued, Hughes has made over 20 trips to Hawaii from his home base in Dallas and numerous other trips to Pasadena and San Diego to consult with architects and engineers on the Pacific Quay project. He has met repeatedly with virtually every community group in the area and has been more than favorably received. The Downtown Neighborhood Board has unanimously approved the Pacific Quay project as have numerous other groups. The Pacific Quay project has widespread public support unlike the failed project in Kakaako. This public support is largely due to Hughes' efforts.

This project should have been in a position to break ground in early 2007. As a result of all of these various delays, the cost of the project has risen by nearly \$40 million. And, in the meanwhile the citizens of Honolulu have been deprived of, and ATDC has failed in its State-mandated mission to deliver, a world class development of the Honolulu Harbor.

Even after ATDC's final proposals and its counsel's confirmation of its intent to hold the project hostage over ATDC's separate parking obligation, Hughes offered to travel to Hawaii to meet personally with ATDC's Board to resolve the dispute. The ATDC did not respond.

Faced with ATDC's intransigence on the remaining material negotiating points in the draft Project Component Agreements, and its express confirmation that it intends to hold Hughes hostage over ATDC's own parking liability to a third party, Hughes has regrettably determined arbitration is the only potential path to resolution.

IV. RELIEF SOUGHT

Hughes requests the Arbitrator to order one of the following primary remedies, in addition to such other and further relief as the Arbitrator may determine is appropriate:

First:

1. Determine that the Hughes' position with respect to the items outlined in the draft Project Component Agreements are correct and appropriate and in accordance with the Development Agreement;
2. Determine that the single payment of rent for the Pacific Quay project, to be paid by buyers of condominium units, shall be equal to 6% of the gross sales price of each such unit, payable at closing, and subject to the floor and ceiling as set forth in Hughes' rental proposal;
3. Determine that (i) the costs associated with the ATDC's delay; and (ii) the public infrastructure costs to be paid by Hughes shall be deducted from the rent;
4. Determine that Hughes has no obligation to either the ATDC or the Market Place lessee with respect to the Market Place parking issues except to pay the sum of \$50,000.00 per year directly to a parking facility for temporary parking during the construction period;
5. Order the ATDC to execute and perform the option and ground lease; and
6. Order the ATDC to pay Hughes' attorney's fees and costs.

- OR -

Second:

1. Determine that the ATDC has repeatedly, materially and substantially breached the covenant of good faith and fair dealing contained in the Development Agreement and determine the amount of damages from the ATDC that the Developer is entitled therefor, including, but not limited to, (i) contract damages for the project profits which would have inured to Developer had it not been for the ATDC's breach of contract, and (ii) bad faith tort damages for the breach of the covenant of good faith and fair dealing;
2. Determine that the ATDC has committed an unlawful taking of Hughes' vested development rights in the Pacific Quay project and award Hughes damage for the value of such property; and,
3. Order the ATDC to pay Hughes reasonable attorney's fees and costs.

ATTORNEYS AT LAW



James A. Stubenberg
jstubenberg@stubenbergdurrett.com

February 22, 2008

Hawaii State Senate
Committee on Water and Land
Senator Clayton Hee, Chair
Senator Russell S. Kokubun, Vice-Chair

Hawaii State Senate
Committee on Governmental Operations
Senator Clarence K. Nishihara, Chair
Senator Donna Mercado Kim, Vice-Chair

Re: Senate Concurrent Resolution No. 54
Requesting the Auditor to Conduct an Audit
of the Aloha Tower Development Corporation,
Particularly With Regard to Lawsuits Relating
to Development Projects

Dear Senators:

Our office is development counsel for Kenneth H. Hughes, Inc., the developer named in that certain Development Agreement with the Aloha Tower Development Corporation ("ATDC") dated October 12, 2004.

Please be advised that we fully support Senate Concurrent Resolution No. 54 as does the developer and its principal, Mr. Kenneth Hughes.

The ATDC is in material breach of the Development Agreement. The developer has sued the ATDC by way of an arbitration proceeding and is seeking either specific performance and/or substantial damages and attorney's fees. The developer is being represented by Jeffrey S. Portnoy at Cades Schutte. The arbitration hearing is scheduled for May 12, 2008.

Senator Clayton Hee
Senator Russell S. Kokubun
Senator Clarence K. Nishihara
Senator Donna Mercado Kim
February 22, 2008
Page 2

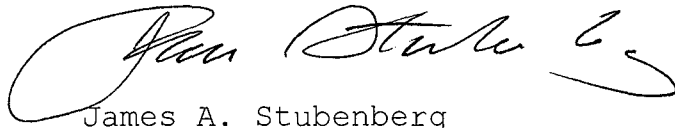
Attached is a copy of the Statement of Claims filed by the developer in the arbitration proceeding.

The Statement of Claims fully describes the conduct of the ATDC and supports the rationale for a legislative audit.

If you have any questions, please feel free to contact me.

Kindest regards,

STUBENBERG & DURRETT LLP

A handwritten signature in cursive script, appearing to read "James A. Stubenberg", written in dark ink.

James A. Stubenberg

JAS:jdc
Attachment



DISPUTE PREVENTION & RESOLUTION, INC.

DEMAND FOR ARBITRATION®

This Demand is Made Upon: Name(s) of the Party(s)

Respondent: Aloha Tower Development Corporation
 Address: 600 Fort Street Mall, Pier 10 Terminal
 2nd Floor, Honolulu, Hawaii 96813
 Phone: (808)586-2530 Fax (808)586-3046

Respondent: _____
 Address: _____
 Phone: _____ Fax _____

Attorney: Gregg J. Kinkley, Deputy Attorney General
 Firm: Commerce & Economic Development Division
 Address: 425 Queen Street, 3rd Floor
 Honolulu, HI 96813
 Phone: 808 586-1180 Fax: 808 586-1205

Attorney: _____
 Firm: _____
 Address: _____
 Phone: _____ Fax: _____

The below-named Claimant, a party to an arbitration provision contained in a written contract/agreement, dated October 12, 2004, hereby demands arbitration pursuant thereto.

Respondent(s) are hereby notified that copies of our arbitration agreement and this Demand for Arbitration are being filed with Dispute Prevention & Resolution, Inc. in Honolulu, Hawaii, along with a request to commence administration of an Arbitration proceeding.

Claimant's Signature: _____ Title _____
 (May be Signed by Claimant's Attorney)

Claimant: Kenneth H. Hughes, Inc.
 Address: 7001 Preston Road, Suite 500
 Dallas, Texas 75205
 Phone: (214)224-4640 Fax: (214)219-2080

Claimant: _____
 Address: _____
 Phone: _____ Fax: _____

Attorney: Jeffrey S. Portnoy
 Firm: Cades Schutte LLP
 Address: 1000 Bishop Street, Suite 1200
 Honolulu, Hawaii 96813
 Phone: 808-521-9221 Fax: 808-540-5040

Attorney: _____
 Firm: _____
 Address: _____
 Phone: _____ Fax: _____

- The arbitration provision in this matter is governed by Hawaii Revised State Section 658A.
- We request an administrative conference with Dispute Prevention & Resolution, Inc. to discuss:
- Settlement Procedures Discovery Issues Form and Scope of Award of Arbitrator Other Issues

To initiate arbitration proceedings: Claimant should send an original demand, a copy of the complete contract or agreement containing the arbitration provision, and a copy of the relevant pleadings and/or a statement of claims to each Respondent(s) by hand delivery or by U.S. Mail First Class, Certified/Return Receipt Requested. In addition, please send 2 copies of this Demand, the Contract or Agreement, and the pleadings/statement of claims to: Dispute Prevention & Resolution, Inc., 1155 Pauahi Tower, 1001 Bishop Street, Honolulu, HI 96813 (Phone: (808) 523-1234, Fax: (808) 537-1377, E-mail: keithhunter@dpr4adr.com). No filing fees are charged by DPR.

If you would like DPR to contact the other parties to ascertain whether they wish to **MEDIATE** this matter, please check this box (there is no administrative fee for this service). Mediation is a non-binding process.

COPY

STATEMENT OF CLAIMS

I. INTRODUCTORY STATEMENT

This arbitration filing represents the unfortunate and wholly avoidable culmination of over five years of mismanagement -- or worse -- by a public agency of the State of Hawaii of the bidding and award of a private development project to build a luxury mixed use complex on a vacant piece of land on the Honolulu harbor. After literally years of effort to get the State to deliver on its contractual obligations and representations, and after yet another reversal by the State of a material aspect of the approved development plan, the developer is left with no choice but to bring this action to compel the State to either (i) deliver the property in a financeable form consistent with the parties' contract and State-approved development plan so that development may proceed; or (ii) admit that it is unable or unwilling to do so and compensate the developer for its substantial losses and lost opportunity suffered at the hands of a dysfunctional public agency.

II. SUMMARY OF THE DISPUTE AND RELIEF SOUGHT

Claimant Kenneth H. Hughes, Inc. ("Hughes") is a Texas-based real estate development company whose Chairman and namesake, Ken Hughes, has more than forty years' experience developing award winning mixed use urban development projects throughout the country. Hughes and Aloha Tower Development Corporation ("ATDC"), a public agency of the State of Hawaii, are the parties to an October 12, 2004, Development Agreement that provides for the private development by Hughes of a mid-rise residential condominium and retail complex on Piers 5 and 6 in Honolulu Harbor. This project, referred to as "Pacific Quay," originally was the subject of a public Request for Proposal ("RFP") issued by ATDC in 2002. Hughes responded to the RFP and the ATDC decided to move forward with Hughes. Accordingly, the parties entered into a 2003 Pre-Development Agreement, which ultimately culminated in the 2004 Development Agreement and a subsequent Board-approved detailed project plan, the operative agreements at issue in this arbitration.

Sadly, in the three years since execution of the Development Agreement, Hughes' ability to move forward with the Pacific Quay development has been stymied first by bureaucratic delays, and ultimately ATDC's inability or refusal, *inter alia*, to deliver the public infrastructure components that it contracted to provide pursuant to the Development Agreement; to negotiate in good faith and enter into component agreements consistent with the Development Agreement and approved project plans to allow Hughes to move forward with the project; and to deliver the property free of encumbrances that would otherwise destroy the developers ability to finance and complete the project.

Most recently, for reasons not fully understood by Hughes, ATDC has proposed substantial changes to the structure, mutual responsibilities, finances, and other material terms of the arrangement contemplated by the RFP and Hughes proposal, the Development Agreement and subsequently approved project plans. ATDC's recently proposed changes, together with its prior delays and failures to deliver the public infrastructure components necessary for Hughes to proceed, essentially render the project economically unfeasible and are in direct contravention of the parties'

agreements. Hughes does not know why those entrusted to carry out ATDC's mission apparently have determined to scuttle this deal, which undeniably would result in substantial benefits to the State. Regardless of whether ATDC's intransigence is motivated by changed political winds, private conflicts of interest, inconsistent commitments to third parties, or simple incompetence or inexperience, it has resulted in a breach of the Development Agreement by ATDC and a denial of Hughes' vested right to develop the Pacific Quay project.

Left with no alternative, Hughes brings this action (i) to compel ATDC to comply with its obligations under the Development Agreement and enter into project component agreements fairly reflecting the terms and conditions of the parties' undertakings, taking into account the delays, expenses, and increased costs already incurred as a result of ATDC's conduct; or, alternatively, (ii) to be compensated for the substantial damages and losses arising from ATDC's conduct and the resulting deprivation of Hughes' property and contract rights.

III. FACTUAL BACKGROUND

A. THE MEETING OF THE PARTIES

1. The Offeror - ATDC

The Aloha Tower Development Corporation ("ATDC") is a State of Hawaii agency that was created by the Legislature in 1981 for the express purpose of undertaking the redevelopment of the Aloha Tower Complex in Honolulu Harbor. It generally has jurisdiction over Piers 4 through 11 in the harbor pursuant to HRS Chapter 206J and by way of a Master Lease with the Hawaii Department of Transportation. The ATDC does not own fee simple title to any of the lands in its jurisdiction, but is charged with the mission to procure appropriate private development of those lands through long-term ground subleases. Since its inception, ATDC has completed only one private development project within its jurisdiction.

In 1993, ATDC entered into a sublease with Aloha Tower Associates, as a lessee, pursuant to which the lessee constructed and operates the Aloha Tower Market Place ("Aloha Market Place"). The ATDC and the Market Place also entered into a Parking Agreement in September 1993, which has been the subject of litigation between those two parties for at least ten years. Pursuant to the Parking Agreement, ATDC was required to supply a certain number of parking spaces to the Aloha Market Place within a designated zone. Although that parking originally was located on Piers 5 and 6, ATDC reserved the right to relocate that parking anywhere within the parking zone on thirty days' notice. Whether because of the dispute with the Aloha Market Place or for other reasons, following the construction of the Market Place and the ensuing lawsuits, ATDC apparently did not pursue any further developments within its jurisdiction for another ten years.

2. The Offer -- RFP

In late 2002, ATDC issued a Request for Proposal ("RFP") for the purpose of soliciting proposals "...from qualified developers to undertake the redevelopment of Piers 5 and

6.” A copy of the RFP is attached hereto as Exhibit A. The RFP was specifically written and designed for a private development and not a public project or joint venture with ATDC. The RFP provided that “the land would be made available on a [ground] lease basis for a maximum term of 65 years.” Since the RFP contemplated a privately-financed project, it was implicit that the ground lease be in a financeable form. The RFP further provided that the rent for the ground lease would be based on what the developer determined to be appropriate for the project. One of the proposed elements of the RFP that was not initially significant but has become of particular relevance to the current dispute was the request that the proposal commit to supply replacement parking for the Aloha Market Place, presumably in an effort to fulfill ATDC’s obligation to the Aloha Market Place pursuant to their parking agreement. Unfortunately, there initially were no takers for the RFP.

3. The Sole Bidder - Ken Hughes

In an effort to locate a developer willing to bid on the RFP, Bill Whitney, a development consultant to ATDC who helped draft the RFP, approached Hughes. Hughes is an experienced urban developer who has developed many award winning projects across the country. He has a national reputation as a developer of first-class urban projects including mixed-use urban projects with a transportation component. Hughes is a member of the Board of Governors of the Urban Land Institute (the “ULI”), a guest lecturer at Harvard University, and the developer of Mockingbird Station in Dallas, Texas, which was listed by the ULI as one of the 40 best projects in the world for 2006.

At Mr. Whitney’s urging, Hughes reviewed the Aloha Tower site and the RFP. Hughes submitted a comprehensive written response to the RFP that included a general development plan not just for Piers 5 and 6, but also for the entire harbor front, modeled after Circular Quay and Darling Harbor on the Sydney, Australia waterfront. With respect to Piers 5 and 6, Hughes’ proposal specified a single mixed-use building with residential, retail and parking components on a 65-year ground lease. It also responded in detail to each of the components of the RFP, specifying how Hughes proposed to address each of the requirements of the RFP or, if Hughes did not propose to meet any proposed elements of the RFP, expressly so stating. Importantly, Hughes’ response to the RFP expressly specified, *inter alia*, that Hughes would not be financially responsible to build additional parking for the Market Place as proposed by the RFP and that any such parking would not be located on Piers 5 and 6. However, Hughes did offer to oversee development and construction of parking facilities elsewhere on ATDC’s jurisdiction at their expense. A copy of Hughes’ Proposal in response to the RFP is attached hereto as “Exhibit B.”

B. ATDC’S ACCEPTANCE AND THE OPERATIVE CONTRACTS

1. The Pre-Development Agreement

ATDC quickly and enthusiastically accepted Hughes’ proposal and agreed to fund \$200,000 for Hughes to commission certain development and feasibility studies. This funding was part of a Pre-Development Agreement between the ATDC and Developer dated September 1, 2003. In that document, a copy of which is attached hereto as “Exhibit C,” ATDC’s Board of Directors (the “ATDC Board”) authorized commencement of discussions with Hughes

towards completion of a development agreement and eventual lease pursuant to which Hughes would develop Piers 5 and 6 as proposed in Hughes' response to the RFP. The express purpose of the Pre-Development Agreement was to permit the parties to determine to their mutual satisfaction whether the certain issues identified by Hughes as interfering with the commercial feasibility of the project could be alleviated, including (1) the existence of a power plant blocking the view plane; (2) poor traffic patterns in the area; and (3) the lack of adequate parking spaces. Importantly, this agreement and funding specifically covered the commission of a parking study by Hughes to address the location of construction parking for the project, as well as temporary and permanent replacement parking for the Aloha Market Place, in recognition of the fact that such parking was not proposed by Hughes and would not be included within the Pacific Quay development.

2. The Development Agreement

Following extensive discussions and negotiations between Hughes and ATDC, and following successful completion by Hughes of the agreed upon studies pursuant to the Pre-Development Agreement, the parties negotiated and entered into the October 12, 2004, Development Agreement (the "Development Agreement"), a copy of which is attached hereto as "Exhibit D."

The Development Agreement is the controlling contract between the parties and attaches and expressly incorporates by reference the RFP, Hughes' Response, and the Pre-Development Agreement. The Development Agreement lists eleven (11) specific projects in Schedule 1, all but one of which are public infrastructure projects that are to be financed with public funding. Those public projects expressly include two separate parking facilities, not located on Piers 5 and 6, that would supply replacement parking for the Aloha Market Place as proposed by Hughes, validated by the parking study, and agreed by ATDC. With respect to these and the other public elements of the plan, the Development Agreement specifies that the Developer's sole involvement with respect to those project is to serve as the "project coordinator" if selected by ATDC.

The sole private development specified in the Development Agreement is the Pacific Quay project on Piers 5 and 6. With respect to the Pacific Quay project, the Development Agreement, among many other things:

- a. specifically incorporates and refers to the RFP and the Developer's proposal, wherein the Developer described the Pacific Quay project as a mixed-use private development consisting of residential units, retail and parking which would be privately financed;
- b. states "... this Agreement provides for the private development by KH of a private condominium/retail project on Piers 5 and 6....";
- c. expressly provides that "ATDC hereby grants to KH the exclusive right to develop, and KH agrees to develop, ... Piers 5 and 6....";

- d. expressly incorporates by reference the RFP, Hughes' Response, the Pre-Development Agreement;
- e. clearly recognizes that the issue of "adequate parking spaces serving the development area" had to be resolved or else the project "would be neither financeable nor viable," and recites that the parties had in fact determined to their mutual satisfaction that this issue had been resolved during the course of the Pre-Development Agreement, which included the parking study;
- f. recites that the ATDC Board had voted on October 12, 2004, to proceed with the project subject only to the enactment of certain legislation and the express contingencies set forth in the Agreement;
- g. provides that the Developer has the right to hypothecate the development rights in order to provide financing for the project;
- h. confirms that "it is the intent of the ATDC to effectuate all the public improvement project components in Schedule 1 ... and that it is the "intent of KH to effectuate all the private improvement project components, including without limitation, the establishment of Pacific Quay....";
- i. notes that no joint venture or partnership is created between the ATDC and the Developer; and
- j. agrees that all disputes or claims are to be resolved by mediation and/or arbitration pursuant to Section 21 of the Agreement.

Section 7 of the Development Agreement also specified that each of the projects described would require more definitive agreements in order to memorialize and effectuate the particulars of each such project. The Development Agreement therefore requires that the parties "negotiate in good faith to enter into such Project Component Agreements and along the parameters set forth in this Agreement, including all requirements inherent and explicit in Schedule 1, in order that the Project may be completed." Importantly, the Development Agreement nowhere provides for or otherwise allows the parties to fail to complete Project Component Agreement, nor does it condition either party's performance on their ability to negotiate Project Component Agreements. To the contrary, the Development Agreement is quite specific regarding the conditions to each side's obligations, and does not include ATDC's failure to negotiate Project Component Agreements as a basis for eliminating Hughes' development rights.

The RFP, the Developer's proposal and the Board's acceptance thereof all clearly state that the Pacific Quay project is to be developed as a private development on a 65-year ground lease. The Development Agreement also makes clear in multiple places that this is a purely private development for which Hughes is exclusively required to arrange funding. The definitive

project component agreement for Pacific Quay, therefore, is necessarily the ground lease itself. With respect to the public infrastructure projects, the definitive project component agreements would be in the nature of specific project management agreements, as the Development Agreement specifies.

In addition to the specific language in the Development Agreement requiring that the parties negotiate in good faith to enter into the ground lease (the specific project component agreement pertaining to the Pacific Quay project), the development contract "...contains an implied covenant of *good faith* and *fair dealing* that neither party will do anything that will deprive the other of the benefits of the agreement." See Simmons v. Puu, 105 Haw. 112 (2004). In Simmons, the court emphasized:

"The obligation to deal in good faith is now a well-established principle of contract law. Restatement (2nd) Contracts, Section 205 (1979) provides that "every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."

C. PERFORMANCE OF THE DEVELOPMENT AGREEMENT

1. The ATDC's Failed Legislative Attempt

Commencing in late 2004, the ATDC decided to attempt to convince the legislature to allow it to sell the land to the Developer so that the Developer could sell the condominium units in fee simple. This was done with the full concurrence of Hughes, as it would enhance the value of the project. The ATDC also sought funding from the legislature for the public projects infrastructure described in the Development Agreement. The ATDC prepared proposed legislation and actively lobbied during the legislative session of 2005.

a. The ATDC Approval of the Detailed Project Plan

The ATDC was unsuccessful in obtaining legislation either to sell the land or to obtain funding. Accordingly, at the request of the Board, the developer prepared a detailed description of the proposed Pacific Quay development and submitted it to the ATDC Board in early 2006. This was consistent with the Development Agreement, which expressly provided that if the legislation, funding or other governmental action necessary to accomplish the project was not authorized, the parties would reassess the project and consider alternative approaches. If the parties determined that a proposed alternative plan was feasible and desirable, they would proceed with the project as amended. In accordance with this process, Hughes provided to the ATDC a detailed project plan ("Detailed Project Plan"), limited to the development of Piers 5 and 6 and excluding any other portions of the overall Harbor public infrastructure, as the proposed alternative.

Importantly, Hughes' Detailed Project Plan did not provide for the Pacific Quay development to assume any or all of ATDC's parking obligations to the Market Place

or otherwise dedicate any parking spaces to that site. Rather, it provided for parking for residents and guests of Pacific Quay, plus a number of additional fee parking spaces to be available to the general public.

The ATDC responded by forming a 3-member committee to review the Pacific Quay Detailed Project Plan. After review, the committee unanimously recommended approval to the Board, and the Board approved it in June of 2006. The sub-committee approval recommendation for the project stated that it was conditioned upon the Developer's commitment to the improvement of the parking situation in the development area. At a meeting with the sub-committee, Hughes noted that the Detailed Project Plan would increase by 50% the parking available to the public and, therefore, he was improving the parking situation in the development area. There was never any discussion concerning any obligation on the part of Hughes to solve the Market Place parking situation, nor was there ever any discussion concerning an "obligation" that Hughes might owe the Market Place operator to supply parking.

In connection with ATDC's approval of the Detailed Project Plan, the ATDC staff was also directed to employ outside counsel to work with the Developer in drafting a ground lease. Hughes also immediately started on the development process, including the arranging of financing.

b. The ATDC Permits

The ATDC is a "one-stop" redevelopment agency and has its own zoning rules. It is not subject to City zoning. The zoning rules are contained in the ATDC Project Area Rules.

The Project Area Rules ("Rules") require only two permits, which are nondiscretionary, in connection with any development. The first is called a Project Eligibility Review (Rule Section 15-26-59). This review is essentially a sign off from various City and State agencies concerning the availability of utilities and other offsite infrastructure to the project. Hughes applied for the Project Eligibility Review in November 2006, and it was satisfactorily completed in January 2007. As part of that process, the developer requested a change in the ATDC zoning rules that would permit the construction of the specific building which had been proposed by the developer since the original response to the RFP. The public hearing was conducted, and the ATDC Board of Directors approved the zoning change in January 2007.

The other permit under the Rules is a Development Permit (Rule 15-26-60). This is a nondiscretionary permit which simply confirms that the project sought to be built conforms to the zoning rules. Since the zoning rules had already been changed to fit the project, this was not a major undertaking. Hughes submitted the Application for the Development Permit on March 20, 2007. The ATDC did not respond to the application and thus, pursuant to the Rules, the application was deemed accepted.

Under the Rules, there are no discretionary permits required to be obtained from the ATDC.

2. The ATDC Delays

Initially, the ATDC staff failed to promptly secure outside counsel. Five months passed from the date that they were directed to secure outside counsel before that selection was made. Despite constant prodding by Hughes and his counsel, another two months passed before any documents were generated by the outside counsel and the ATDC staff.

3. The ATDC's Bad Faith Attempt to Change the Deal

When ATDC finally did provided draft Project Component Agreements in January 2007, they were woefully inadequate and represented a dramatic departure from the terms of the Development Agreement and the subsequently approved Detailed Project Plan. Moreover, the ATDC refused to submit a draft Ground Lease (although the developer had submitted a draft to the Attorney General's office for review at least 1-1/2 years prior). Instead, in an act of extreme bad faith, the ATDC sought to create an entirely new development agreement which, among other things:

- a. Created a new "feasibility and viability" review process not sanctioned by the Rules;
- b. Completely stripped the developer of any of its rights under the Development Agreement;
- c. Restricted the developer to a 10% profit interest;
- d. Gave the ATDC complete control over construction, marketing and operation of the project;
- e. Required onerous financial conditions despite the fact that this matter only concerns a ground lease with single-payment rent;
- f. Gave the ATDC complete approval rights over the private financing;
- g. Saddled Hughes with certain of ATDC's parking obligations to the Market Place; and,
- h. Provided for strangely punitive remedies bearing no resemblance to the developer's proposal, the Development Agreement and the approval by the ATDC Board of the Detailed Project Plan.

In sum, the document was a poorly drafted, unsynchronized menage of provisions taken from loan agreements, security agreements, mortgages and leases. It attempted to create a situation in which the ATDC would be in complete control of the entire project, from beginning to end. Perhaps most fundamentally, it was not even remotely financeable under any

scenario. To make matters worse, the ATDC's outside counsel informed the developer's counsel that he was "not authorized to discuss the ground lease."

As noted above, the ATDC's document for the first time purported to require Hughes to solve the ATDC's longstanding parking problems with the Market Place. The ATDC's document made Hughes' rights contingent upon a resolution of the Market Place parking dispute with the Market Place operator on terms acceptable to the ATDC. It also required that Hughes provide replacement parking for the Market Place, at no cost to either the ATDC or the Market Place operator. In other words, Hughes would have to absorb over \$20 million in additional construction costs, with absolutely no return on the money. Of course, neither Hughes nor ATDC agreed to make the Pacific Quay project contingent upon the ATDC resolving its issues with the Market Place operator. Nor did the Pre-Development Agreement, Development Agreement, or the Detailed Project Plan require Hughes to supply this parking. As such, ATDC's draft document was nothing more than an attempt by the ATDC to "hijack" the Pacific Quay project in order to solve its problems.

D. HUGHES' EFFORTS TO SALVAGE THE DEAL

Notwithstanding ATDC's dramatic departure from the parties' prior agreements, Hughes was determined to complete the Project Component Agreements so that the parties could move forward with the development, to both of their substantial anticipated benefit. Yet for reasons unknown to Hughes, the ATDC and/or its staff has continued to demonstrate a determination to stymie his efforts in that regard.

1. The Option Agreement and Ground Lease

In March 2007, in response to ATDC's shocking display of bad faith, Hughes threatened to submit this matter to arbitration. In response, the ATDC appeared to change its position and the drafting of the documentation appeared to be heading in the right direction. In addition to the ground lease, the parties agreed to use an option to lease in order to facilitate the development process. Hughes' counsel took the lead in drafting the Project Component Agreements.

By August 2007, Hughes' counsel had submitted forms of the option and the ground lease which were acceptable to Hughes and were consistent with the spirit and substance of the Development Agreement and the Detailed Project Plan, as well as industry standards for private developments of this type. After more than a month without comment, the ATDC responded with numerous substantive revisions that, among other things, again attempted to strip away Hughes' rights, granted essential overall control of the private development process to the ATDC, and reinstated the Market Place parking issue. ATDC did not respond at all to Hughes' draft of the ground lease.

2. The Ground Lease Rent

Although ATDC had failed altogether to propose a form of ground lease, Hughes attempted to negotiate with ATDC an appropriate rent figure. With respect to the determination of rent, Hughes has made three proposals. With respect to the first two proposals, the ATDC has simply rejected the proposals without any proposal of its own. The ATDC's counsel responded to the third proposal with a meaningless counter-proposal. As such, Hughes has never received a good faith proposal.

The parties did agree to a single payment of rent. That single payment of rent is not deductible by Hughes as a project cost, and thus it has to be paid by each individual buyer as a component of the purchase price for a unit. The amount of the single payment of rent has to be specifically spelled out on the face of the contract and has to be paid by the buyer to the ATDC.

There is obviously a limit to what a buyer will pay for lease rent. Hughes made a proposal based upon the advice of experts as to what would be acceptable to buyers. It is not possible for Hughes to pay for any more than what the buyers themselves are willing to pay, as any such amounts are not deductible as project costs. Hughes also offered to pay for \$12.5 million in infrastructure costs to make the site ready for development. This work is primarily shoreline bulkhead and pier work, all of which will belong to the State, is for the benefit of the State, and will not be owned or operated by the project. By virtue of the RFP, the developer was led to believe that this contribution would be taken into account with respect to the determination of rent.

3. The Revised Option Agreement and Subsequent Negotiations

In August 2007, ATDC's counsel provided its "markup" of Hughes' proposed Option Agreement. As mentioned above, that document again represented a seismic shift from the Development Agreement and Detailed Project Plan, granting significant approval and other rights to ATDC and imposing substantial obligations on Hughes that were inconsistent with any financeable or commercially feasible private development agreement and incongruous with the four years of the parties previous dealings.

In response, Hughes prepared yet another revised draft of the Option Agreement and Ground Lease, acceding to as many of ATDC's proposals as possible, while remaining true to the underlying agreements and, perhaps most importantly, ensuring the financeability of the project. A copy of Hughes' final proposals, provided to ATDC in September 2007, are attached as Exhibits E and F.

In October 2007, still without receiving approval of or comments on the draft documents from ATDC, counsel for Hughes and ATDC met by teleconference to discuss the draft documents and the material issues remaining.

In that call, counsel for ATDC identified three substantive issues upon which there remained material differences:

- a. Financial issues such as option fees, extension fees and rent

- b. Remedies available to either party
- c. Aloha Tower Market Place Parking

4. ATDC's Parking Bombshell

Following the call with ATDC, and in an effort to correct what Hughes believed to be a breach of the underlying agreement, James Stubenberg, counsel for Hughes, communicated with counsel for ATDC, Gregg Kinkley of the Attorney General's office, regarding the issue of parking, which they had discussed at length in the past. In those communications, which are attached hereto as Exhibit G, Mr. Kinkley made clear for the first time ATDC's new position that it sought to obligate Hughes, for the 65+ year duration of the project, to "help [ATDC] solve its parking problems with [the Market Place]. As Mr. Kinkley emphasized, if ATDC could not find a solution to its "sole satisfaction," then Piers 5 and 6 could be used for the Market Place parking. Most importantly, Mr. Kinkley admitted that it was ATDC's intention to strip Hughes of the "legal availability of development rights" if he would not accede to ATDC's demands.

5. Hughes' Good Faith

Since the RFP was issued, Hughes has made over 20 trips to Hawaii from his home base in Dallas and numerous other trips to Pasadena and San Diego to consult with architects and engineers on the Pacific Quay project. He has met repeatedly with virtually every community group in the area and has been more than favorably received. The Downtown Neighborhood Board has unanimously approved the Pacific Quay project as have numerous other groups. The Pacific Quay project has widespread public support unlike the failed project in Kakaako. This public support is largely due to Hughes' efforts.

This project should have been in a position to break ground in early 2007. As a result of all of these various delays, the cost of the project has risen by nearly \$40 million. And, in the meanwhile the citizens of Honolulu have been deprived of, and ATDC has failed in its State-mandated mission to deliver, a world class development of the Honolulu Harbor.

Even after ATDC's final proposals and its counsel's confirmation of its intent to hold the project hostage over ATDC's separate parking obligation, Hughes offered to travel to Hawaii to meet personally with ATDC's Board to resolve the dispute. The ATDC did not respond.

Faced with ATDC's intransigence on the remaining material negotiating points in the draft Project Component Agreements, and its express confirmation that it intends to hold Hughes hostage over ATDC's own parking liability to a third party, Hughes has regrettably determined arbitration is the only potential path to resolution.

IV. RELIEF SOUGHT

Hughes requests the Arbitrator to order one of the following primary remedies, in addition to such other and further relief as the Arbitrator may determine is appropriate:

First:

1. Determine that the Hughes' position with respect to the items outlined in the draft Project Component Agreements are correct and appropriate and in accordance with the Development Agreement;
2. Determine that the single payment of rent for the Pacific Quay project, to be paid by buyers of condominium units, shall be equal to 6% of the gross sales price of each such unit, payable at closing, and subject to the floor and ceiling as set forth in Hughes' rental proposal;
3. Determine that (i) the costs associated with the ATDC's delay; and (ii) the public infrastructure costs to be paid by Hughes shall be deducted from the rent;
4. Determine that Hughes has no obligation to either the ATDC or the Market Place lessee with respect to the Market Place parking issues except to pay the sum of \$50,000.00 per year directly to a parking facility for temporary parking during the construction period;
5. Order the ATDC to execute and perform the option and ground lease; and
6. Order the ATDC to pay Hughes' attorney's fees and costs.

- OR -

Second:

1. Determine that the ATDC has repeatedly, materially and substantially breached the covenant of good faith and fair dealing contained in the Development Agreement and determine the amount of damages from the ATDC that the Developer is entitled therefor, including, but not limited to, (i) contract damages for the project profits which would have inured to Developer had it not been for the ATDC's breach of contract, and (ii) bad faith tort damages for the breach of the covenant of good faith and fair dealing;
2. Determine that the ATDC has committed an unlawful taking of Hughes' vested development rights in the Pacific Quay project and award Hughes damage for the value of such property; and,
3. Order the ATDC to pay Hughes reasonable attorney's fees and costs.