

EXHIBIT 1

CITY OF UKIAH vs. UKIAH VALLEY SANITATION DISTRICT
ROUND THREE

April 3, 2013

SUMMARY

The Grand Jury (GJ) has been documenting the adversarial relationship between the City of Ukiah and the Ukiah Valley Sanitation District (UVSD) since 2005. Considering new costly environmental regulations, downgrading of the sewer plant loan, disgruntled ratepayers, and the lack of a new customer base, this continued animosity between the two agencies is only making a serious situation worse.

Both entities have little reason to trust each other. They are bound together by a Participation Agreement (PA) that is flawed and unworkable, and favors the City. The City has shown disrespect for the UVSD by ignoring their requests for basic information. The City's antiquated computer system added to the problem by making it difficult to provide information to the UVSD. City management staff states they want annexation of the UVSD's assets. The UVSD is considering withdrawing from the PA and joining with Ukiah Valley Water Districts.

City upper management continues to be unresponsive to official communication from the UVSD. The UVSD is reactive to the City, the City is reactive to the authorities, and no one is doing the long-range planning which is necessary for a successful operation. The end result will depend on what Local Area Formation Commission (LAFCo) recommends and permits. Both parties may take legal action to amend or break the PA.

Adding to the problem are the Moody's downgrade of the sewer bonds, and new water board regulations which have already cost \$372K just to assess the situation. In addition, the aging infrastructure is in need of repairs. These issues will result in additional sewer rate hikes in the near future.

The GJ is recommending that the City and the UVSD learn how to work together beginning with improving their communication with each other. The City needs to provide documents to the UVSD and expedite implementation of their financial system. The UVSD should move forward towards implementing its own financial system and be attentive to the activities of the city council concerning water and sewer issues. LAFCo should conduct a feasibility study on the consolidation of sewer and water agencies. As final consideration, the UVSD should seek legal counsel regarding capture of lost revenues and options to disassociate from the PA.

GLOSSARY

Equivalent Sewer Service Unit (ESSU): a unit of measurement of sewage capacity.

Freedom of Information Act (FOIA): requires disclosure of governmental records to the public upon request.

Moody's: A leading independent bond rating agency and provider of global economic analysis, data, forecasting and credit risk management that recently downgraded the City of Ukiah's Bonds.

Participation Agreement (PA): a contract between the City and the UVSD on joint usage of the sewer system.

Sphere of Influence (SOI): an area of actual or possible service provided by a government agency.

BACKGROUND

In 1954, the Ukiah Valley Sanitation District joined with the City to provide sewer services for the Ukiah Valley. On July 19, 1995, the City of Ukiah and the UVSD entered into a Participation Agreement (PA) for the operation of sewer facilities. The UVSD was a dependent district governed by city and county officials until 2006, at which time they became an independent district with an elected board. There were never any modifications to the PA to address this change.

Since 2006, the GJ has conducted three investigations regarding the relationship between the City of Ukiah and the UVSD. The investigation resulted in a report (Time for Change dated May 21, 2009), which included 19 recommendations by the GJ. Although the City responded positively to most of the recommendations, none of them were implemented and all of the problems still exist.

A joint Ad Hoc Committee was formed in 2009, and in a report, made recommendations to revise the PA. These recommendations were described as “good governance improvements”. None of these revisions were made.

In 2012-2013, the GJ received a complaint accusing the City of unfair treatment towards the UVSD. This GJ decided to re-examine the relationship between the UVSD and the City and investigate the reasons for the City's financial downgrade by Moody's.

APPROACH

The GJ interviewed managers and employees from the City of Ukiah, board members from UVSD and LAFCo, Ukiah City Council members, an Independent financial consultant, and a Ukiah contractor. The GJ toured the Ukiah Waste Water Treatment Plant. The GJ reviewed the following documents:

- Participation Agreement
- Ad Hoc Committee Recommendations
- Sewer Bond documents
- Sewer bills from UVSD and City of Ukiah customers
- City of Ukiah Budgets
- City of Ukiah Municipal Service Review – Parts 1 & 2
- UVSD Municipal Service Review
- LAFCo Meeting Minutes
- John Dickerson’s Consolidation Report
- California Proposition 218

DISCUSSION

The relationship between the City of Ukiah and the UVSD is not working. The disparities are numerous and serious and indicate a lack of good governance to the detriment of the UVSD, and therefore the community it serves. This dysfunctional relationship is characterized by an unfair Participation Agreement (PA), fiscal mismanagement, a lack of cooperation by City upper management, and unclear policies and procedures that are a disservice to the UVSD. The GJ’s investigation of the current relationship uncovered the following.

Participation Agreement

The PA that binds the two entities has been biased towards the City from the start, and is not a fair or workable document. The PA essentially transfers the primary functions of the UVSD, to the City of Ukiah, leaving the UVSD with no oversight or control. The City has no motivation or reason to change the PA. Both the GJ and Joint Ad Hoc Committee made suggestions to improve the PA; however the recommendations were not implemented.

The City is responsible for collecting all revenue and paying all costs. The sharing of the cost is based on receipts of the ratepayers rather than the allocation of ESSU’s, as specified in the PA. There continue to be discrepancies in the assignment of revenue of some UVSD ratepayers residing within the city limits.

The PA does not address the problem of the rate variance between the UVSD ratepayers and the City ratepayers that reside within the city limits.

The City is responsible for operation and maintenance of the plant and the sewer collection system. However, the City does not maintain records of the specific costs involved; it is impossible to determine the accuracy of the City’s allocation of costs to the UVSD. The UVSD has found reason to question the City’s records and charges.

The agreement requires the City and the UVSD to meet jointly once a year to carry out the purpose of the PA, and this has not been complied with.

Other than budget matters, the agreement does not include a method for dispute resolution.

Serious Financial Issues

In 2012, two serious financial issues developed requiring cooperation and joint future planning. The Moody's downgrade of the sewer bond makes borrowing money more costly, and the newly mandated requirements for removing additional chemicals from the sewer plant discharge requires expenditures of large sums of money.

Ratepayer costs for both the City and the UVSD have doubled and are expected to increase again. Both sides are to blame for the current situation. The Moody's downgrade of the City of Ukiah's outstanding bond debt of \$71.9M went from A2 to Baa1. The downgrade reflects the City's reliance on unexpended bond proceeds and capitalized interest to meet the rate covenant in fiscal 2011 and 2012, and the use of the Rate Stabilization Fund in 2013. This deterioration of finances points to a large rate increase in 2013 and beyond. The unused bond money and interest earned is being used to pay the indebtedness of the bonds.

New North Coast Regional Water Quality Control Board regulations are asking for additional technological requirements and modifications to the sewer plant. The facts reflect that the City has neglected to notify the UVSD in a timely manner of these new regulations, or of the City's decision to hire an engineering firm to study the matter and propose solutions to treat the nitrate/ammonia problem. Initial contract cost is \$372K, of which 65% is the responsibility of the UVSD. The UVSD has accused the City of insufficient notification of study and negotiations of the contract.

The sewer system infrastructure is aging and parts of it are in need of repair. Problems of infiltration (the entrance of ground waters into the sewer pipe) exist in the sewage collection system, which overwhelms the capacity of the sewer treatment plant in the winter months. With the financial assistance of grants some repairs have been accomplished but much more remains to be done. The repair and/or replacement of lateral lines and trunk lines will result in future costs to ratepayers.

The proximity of the percolation ponds that hold effluent from the wastewater treatment plant will eventually have to be closed due to their proximity to the Russian River. This effluent may be used for irrigation at parks, golf courses, orchards, etc. However, the additional treatment of the water and the infrastructure to carry the water to where it may be used will be costly.

The UVSD maintains that the City continues to ignore their request for financial documentation and information. The UVSD states the information received from the city

is confusing and un-useable. City management states that the questions asked by the UVSD are not specific.

The UVSD has requested a list of district customers; however the city's current billing system cannot deliver this basic information. The City has promised a new computer system since 2007, and informed us that the new system is finally being implemented. The UVSD's continuing request for a basic customer list and the City's inability to provide this information has now resulted in a FOIA request. UVSD claimed originally there were 172 accounts in the overlap area that were being incorrectly credited to the City. Recent clerical efforts on behalf of the City have resulted in reducing the number of discrepancies. The UVSD has recently decided to develop their own duplicate financial system to track costs since the City continues to deny their requests for information.

Instead of sending delinquent UVSD bills to the county tax collector, the City mistakenly sent them to a private collection agency resulting in delayed payments and loss of revenues. The UVSD has taken this function over from the city to avoid further problems.

In order to take advantage of planned road construction on North State Street, the UVSD laid sewer lines for future development. The development has not materialized resulting in a \$250K cost to the UVSD with no incoming revenue.

Possible Solutions

Two conflicting solutions to the impasse have been suggested; each benefits a specific entity.

A recent study by an independent consultant contracted by UVSD, titled, "Consolidation of Wastewater and Water Services in the Ukiah Valley", outlines a possible solution for dissolving the PA and strengthening the district. This would mean the consolidation of the UVSD and water districts for the Ukiah Valley. This solution requires the assistance of LAFCo, other cooperative water agencies, legal counsel, and possibly the state legislature. The authority of LAFCo is principally one of planning and regulating the extent of individual government services in a particular area of influence, to encourage orderly government and discourage urban sprawl.

The City is proposing detachment of the overlap areas of city and district and annexation of contiguous areas to the City. This solution reduces the extent of responsibility and service area of UVSD but does not resolve the issues inherent in the PA and does not address the financial responsibilities and obligations.

Positives

There are some positive things to note. The City has been promising a new financial system since 2007, and city staff stated that they are working on making the system operational later this year. Communication has improved as mid-level City staff and

UVSD have begun working together. To correct the infiltration problems, the City has lined a small portion of the clay pipes in older neighborhoods. There is also a small pilot project known as the Water Reuse Program to be used in the pear orchards south of town. After taking a tour of the Waste Water Treatment Plant, the GJ was impressed by the small, dedicated staff and its efficient operation.

FINDINGS

- F1. The City of Ukiah has not provided UVSD with sufficient information forcing UVSD to make a Freedom of Information Act (FOIA) request.
- F2. The City of Ukiah’s antiquated financial systems have added to the tension between the two organizations.
- F3. The unilateral management by the City of Ukiah has resulted in fees/fines that the UVSD has been required to pay. City upper management has shown a lack of respect to UVSD by being unresponsive to requests, and expecting UVSD to immediately concur with the city’s decisions.
- F4. The Participation Agreement (PA) is not a workable document and has a clear bias towards the City of Ukiah.
- F5. LAFCo is in a position to facilitate resolution of conflicts between agencies by means of the municipal service review and sphere of influence.

RECOMMENDATIONS

- R1. The City of Ukiah should provide UVSD with a copy of their customer list per the FOIA request. (F1, F2, F3)
- R2. The UVSD complete the creation of its own accounting system. (F2)
- R3. The UVSD use legal counsel to recapture lost revenues from the City of Ukiah. (F3)
- R4. The UVSD seek legal counsel regarding options to disassociate from the Participation Agreement. (F4)
- R5. LAFCo conduct a feasibility study on consolidation of sewer and water agencies and provide conflict resolution between UVSD and the City of Ukiah. (F5)

REQUEST FOR RESPONSES

Pursuant to Penal code section 933.05, the following responses are *required*:

- Ukiah Valley Sanitation District Board: respond to F2-F4 and R2- R4 within 90 days
- Ukiah City Council: respond to F1 and R1 within 90 days

The governing bodies indicated above should be aware that the comment or response of the governing body must be conducted subject to the notice, agenda and open meeting requirements of the Brown Act.

The Grand Jury *requests* the following individuals respond:

- Jane Chambers, Ukiah City Manager: respond to F1 and R1 within 60 days
- Bruce Baracco, Local Area Formation Commission Organization (LAFCo): respond to F5 and R5 within 60 days

Reports issued by the Civil Grand Jury do not identify individuals interviewed. Penal Code Section 929 requires that reports of the Grand Jury not contain the name of any person or facts leading to the identity of any person who provides information to the Civil Grand Jury.
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EXHIBIT 2

OPERATING
AGREEMENT FOR THE
COMBINED SEWER
SYSTEM SERVING THE
UKIAH VALLEY
SANITATION DISTRICT
AND THE CITY OF UKIAH

Table of Contents

I. RECITALS:.....	1
II. TERMS	3
A. DEFINITIONS.....	3
B. BILLING AND COLLECTION OF REVENUE—DISTRICT CUSTOMERS	5
1. Transfer of Records.....	5
2. Transfer of Responsibility for Billing and Collection Services.....	6
3. Responsibility for Billing and Collection Services Where CITY Continues Billing & Collection Functions for Combined CITY/DISTRICT Sewer System.....	6
4. Implementation of DISTRICT Assuming Billing and Collection Function	7
5. Prohibition on Further CITY Charges.....	7
C. OPERATIONS AND MAINTENANCE.....	7
1. DSS and CSS (Collection Systems) and Trunk Line.....	7
a. Transfer of Records.....	7
b. Transfer of Responsibility to Operate and Maintain DSS and Trunk Line.....	8
c. Responsibility to Perform Operations and Maintenance.....	8
d. Provision of Information to Determine Whether to Assume Operation and Maintenance of DSS and/or Trunk Line.....	9
e. Implementation of DISTRICT Assuming Operation and Maintenance Function.....	9
f. Prohibition on Further CITY Charges.....	9
g. DISTRICT obligation to furnish CITY with records.....	9
2. CWWTP.....	10
a. Transfer of Records.....	10
b. DISTRICT’s Utilization of CWWTP.....	10
c. Responsibility to Perform Operations and Maintenance.....	11
3. Performance Standards & Information Sharing.....	11
a. Performance Standards.....	11
b. Information Sharing.....	11
D. COST ALLOCATION	11
1. Operations and Maintenance Costs of CWWTP, Trunk Line, DSS & CSS	11
a. Cost Allocation.....	11
(1) CWWTP, DSS, CSS & Trunk Line:.....	11
(2) DSS & CSS Cost Segregation.....	14
b. Exclusions, Exceptions & Other Adjustments to the Cost Allocation.....	14
(1) Customers and Connections Excluded from Allocation Methodology	14
(2) Customers and Connections Transferred.....	14
(3) Billing & Collection Services Costs.....	15
(4) Costs Associated with Operations and Maintenance of CSS and DSS.....	15
(5) Capital Improvement Costs Excluded.....	16
(6) Recycled Water Project.....	16
2. Bond Debt Service	16
a. Background.....	16
b. Installment Payments.....	17
c. Bond Debt Refinancing.....	17
d. Limitations on DISTRICT Assumption and CITY Discontinuance of Functions:.....	17
3. Capital Improvement Costs.....	20
a. Shared Capital Improvement Costs.....	20
b. Capital Improvements to DSS and CSS.....	21
c. Capital Improvements to the Trunk Line	21
4. Reporting Allocated Costs.....	21
a. Budgeted Costs.....	21
b. Actual Cost True Up.....	22
5. Information Sharing.....	23
6. Rate Studies.....	23
E. ALLOCATION OF REMAINING CWWTP CAPACITY-PROJECT CAPACITY	23
1. Capacity Allocation.....	23
2. Calculating Consumption of Remaining ESSUs	25

F.	CHANGES OF ORGANIZATION AND DISTRICT REGIONAL WASTE WATER	
	TREATMENT PLANTS (DRWWTP)	26
1.	Changes of Organization.....	26
2.	DRWWTP Development	26
3.	Obligation to meet and confer.....	27
4.	Transfer of Capacity Project ESSU-Connections Through a Change of Organization or to a DRWWTP.....	27
	a. ESSU Numerical Value.....	27
	b. Payment of Transferred Connections Assigned Capacity Project ESSUs	27
	c. Effect of Transfer on Cost Allocation.....	28
	d. Effect of Transfer on Remaining CWWTP Capacity Project Capacity Allocation.....	28
	e. DISTRICT's Transfer of ESSUs Within CITY Limits.....	28
5.	Transfer of Non-Capacity Project ESSUs:.....	28
	a. ESSU Numerical Value.....	29
	b. Effect of Transfer on Cost Allocation.....	29
	c. Effect of Transfer on Remaining CWWTP Capacity Project Capacity	29
6.	Use of CWWTP Capacity Following Transfers.....	29
G.	ARBITRATION.....	30
1.	Fast-Track Alternative Dispute Resolution.....	30
	a. Notice.....	30
	b. Response	30
	c. Good-faith effort to resolve.....	30
	d. Binding Arbitration.....	30
	(1) Arbitrators.....	30
	(2) Arbitration.....	30
2.	Arbitration of other disputes	31
H.	MISCELLANEOUS.....	31
1.	Entire Agreement Conditional.....	31
2.	Effect on Participation Agreement, As Amended.....	31
3.	Indemnification.....	31
4.	Duration of Agreement.....	32
5.	No Third-Party Beneficiaries.....	32
6.	Time is of the Essence.....	32
7.	Integration Clause.....	32
8.	Cooperation Clause.....	32
9.	Construction.....	32
10.	Notices.....	32

**OPERATING AGREEMENT FOR THE COMBINED SEWER SYSTEM
SERVING THE UKIAH VALLEY SANITATION DISTRICT AND THE
CITY OF UKIAH**

This Operating Agreement for the Combined Sewer System Serving the Ukiah Valley Sanitation District and the City of Ukiah ("Agreement") is made and entered into in Ukiah, California, on the date last executed below ("Effective Date"), by and between the City of Ukiah ("CITY"), a general law municipal corporation, and the Ukiah Valley Sanitation District, a county sanitation district ("DISTRICT"). DISTRICT and CITY are, at times, collectively referred to hereafter as the "Parties."

I. RECITALS:

1. A proceeding between the Parties is presently pending in Sonoma County Superior Court entitled *Ukiah Valley Sanitation District v. City of Ukiah*, case no. SCV 256737 ("the Action").
2. The Parties entered a Participation Agreement, dated July 19, 1995 ("Participation Agreement"), as amended on March 24, 1999 ("Amendment No. 1") and again December 15, 2004 ("Amendment No. 2), collectively the "Participation Agreement," which set forth, among other things, the Parties' responsibilities regarding, and the terms under which the Parties provide, wastewater collection and treatment services to their respective ratepayers and residents.
3. Under the Participation Agreement, the CITY operates the Combined CITY/DISTRICT Sewer System (as defined herein) as one system with the combined treatment and collection costs apportioned between the CITY and the DISTRICT based on the ratio of CITY to DISTRICT Equivalent Sewer Service Units ("ESSUs") for each year of operation. The CITY also is the paying and receiving agent for the DISTRICT, performs all billing and collection services for the Combined CITY/DISTRICT Sewer System, and accounts to the DISTRICT for the funds it collects from DISTRICT ratepayers.
4. The sewer services the CITY performs can be fairly characterized as three functions ("Sewer Services"): (1) billing/collection of sewer service and connection fees, and disbursement of funds collected on behalf of the DISTRICT for payment to CITY for DISTRICT's allocated share of certain sewer system operations, maintenance, capital improvement, and financing costs, and accounting to the DISTRICT for the funds collected or spent; (2) operations and maintenance of the CITY wastewater collection facilities and the DISTRICT wastewater collection facilities, including the Trunk Line (defined below); and (3) operations and maintenance of CITY's wastewater treatment plant (defined below as CWWTP).
5. The Participation Agreement recites that CITY owns the CWWTP and predecessor agreements of the Parties recite that DISTRICT constructed the Trunk Line and the DISTRICT claims ownership thereof. The CITY contends that it owns wastewater collection facilities within its sewer-service jurisdictional boundaries (defined below collectively as CSS). The DISTRICT contends that it owns wastewater collection facilities within its sewer-service jurisdictional boundaries and the Trunk Line located within both the CSS and DSS that

transports all wastewater from the Parties' respective wastewater collection facilities to CWWTP.

6. In connection with the issuance of \$75,060,000 aggregate principal amount of the Association of Bay Area Governments 2006 Water and Wastewater Revenue Bonds, Series A (the "2006 Bonds") to finance a project ("CWWTP Project") to rehabilitate / upgrade and increase the capacity of the CWWTP, (A) the Parties entered Amendment No. 2 and a Financing Agreement, dated March 2, 2006 ("Financing Agreement"), (B) the CITY entered an Installment Sale Agreement, dated as of March 1, 2006 ("2006 ISA") with the Association of Bay Area Governments ("ABAG") and Wells Fargo National Bank, as bond trustee ("Bond Trustee"), and (C) ABAG and the Bond Trustee entered into an Indenture of Trust, dated as of March 1, 2006 ("2006 Indenture"). Under the 2006 ISA, the CITY agreed to repay the 2006 Bonds by making installment payments ("2006 Installment Payments"). The purpose of the Financing Agreement was to apportion a portion of the 2006 Installment Payments to the DISTRICT in accordance with the methodology set forth in the Participation Agreement. Under the Financing Agreement, the DISTRICT agreed to set rates for services and facilities furnished by the DISTRICT's portion of the Combined CITY/DISTRICT Sewer System during each fiscal year that are sufficient, after making allowance for contingencies and error in the estimates, to yield net revenues (being total revenues less all costs apportioned to the DISTRICT under the Participation Agreement for the operation, maintenance and repair of the DISTRICT's portion of the Combined CITY/DISTRICT Sewer System) which are at least equal to 120% of the DISTRICT's allocated share of the 2006 Installment Payments for that fiscal year. In addition, the Financing Agreement provides that the CITY, as the DISTRICT's collecting and paying agent, apply revenue it collects on the DISTRICT's behalf to pay the DISTRICT's allocated share of the 2006 Installment Payments.

7. The CITY and the DISTRICT mutually desire to pursue a refinancing of the 2006 Bonds to obtain debt service savings and to accommodate the DISTRICT's elections under this Agreement ("Refinancing"). The Refinancing will require transparency and full cooperation between the Parties and, as set forth herein, both CITY and DISTRICT agree that each shall be included in all written and oral communications relating to the Refinancing involving third parties (e.g. underwriters, investors, rating agencies, advisors). The Parties agree to make good faith efforts to undertake the Refinancing in a timely manner, acknowledging the same will require an unconditional commitment by both the CITY and the DISTRICT to pay their respective share of the debt service for the Refinancing in accordance, and in keeping, with this Agreement and the requirements of underwriters, bond insurers and bond counsel to obtain the most favorable bond rating and interest rate available under the market conditions for tax free revenue bonds existing at the time of the Refinancing

8. The Parties enter this Agreement for the following purposes:

a. to settle the claims asserted in the Action in accordance with the Settlement Agreement and Release, attached hereto as **Exhibit 1**;

b. to set forth the terms under which the DISTRICT may assume, at its election, all or part of the first two Sewer Services functions currently performed by the CITY pursuant to the Participation Agreement;

c. to amend the terms of the Participation Agreement. The Parties agree in section II.H.2. that, in the event of any inconsistency between any provision of this Agreement and the Participation Agreement, this Agreement shall control.

II. TERMS

A. DEFINITIONS

1. "2006 Bonds" means the \$75,060,000 aggregate principal amount of the Association of Bay Area Governments, 2006 Water and Wastewater Revenue Bonds, Series A issued pursuant to the 2006 Indenture.
2. "Capacity Project" means the "project to increase the capacity of the wastewater treatment plant to permit additional new connections in both the DISTRICT and the CITY for treatment of wastewater in the CWWTP, as more particularly described in paragraph 7, page 2 of Amendment No. 2.
3. "Capacity Project ESSUs" means the 2,400 ESSUs made available in the CWWTP by the Capacity Project for new Connections or increased use by existing Connections.
4. "Capital Improvement" means the addition of a permanent structural change or the restoration, repair, or replacement of some aspect of a facility that will either enhance the asset's overall value, increase its useful life or adapt it to new uses
5. "CITY Customer" means any Customer with a Connection to the CSS.
6. "CITY Combined Sewer Budget" means the annual fiscal year budget (July 1-June 30) adopted by the City Council, in accordance with this Agreement, for the Combined Sewer System.
7. "City Sewer System" or "CSS" means all portions of the sewer collection system located within the CITY's sewer-service jurisdictional boundaries, including, but not limited to, all sewer laterals, mains, and related facilities that are part of the combined sewer system. For purposes of this Agreement, the CSS shall extend to include any additional portions of the sewer collection system located within boundaries to which the CITY's sewer-service jurisdiction may extend through future changes in organization. Notwithstanding any contrary provision, the Trunk Line shall not be a part of the CSS.
8. "Combined CITY/DISTRICT Sewer System" means the CSS, DSS, Trunk Line and CWWTP, and any combination of all or part of the foregoing, the Direct and Indirect costs of which are shared by the Parties in accordance with this Agreement.

9. "Connection(s)" means the lateral sewer line that serves to transport wastewater directly from any property or structure (residential, commercial, industrial, or otherwise) to a sewer main located within the DSS or CSS.

10. "Connection fee" means the fee for a connection based on the ESSUs assigned to the Connection in accordance with section II.E.

11. "Customer(s)" means any customer (whether individuals, businesses, governmental entities or otherwise) or property maintaining a Connection to the DSS or CSS.

12. "CWWTP" means the CITY's wastewater treatment plant.

13. "Direct Costs" means all costs specifically and completely attributable to the Combined CITY/DISTRICT Sewer System but specifically excluding Indirect Costs.

14. "DISTRICT Combined Sewer Budget" means the annual fiscal year budget adopted by the DISTRICT's board, in accordance with this Agreement, for the Combined CITY/DISTRICT Sewer System.

15. "DISTRICT Customer" means any Customer with a Connection to the DSS.

16. "DISTRICT Sewer System" or "DSS" means all portions of the sewer collection system located within DISTRICT's boundaries, including, but not limited to, all sewer laterals, mains, and related facilities that are part of the combined sewer system. DSS does not include the Trunk Line, although it is owned by the DISTRICT. For purposes of this Agreement, the DSS shall extend to include any additional portions of the sewer collection system located within boundaries to which the DISTRICT's sewer-service jurisdiction may extend through future changes in organization.

17. "DRWWTP" means any future DISTRICT regional wastewater treatment plant(s) and includes any non-CITY facility utilized by DISTRICT to treat sewer wastewater.

18. "ESSU(s)" means the equivalent sewer service units assigned to a Connection or reserved for a Connection (residential, commercial, industrial, or otherwise) for the purpose of charging a Connection fee and used to determine the number of the 2,400 Capacity Project ESSUs used by each party and the number of ESSUs assigned to a Connection for purposes of transferring ESSUs from one party to the other.

19. "Effective Date" means the date set forth in the opening paragraph hereof.

20. "Financing Agreement" means that certain agreement executed by CITY and DISTRICT on March 2, 2006, as amended or supplemented.

21. "Indirect Costs" means all costs used by or which support the Combined CITY/DISTRICT Sewer System that are not Direct Costs. Indirect Costs include, but are not limited to, billing and collections, general services allocation, administration, and overhead costs.

22. "Installment Payments" means the payments required under the 2006 Installment Sale Agreement, or any agreement entered in connection with the Refinancing.

23. "2006 Installment Sale Agreement" means that certain agreement entered by CITY, ABAG, and the Bond Trustee, dated March 1, 2006, as amended or supplemented.

24. "Overlap Area" means that portion of the DISTRICT's jurisdictional boundaries that is within the City limits of CITY.

25. "Participation Agreement" means the Participation Agreement entered into by the Parties on July 19, 1995, and includes, unless otherwise specified, Amendment No. 1 to the Participation Agreement, dated March 24, 1999 ("Amendment No. 1"), and Amendment No. 2 to the Participation Agreement ("Amendment No. 2"), dated December 15, 2004.

26. "Settlement Agreement" means the Settlement Agreement and Release, attached hereto as **Exhibit 1**.

27. "Sewer service jurisdictional boundaries" means the area within the boundaries of the CITY or the DISTRICT within which the CITY or the DISTRICT maintains jurisdiction to provide sewer services.

28. "Trunk Line" means the main sewer line running to the CWWTP into which all sewage from the Combined CITY/DISTRICT Sewer System enters. The Trunk Line is owned by the DISTRICT.

29. "Upgrade/Rehabilitation Project" means the "project to rehabilitate and upgrade the wastewater treatment plant," as more particularly described in paragraph 7, page 2 of Amendment No. 2 to the Participation Agreement.

B. BILLING AND COLLECTION OF REVENUE—DISTRICT CUSTOMERS

1. **Transfer of Records.** Within sixty (60) days after written request from the DISTRICT, CITY shall provide DISTRICT the same or reasonably similar access to CITY billing and collection records and information, in the form maintained by the CITY, as the CITY staff has to those records and information, including all such billing and collection records maintained by CITY, its agents, or third parties who hold, maintain, or use the same to perform sewer billing and collection services for CITY. Absent agreement of the Parties, the CITY shall have no obligation to convert records or information into another format or electronic form. The purpose of this provision is to timely provide DISTRICT complete access to all such records, information, and materials so DISTRICT may promptly and fully perform billing and collection services on its own behalf for DISTRICT Customers in a manner consistent with that done by CITY and for continuity of such service during and following the transition of services provided for herein. CITY shall use its best efforts to cooperate with the DISTRICT, to timely transfer customer account information and billing and collection records to DISTRICT, and to otherwise comply with this provision. The

Parties each acknowledge and agree they are required to maintain confidentiality of Customer account information and to take adequate security measures to protect against identity theft.

2. **Transfer of Responsibility for Billing and Collection Services.** Subject to section II.D.2.d., on not less than twelve (12) months written notice to CITY, or such other period of notice as agreed upon by the Parties, DISTRICT may, in its sole discretion, elect to discontinue all of the billing and collection services provided to DISTRICT by CITY. Upon assuming its own billing and collection services DISTRICT shall establish or utilize its own billing systems to send bills and collect revenues and financial accounts in which to deposit and manage such funds. If DISTRICT wishes to discontinue only a portion of the billing and collection services provided to DISTRICT by CITY: DISTRICT's written notice to CITY shall include a description of which portion of the billing and collection services it is assuming; DISTRICT may do so only with CITY approval, in CITY's sole discretion; and, CITY shall notify DISTRICT in writing within 45 days of its decision concerning DISTRICT's partial assumption request--otherwise partial discontinuance shall be deemed approved. Subject to section II.D.2.d. on not less than eighteen (18) months written notice to DISTRICT, and not less than twelve (12) months after CITY transfers to DISTRICT all billing and collections records as required by section II.B.1., CITY may discontinue performing DISTRICT's billing and collection functions. If CITY wishes to discontinue performing only a portion of DISTRICT's billing and collection functions: CITY's written notice to DISTRICT shall include a description of the portion of the billing and collection services it wishes to discontinue; CITY may do so only with DISTRICT's approval, in DISTRICT's sole discretion; and, DISTRICT shall notify CITY in writing within 45 days of its decision concerning CITY's partial assumption request--otherwise partial discontinuance shall be deemed approved. The Parties acknowledge and agree they shall use best efforts to cooperate with each other so as to efficiently and accurately set rates.

3. **Responsibility for Billing and Collection Services Where CITY Continues Billing & Collection Functions for Combined CITY/DISTRICT Sewer System.** Notwithstanding section II.B.1, unless or until discontinued as provided in section II.B.2, CITY shall continue to provide all billing and collection of revenue services for the Combined CITY/DISTRICT Sewer System, including provision of such services to DISTRICT Customers. The CITY shall continue to account for DISTRICT revenues and expenditures in accordance with GASB guidelines and generally accepted accounting standards, which accounting shall be segregated from CITY's accounting of its own revenues and expenditures when identifiable as such. Notwithstanding section II.B.1., as long as the CITY continues to perform billing and collection services to the DISTRICT, CITY shall provide DISTRICT with access to requested billing and collection records pertaining to DISTRICT Customers (in the same medium, manner, and form as otherwise required under section II.B.1.), including, but not limited to, Customer list(s), Customer balance detail, Customer payment detail, Customer invoices, accounts receivable detail, general ledger, income and expense statements, trial balances, deposits to DISTRICT and/or funds/accounts in which DISTRICT funds are held, transfers from such funds/accounts, and any other such information in the CITY's possession or under its control requested by DISTRICT, including without limitation that related to: (1) the amount of revenue collected from DISTRICT Customers; (2) the operations and maintenance costs of the DSS, CSS, and Trunk Line; (3) the DISTRICT's allocated portion of operations and maintenance costs of the CWWTP; (4) Capital Improvement costs of the Combined CITY/DISTRICT Sewer System, including those portions

properly allocated to DISTRICT; and, (5) DISTRICT's allocable share of the Installment Payments (or any Refinancing thereof).

4. Implementation of DISTRICT Assuming Billing and Collection Function.

Upon any notice of discontinuance pursuant to Section II.B.2, if either party desires to discuss details or issues associated with transferring all or any portion of the billing and collection function to the DISTRICT, the Parties or their representatives shall meet to undertake that discussion within 30 days of the notice. If a dispute arises concerning those details or issues, unless otherwise agreed in writing, the Parties shall each identify the disputed details or issues, along with a proposed resolution, in a writing provided to the other not later than sixty (60) days after the notice required by section II.B.2. is given. Should the dispute persist, the matter shall be submitted to dispute resolution as provided in Section II.G.1 within seventy-five (75) days after the notice required by section II.B.2. is given, unless the Parties agree to extend the time. For purposes of this provision, if the arbitrator determines a party unreasonably proposed or opposed disputed items, the other party in such proceeding shall be entitled to recover from the party found unreasonable its attorney's fees, costs, and expenses incurred therein. Nothing in this provision shall be deemed to alter, modify, or limit the DISTRICT's right under this Agreement to receive records and information under section II.B.1 or, subject to Section II.D.2.d., assume its own billing and collection functions.

5. Prohibition on Further CITY Charges. Effective on, and prorated to, the date DISTRICT begins performing all or any portion of its own billing and collection services, CITY shall be prohibited from charging DISTRICT for any costs, however characterized, for or associated with the billing and collection services assumed by DISTRICT, except for services expressly requested by DISTRICT in support of DISTRICT performing its own billing and collection services.

C. OPERATIONS AND MAINTENANCE

1. DSS and CSS (Collection Systems) and Trunk Line.

a. **Transfer of Records.** Within sixty (60) days after the CITY receives a written request from the DISTRICT, CITY shall provide DISTRICT the same or reasonably similar access to operations and maintenance records and information, in whatever form maintained by the CITY, as the CITY staff has to those records and information, including all such records and information maintained by CITY, its agents, or third parties who hold, maintain, or use the same to perform services that are material to the DISTRICT's assumption of operation and maintenance of the DSS and/or Trunk Line. Such records shall include information and materials material to CITY's operations and maintenance of the DSS (as well as information and material concerning the CSS and CWWTP which are necessary or beneficial in the performance of operations and maintenance of the DSS), the Trunk Line, and the DISTRICT's allocated portion of operations and maintenance costs of the CWWTP, Trunk Line and DSS. The CITY shall not be in breach of this Section II.C.1.a, if, beyond CITY's reasonable control, third parties fail to produce the records within the time required herein or are not legally required to provide the information at the CITY's direction. The records shall be transferred in usable, digital, form, if reasonably feasible, and in hard copy form where appropriate or necessary or otherwise requested by

DISTRICT. CITY may elect to satisfy this requirement by providing DISTRICT with access to such records as maintained by the CITY in the ordinary course of business. Absent agreement of the Parties, the CITY shall have no obligation to convert records or information into another format. The purpose of this provision is to timely provide DISTRICT with such records (or access thereto), information, and materials so DISTRICT may promptly and fully perform operations and maintenance functions for the DSS and/or Trunk Line in a manner consistent with that done by CITY and to provide continuity of such service during and following the transition of services provided for herein. Consistent with the provisions of this section II.C.1.a, CITY shall use its best efforts to cooperate with the DISTRICT, to timely transfer or provide access to such records and information to the DISTRICT, and to otherwise comply with this provision.

b. **Transfer of Responsibility to Operate and Maintain DSS and Trunk Line.** Subject to section II.D.2.d., DISTRICT may, in its sole discretion, elect to discontinue all of the operations and maintenance services provided to DISTRICT by CITY for the DSS and / or Trunk Line upon not less than twelve (12) months written notice to CITY, unless otherwise agreed by the Parties. If DISTRICT wishes to discontinue only a portion of the operations and maintenance services provided by the CITY to DISTRICT for the DSS or Trunk Line: DISTRICT's written notice to CITY shall include a description of the portion of the operation and maintenance services it is assuming; DISTRICT may do so only with CITY approval, in CITY's sole discretion; and, CITY shall notify DISTRICT in writing within ninety (90) days of its decision concerning DISTRICT's partial assumption request--otherwise partial discontinuance shall be deemed approved. Subject to section II.D.2.d., on not less than twenty-four (24) months written notice to DISTRICT, and not less than eighteen (18) months after the CITY transfers to DISTRICT operations and maintenance records as required by section II.C.1.a., CITY may discontinue performing operations and maintenance of the DSS or Trunk Line. If CITY wishes to discontinue performing only a portion of such operations and maintenance functions: CITY's written notice to DISTRICT shall include a description of the portion of the operation and maintenance services it wishes to discontinue; CITY may do so only with DISTRICT's approval, in DISTRICT's sole discretion; and, DISTRICT shall notify CITY in writing within ninety (90) days of its decision concerning CITY's partial assumption request--otherwise partial discontinuance shall be deemed approved. In any event, unless otherwise agreed, discontinuance of such service shall not occur until DISTRICT provides CITY with a copy of the completed application DISTRICT has filed with the North Coast Regional Water Quality Control Board ("NCRWQCB") for a NPDES/Waste Discharge permit, to the extent required, for the portion of the DSS or Trunk Line DISTRICT would operate and maintain ("Waste Discharge Permit"). The DISTRICT may not assume the operations and maintenance of the DSS less than six (6) months after the NCRWQCB has issued the Waste Discharge Permit, to the extent a permit is required. Notwithstanding any other provision in this Agreement, CITY may not discontinue operation and maintenance functions for the DISTRICT unless DISTRICT is then permitted to assume its own billing and collection functions.

c. **Responsibility to Perform Operations and Maintenance.** Notwithstanding section II.C.1.a., unless and until discontinued as provided in section II.C.1.b., CITY shall continue to provide all operations and maintenance services for the DSS, CSS, and Trunk Line in accordance with the Participation Agreement and the standards in Section II.C.3.a., as well as the information and materials required by section II.B.3.

d. **Provision of Information to Determine Whether to Assume Operation and Maintenance of DSS and/or Trunk Line.** CITY shall promptly provide DISTRICT with any information and records within CITY's custody or control reasonably requested by DISTRICT to evaluate the relative cost and benefit to the DISTRICT of assuming in whole or in part the operation and maintenance of the DSS and/or Trunk Line and the means of undertaking such operation and maintenance and setting rates to cover such costs.

e. **Implementation of DISTRICT Assuming Operation and Maintenance Function.** Upon any notice of discontinuance pursuant to section II.C.1.b., if either party desires to discuss details or issues associated with transferring all or any portion of the operation and maintenance function of the DSS or Trunk Line to the DISTRICT, the Parties or their representatives shall meet to undertake that discussion within 30 days of the notice. If a dispute arises concerning those details or issues, the Parties shall each identify the disputed details or issues, along with a proposed resolution, in a writing provided to the other not later than sixty (60) days after the notice required by section II.C.1.b. is given. Should a party fail to meet and confer regarding said details or should the dispute persist, the matter shall be submitted to dispute resolution as provided in Section II.G.1 within seventy-five (75) days after the notice required by section II.C.1.b. is given unless the Parties agree to extend the time. For purposes of this provision, if the arbitrator determines a party unreasonably proposed or opposed disputed items, the other party in such proceeding shall be entitled to recover from the party found unreasonable its attorney's fees, costs, and expenses incurred therein. Nothing in this provision shall be deemed to alter, modify, or limit the DISTRICT's right under this Agreement to receive records and information under section II.C.1.a. or assume operations and maintenance functions of the DSS or Trunk Line. CITY shall maintain the right to continued use of the Trunk Line in accordance with Section II.C.2.b.

f. **Prohibition on Further CITY Charges.** Effective on, and prorated to, the date DISTRICT begins performing its own operations and maintenance services, CITY shall (1) have no obligation to incur any expense or provide any assistance to DISTRICT in connection with the operation or maintenance of the DSS (except continued compliance with section II.C.1.a.) and (2) shall be prohibited from charging DISTRICT for any costs, however characterized, associated with or for operations and maintenance of the DSS, CSS, or Trunk Line assumed by DISTRICT, except for services expressly requested by DISTRICT in support of DISTRICT performing operations and maintenance functions.

g. **DISTRICT obligation to furnish CITY with records.** Within sixty (60) days after the DISTRICT assumes operations and maintenance of all or a portion of the DSS or Trunk Sewer, and within any future request for such information by CITY, DISTRICT shall provide CITY the same or reasonably similar access to operations and maintenance records and information, in whatever form maintained by the DISTRICT, as the DISTRICT staff has to those records and information, including all such records and information maintained by DISTRICT, its agents, or third parties who hold, maintain, or use the same to perform services that are material to the DISTRICT's assumption of operation and maintenance of the DSS and/or Trunk Line and the CITY's operation and maintenance of the CSS, CWWTP, and/or Trunk Line. Such records shall include information and materials material to DISTRICT's operations and maintenance of

the DSS or Trunk Line. The DISTRICT shall not be in breach of this Section II.C.1.g, if, beyond DISTRICT's reasonable control, third parties fail to produce the records within the time required herein or are not legally required to provide the information at the DISTRICT's direction. The records shall be transferred in usable, digital, form, if reasonably feasible, and in hard copy form where appropriate or necessary or otherwise requested by CITY. DISTRICT may elect to satisfy this requirement by providing CITY with access to such records as maintained by the DISTRICT in the ordinary course of business. Absent agreement of the Parties, the DISTRICT shall have no obligation to convert records or information into another format. The purpose of this provision is to timely provide CITY with such records, information, and materials so CITY may promptly and fully perform operations and maintenance functions for the CSS and/or Trunk Line or the CWWTP. Consistent with the provisions of this subsection II.C.1.g, DISTRICT shall use its best efforts to cooperate with the CITY, to timely provide access to such records and information to the CITY, and to otherwise comply with this provision.

Nothing in this Agreement shall be deemed to restrict the right of CITY to continue utilization of the Trunk Line for transmission of sewage from the CSS to the CWWTP, inclusive of its rights to discharge additional wastewater into the Trunk Line from present or future Customers and Connections.

2. CWWTP.

a. **Transfer of Records.** Within sixty (60) days after the CITY receives a written request from the DISTRICT, CITY shall provide to DISTRICT access to all records and information in the CITY's possession or under its control concerning the CWWTP. Such records shall include all information and materials associated with CITY's operations and maintenance of the CWWTP, inclusive of each Party's allocated portion of operations and maintenance and Capital Improvement costs of the CWWTP, maintained by CITY, its agents, or third parties who hold, maintain, or use such information and materials to perform operations and maintenance of the CWWTP, provided such third parties are legally obligated to provide the information at the CITY's direction. The records shall be made available or transferred in usable, digital, form, if feasible and not in violation of any applicable software license, and in hard copy form where appropriate or necessary or otherwise requested by DISTRICT. Absent further agreement of the Parties, CITY shall have no obligation to provide electronic records other than in the form maintained by the CITY. CITY shall make paper records available as maintained in the ordinary course of business for DISTRICT inspection and copying. DISTRICT shall not be charged for CITY time or other costs associated with producing copies beyond copying charges permitted by the California Public Records Act. (Govt. Code, §§ 6250 *et seq.*) The purpose of this provision is to timely provide DISTRICT complete access to all such records, information, and materials so DISTRICT may promptly and fully assess the CWWTP and its operational, maintenance, and capital costs. Consistent with the provisions of this subsection II.C.2.a, CITY shall use its best efforts to cooperate with the DISTRICT, to timely transfer or provide access to such records and information to the DISTRICT, and to otherwise comply with this provision.

b. **DISTRICT's Utilization of CWWTP.** Nothing in this Agreement shall be deemed to restrict the right of DISTRICT to continue utilization of the existing capacity of the CWWTP, inclusive of its rights to discharge additional wastewater into the CWWTP from present

or future Customers and Connections in accordance with the terms of this Agreement. The Parties' respective rights and ability to discharge additional wastewater / ESSUs to the CWWTP is more particularly described below in this Agreement and may be modified, in accordance with requirements for amending this Agreement, including if the capacity of the CWWTP is increased by a project jointly funded by CITY and DISTRICT to receive and process additional sewage.

c. **Responsibility to Perform Operations and Maintenance.** CITY shall perform all operations and maintenance functions associated with the CWWTP. DISTRICT shall have no obligation whatsoever to perform such functions.

3. Performance Standards & Information Sharing.

a. **Performance Standards.** The performance of all operations and maintenance on and to the Parties' respective systems—the DSS and Trunk Line (DISTRICT) and CSS and CWWTP (CITY)—shall at all times be done in a timely manner and in keeping with, or exceeding, industry standards for the operation and maintenance of a municipal or county sewer district wastewater sewer collection system of the same nature and type as the subject system. To the extent either party is responsible or undertakes responsibility for operations and maintenance of any part of the CWWTP, Trunk Line, CSS, or DSS, that party shall comply with any permits issued for such facilities and operations, as well as applicable provisions of state and federal law, which regulate the subject sewer operations; provided, however, fines and penalties resulting from a discharge from the CWWTP that exceed a specific discharge limit shall be treated as an expense subject to allocation in accordance with Section II.D, unless the violation results from the gross negligence or willful misconduct of the CITY, its employees, contractors, or agents in the operation of the CWWTP, in which case such expense shall be paid exclusively by CITY.

b. **Information Sharing.** The Parties shall jointly implement an information-sharing system and protocol, the purpose of which is to allow one party to reasonably ascertain whether the other party is operating and maintaining the system in the manner consistent with the performance standards referenced above. In any event, each party shall promptly share such information and materials upon reasonable request from the other party.

D. COST ALLOCATION

1. Operations and Maintenance Costs of CWWTP, Trunk Line, DSS & CSS

a. Cost Allocation.

(1) **CWWTP, DSS, CSS & Trunk Line:** CITY and DISTRICT shall each pay a certain allocated share of the costs of the Combined CITY/DISTRICT Sewer System. CITY and DISTRICT shall annually create a budget for the Combined CITY/DISTRICT Sewer System, consisting of the CITY Combined Sewer Budget and DISTRICT Combined Sewer Budget, as approved in accordance with this section II.D. The Parties shall budget such costs in compliance with California state laws and regulations, generally accepted accounting principles and GASB guidelines. The Indirect Costs of CITY and DISTRICT shall be budgeted and applied on a logical, consistent, reasonable, and rational basis. Each year, not later than sixty (60) days

prior to the start of its fiscal year, the Parties shall exchange their respective draft budgets for the Combined CITY/DISTRICT Sewer System and shall also provide any allocation plan and draft budgets of any department or fund of a party that is in turn allocating costs to that party's combined sewer budget.

The Parties will have thirty (30) days to review the draft budgets, pose questions, comments, and concerns and to provide the other Party with written objections to specific budget items or allocations and the basis for the objection to each such item. The Parties shall timely meet and confer in good faith in an effort to resolve all questions, concerns, and disputes. Any budget item not specifically identified in the timely-exchanged written list of objections that includes the specific basis for each objection, shall be deemed approved. A blanket objection to the entire budget shall not preserve the party's right to object to budget items as provided herein. Pending agreement or dispute resolution (as noted below), unresolved items in the budgets that are not deemed approved as provided herein shall not be subject to allocation but may be included in the listing-party's budget as the sole expense of that party. Remaining disputes shall be resolved by binding Fast Track arbitration under section II.G.1. Each party shall pay its respective share of the final combined budgeted costs under this section II.D.1.a.(1), subject to reconciliation and true-up as provided in section II.D.4.b. On the Effective Date, the Parties' initial allocated share of such combined budgeted costs shall be fifty-three (53%) CITY and forty-seven percent (47%) DISTRICT, which shall remain unchanged through June 30, 2019.

Upon not less than 15 days' written notice to the other party, either party may make budget amendments, respectively, to the CITY Combined Sewer Budget or the DISTRICT Combined Sewer Budget. The notice shall include the proposed budget amendment and an explanation of the reason for it. The budget amendments may be made by either party without approval from the other party, unless: (1) the amendment increases the total annual amount budgeted in either budget; (2) increases Direct Costs in any line item within a budget by more than the dollar limit specified in Ukiah City Code Section 1522.B.1, as revised by Resolution No. 2012-13, currently \$30,000, or any successor resolution; (3) increases any Indirect Cost; or (4) adds or subtracts line items within a budget. Either party may object to a budget amendment that does not require approval as set forth above by giving written notice of its objection and the reasons therefor within 15 days of the date notice of the budget amendment was given. If the objection is not resolved within fifteen (15) days after notice of the objection is given, the dispute shall be subject to Fast Track arbitration under Section II.G.1. Approval of the other party shall be required for a budget amendment that: (1) increases the total annual amount budgeted in either budget; (2) increases Direct Costs in any line item within a budget by more than the dollar limit specified in Ukiah City Code Section 1522.B.1, as revised by Resolution No. 2012-13, currently \$30,000, or any successor resolution; (3) increases any Indirect Cost; or, (4) adds or subtracts line items within a budget. The process for requesting budget amendments requiring approval shall be the same process detailed in the preceding paragraph for the annual budget after notice of the budget amendment is given. In an emergency where a budget amendment is necessary to address an emergency condition which, if not addressed immediately could result in personal injury, property damage or violation of waste discharge requirements or other laws or regulations, such budget amendments may be made without approval, but shall remain subject to the notice, objection, informal resolution, and Fast-Track arbitration provisions otherwise set forth in this paragraph.

Commencing July 1, 2019, or as soon thereafter as any disputes over the Allocation Methodology are resolved by agreement or Fast Track arbitration, and on July 1 of each year thereafter, the allocation of such combined budgeted costs shall be adjusted and based on each party's proportionate use of the CWWTP as measured by water consumption and relative strength of sewage discharged to the CWWTP by each party's Customers. Water consumption shall be the average quantity of water used by such customers in the winter months (January, February, and March or some combination thereof) as determined from the records of the water system serving the Customer (e.g., at present, Millview, and Willow County Water Districts, the CITY and Regina Water Company). Relative strength shall be based on the class of connection—residential, minimum, low, moderate and high discharge commercial and industrial, or other—with each class assigned a numerical factor. The numerical factor so assigned shall be designed to fairly capture the relative strength of discharge of the class of connection as compared to other classes. Each Customer's water consumption shall be multiplied by the numerical factor assigned the Customer's Connection. The ratio of the sum of those calculations for the Parties' respective Customers and Connections shall be used to establish each party's proportionate use of the CWWTP for purpose of allocating combined budgeted costs for the next fiscal year under this section II.D.1.a. ("Allocation Methodology"). This calculation shall be performed annually within sixty (60) days of the date on which the referenced water consumption data is obtained. Within one (1) year of the Effective Date, the Parties shall meet and confer in good faith to establish the month or months to be utilized for the water consumption calculation (as it now stands, CITY uses January only and DISTRICT uses average consumption during January through March), the classes of connections, and the numerical factor to be assigned each connection class. The purpose of this provision is to arrive at a fair method to calculate the Parties' respective contribution of discharge for treatment in the CWWTP. If the Parties are unable to arrive at an agreement through this process, either party may initiate arbitration under section II.G.1 to resolve the dispute. The Allocation Methodology calculation, and all information and records on which it is based, shall be promptly exchanged between the Parties in a manner and medium that permits a timely review and analysis. The Parties shall meet and confer in good faith to resolve any disputes related to the calculations within 45 days of the exchange. If the dispute persists after that time, it shall be resolved through dispute resolution under section II.G.1. As of the Effective Date, the Allocation Methodology shall be deemed as follows: CITY 53%; and, DISTRICT 47%.

While the CITY continues to perform billing and collection for the DISTRICT, the water use data shall be collected by the CITY and calculations shall be performed by CITY using the CITY's billing software. CITY shall promptly provide DISTRICT with the data used to make the calculations and disputes shall be resolved as provided in the preceding paragraph. DISTRICT may, but is not required to, perform its own calculations and provide them to CITY, which the CITY may, but is not required to use, when determining customers' sewer bills for the fiscal year. At such time that either party gives notice of discontinuance under Section II.B.2, the Parties shall meet and confer to devise a method for jointly performing the calculations for the Allocation Methodology, the purpose of which is to promote continuity since both CITY and DISTRICT would then be performing billing and collection functions and, additionally, calculations for the Allocation Methodology. If they have failed to agree on the method within sixty (60) days after such notice has been given, the matter shall be resolved through dispute resolution under Section II.G.1. Nothing in this provision shall be deemed to alter, modify, or limit the DISTRICT's right

under this Agreement to receive records and information under section II.B.1 or assume its own billing and collection functions.

The proportion of water consumption and relative strength of discharge attributable to the Parties, respectively, as determined by the Allocation Methodology each year shall, in turn, be that party's allocated share of such combined budgeted costs for the next fiscal year. Commencing with the 2020 fiscal year, the Parties may mutually select a neutral third-party professional to perform an allocation study, the purpose of which would be to assess the Parties' allocation of Indirect Costs to the Combined CITY/DISTRICT Sewer System and thereby aid the budget process prescribed by this Agreement.

(2) DSS & CSS Cost Segregation. As further provided in this Section D.1.a.(2), CITY shall segregate and separately track the costs for the CWWTP, Trunk Line, CSS, and DSS, respectively, with all information, materials, analysis, and other supporting data bearing on the matter to be timely provided to DISTRICT. Within one (1) year of the Effective Date of this Agreement, the Parties shall make a good faith effort to agree on the costs of the DSS and the CSS to be tracked, the manner in which said segregated costs are to be tracked and how and what information, materials, analysis, and other supporting data is to be shared on a continuous basis. If they fail to agree within said time period, either party may initiate Fast Track arbitration under section II.G.1 to resolve the dispute. The purpose of this provision is to: assess the costs of the CSS and DSS, respectively, separate and apart from the other costs of the Combined CITY/DISTRICT Sewer System; and, to assess whether a material deviation over a mutually agreed period of time would result in a material deviation from the allocation of costs using the Allocation Methodology if each party's share of operations and maintenance costs of the collection systems (DSS and CSS) absorbed only the costs of that party's collection system and not those costs of the other party's collection system. The Parties may use this information derived from the assessments to determine whether they want to change the method of apportioning these costs. If a material deviation results, the Parties shall meet and confer in an effort to appropriately modify the Allocation Methodology in light of the deviation and if within ninety (90) days of the commencement of those efforts the Parties fail to reach an agreement, either party may within sixty (60) days thereof initiate arbitration under section II.G.1.

b. Exclusions, Exceptions & Other Adjustments to the Cost Allocation. Notwithstanding the terms above in section II.D.1.a, certain exclusions and exceptions to the cost allocation referenced there shall apply.

(1) Customers and Connections Excluded from Allocation Methodology. The Allocation Methodology shall exclude costs associated with the CWWTP for DISTRICT Customers or Connections who, or which, has wastewater treated by a DRWWTP or by means other than the CWWTP and, to the extent the CITY does not perform such functions for those Customers or Connections, costs associated with billing and collection or operations and maintenance functions.

(2) Customers and Connections Transferred. In the event a Customer or Connection of one party is transferred from that party's sewer-service jurisdictional boundaries to that of the other party ("Receiving Party"), said Customer's / Connection's water

consumption and relative strength of sewage discharge, used to calculate each party's proportionate use of the Combined CITY/DISTRICT Sewer System in order to allocate costs in accordance with the Allocation Methodology, described above in section II.D.1.a.(1), shall be assigned to the Receiving Party effective on, and prorated to, the date of transfer.

(3) Billing & Collection Services Costs. In accordance with section II.B, in the event DISTRICT assumes its own billing and collection services, whether in whole or part: CITY shall be exclusively responsible for one hundred percent (100%) of all costs, however characterized, for or associated with billing and collection services; CITY shall be prohibited from charging DISTRICT for any share of costs, however characterized, for or associated with billing and collection services; and, such costs shall not be considered either a Direct Cost or Indirect Cost or otherwise included among those costs subject to allocation between the Parties. However, in the event DISTRICT only partially assumes its own billing and collection services and CITY continues providing such services in part for DISTRICT, then in order to account for DISTRICT's share of the Combined CITY/DISTRICT Sewer System billing and collection services costs, as budgeted (or segregated) in accordance with section II.D.1.a.(1)(2) (in either event subject to the Indirect Costs limitation set forth in section II.D.1.a.(1)) it shall pay an amount of such costs equal to that ratio which the total number of DISTRICT Connections that then remains subject to CITY's billing and collection services bears to the total number of all sewer Connections within the Combined CITY/DISTRICT Sewer System then subject to CITY's billing and collection services.

(4) Costs Associated with Operations and Maintenance of CSS and DSS. In accordance with section II.C., in the event DISTRICT assumes operations and maintenance of the DSS, whether in whole or in part: CITY shall be exclusively responsible for one hundred percent (100%) of all costs, however characterized, for or associated with the CSS; CITY shall be prohibited from charging DISTRICT for any share of costs, however characterized, for or associated with operations and maintenance of the CSS or DSS; and, no such costs for or associated with operations and maintenance of the CSS shall be considered either a Direct Cost or Indirect Cost or otherwise included among those costs subject to allocation between the Parties (i.e. the costs otherwise subject to allocation under this Agreement shall be limited to Direct Costs and Indirect Costs (subject to the limitations in section II.D.1.a.) of the CWWTP and Trunk Line). However, in the event DISTRICT only partially assumes its own operations and maintenance of the DSS and CITY continues providing such services in part for DISTRICT within the DSS, then in order to account for DISTRICT's share of costs associated with CITY's continued operations and maintenance within the DSS, DISTRICT shall pay a share of Direct Costs and Indirect Costs (subject to the limitations in section II.D.1.a.) for the operations and maintenance of that portion of the DSS for which CITY continues providing such services, with the costs subject to such allocation being as budgeted or segregated in accordance with section II.D.1.a.(1)(2), conditioned on the Indirect Costs limitation set forth in section II.D.1.a.(1). If the DISTRICT only assumes a portion of the operation and maintenance of the DSS: its share of those costs shall be the result of an equation where the numerator is the total water consumption and relative strength of discharge to the CWWTP sourced from those DISTRICT Customers located in the portion of the DSS for which CITY continues providing such services and the denominator is the total water consumption and relative strength of discharge to the CWWTP from such DISTRICT Customers and all CITY Customers; or, if segregated under section II.D.1.a.(2), its share of those costs shall be limited to

the costs properly segregated to the remaining portion of the DSS for which CITY continues providing operation and maintenance services.

(5) **Capital Improvement Costs Excluded.** Notwithstanding any other provision contained herein, the shared costs subject to allocation under section II.D.1. shall not include Capital Improvement costs, except as authorized in Section II.D.3. Allocation of Capital Improvement costs shall be made in accordance with section II.D.3.

(6) **Recycled Water Project.** CITY approved a recycled water project to be constructed in four phases. The CITY represents that it: has received a combination of loan and grant funds under Proposition 1 from the California Water Resources Control Board (“Water Board”) for estimated project costs up to \$32,085,000.00 of which \$10,276,000.00 is estimated to be a grant; the estimated amount of principal due to the State Water Board under the Installment Sale Agreement is \$21,809,000.00; the CITY has entered a contract with Ghilotti Construction to construct phases 1-3 of the recycled water project for \$22,357,358; a change order was subsequently approved for approximately \$4,000,000 for an expanded chlorine contact basin at the CWTP; the loan from the Water Board is secured and payable from the CITY’s water utility, but will dispose of treated wastewater without discharging that water to percolation ponds or directly to the Russian River as well as produce recycled water for irrigation use; and, the CITY anticipates applying for additional funding from the Water Board as loan and grant funds to complete phase 4 at an estimated cost of \$20,000,000. Commencing in fiscal year 2019-2020, the CITY intends to charge the wastewater system for the cost of disposing of wastewater through the recycled water project and, therefore, to include those costs in the proposed CITY Combined Sewer Budget, in accordance with and subject to Section II.D.1 and II.D.3. The CITY agrees that costs, however characterized, related to the recycled water project shall only be included in the combined final sewer system budget of the Parties in compliance with this Agreement and law, including the California Constitution (e.g. Proposition 218 [Cal. Const., Art. XIII.D]). The DISTRICT retains its rights to dispute including any cost, whether sewage disposal (i.e. operations and maintenance) or Capital Improvement, related to the recycled water project, or any portion or amount thereof, as a cost subject to allocation between the Parties under this Agreement. Unresolved disputes shall be subject to the procedures and dispute resolution provisions in Section II.D.1.

2. **Bond Debt Service**

a. **Background.** In Amendment No. 2, the Parties agreed it was necessary to increase the CWWTP's treatment capacity as it then existed (Capacity Project) and to rehabilitate and upgrade the CWWTP as it then existed (Upgrade/Rehabilitation Project). See Recital 6 for a description of the 2006 Bond transaction. The two projects were funded with \$75,060,000 from the 2006 Bonds. In Amendment No. 2, the Parties agreed to allocate those costs of the two projects as follows: Capacity Project—DISTRICT 65% and CITY 35%; and, Upgrade/Rehabilitation Project—based on the ratio of CITY and DISTRICT ESSUs as determined and adjusted annually.

A dispute has arisen between the Parties concerning the percentage of debt service allocated to the Upgrade/Rehabilitation Project and the Capacity Project. To resolve that dispute, the Parties agree to apportion 74.1586% of the debt service to the Upgrade/Rehabilitation Project

and 25.8414% to the Capacity Project. Based on that, the Installment Payments shall be calculated as provided in section II.D.2.b.

b. Installment Payments. Subject to the terms and conditions of the Refinancing:

(1) In fiscal years 2018-2019 and 2019-2020, the DISTRICT shall pay 52% and the CITY 48% of the combined debt service for the Upgrade/Rehabilitation Project and Capacity Project. Commencing in fiscal years 2020 and in subsequent fiscal years, the CITY and the DISTRICT shall pay their respective share of the combined debt service as provided in sections II.D.2.b.(2)-(3).

(2) **Adjustment in Allocation of Capacity Project Installment Payment Obligations.** The Parties' respective obligations to pay Installment Payments associated with the Capacity Project shall be proportionately adjusted from 65% DISTRICT and 35% CITY based on changes in the allocated share of Capacity Project ESSUs by: any transfer by one party to the other of any number of the transferring party's remaining Capacity Project ESSUs as described in section II.E; and/or, DISTRICT's transfer to CITY of ESSUs as described in section II.F. The adjustment shall take effect immediately upon any such transfer(s), with the Parties' respective obligations for Installment Payments associated with the Capacity Project prorated accordingly.

(3) **Adjustment in Allocation of Rehabilitation / Upgrade Project Installment Payments.** The Parties' respective obligations for the Installment Payments associated with the Upgrade/Rehabilitation Project shall be that party's proportionate share of water consumption and relative strength of sewage discharge to the CWWTP by the Parties' respective Customers, as determined in accordance with the cost allocation and Allocation Methodology terms, including exclusions and exceptions, in section II.D.1., as annually adjusted.

c. Bond Debt Refinancing. The Parties shall use best efforts to close the Refinancing as soon as possible. CITY and DISTRICT shall make a good faith effort to complete the Refinancing to obtain the most favorable debt service savings obtainable and to accommodate the DISTRICT's elections and to apportion debt service in accordance with this Agreement. DISTRICT and CITY will work cooperatively and in a timely manner with one another in making those efforts to maximize the benefits of any Refinancing.

d. Limitations on DISTRICT Assumption and CITY Discontinuance of Functions: The following applies regarding the DISTRICT's assumption of and CITY's discontinuance of its own billing and collection or operations and maintenance functions under sections II.B.2 and II.C.1.b:

(1) In the event of any Refinancing:

(a) The DISTRICT may assume its own billing and collection or operations and maintenance functions, as authorized in this Agreement, if not otherwise prohibited under the applicable terms of the Refinancing and in accordance with the applicable terms of the Refinancing;

(b) DISTRICT reserves its right to refinance its portion of the bond indebtedness with its own debt unless otherwise expressly prohibited / limited in an agreement made part of such Refinancing of which DISTRICT is a party and signatory; and,

(c) In pursuing the current Refinancing jointly, CITY and DISTRICT agree that they will include each other in all written and oral communications to or from third parties, unless the communication is subject to the attorney/client privilege or a third party requires separate communications, in which case the non-communicating party shall be given notice and the purpose thereof. The Parties agree to make good faith efforts to undertake the Refinancing in a timely manner, acknowledging the same will require an unconditional commitment by both CITY and DISTRICT to pay their respective share of the debt service for the Refinancing in accordance, and in keeping, with terms of the Refinancing agreements and this Agreement to obtain the most favorable bond rating and interest rate available under the market conditions for tax free revenue bonds existing at the time of the Refinancing.

(2) In the absence of a Refinancing, DISTRICT's assumption of its billing and collecting and/or operations and maintenance functions while the 2006 Bonds are outstanding is subject to the following:

(a) DISTRICT and CITY jointly give the Association of Bay Area Governments ("ABAG"), Syncora Guarantee, Inc., the Bond Trustee and each rating agency then rating the 2006 Bonds ("rating agencies") the form of an amendment to the Financing Agreement and a copy of this Agreement together with written notice that:

i. Under Section II.B.2, DISTRICT may elect to take over all or a portion of its billing and collecting functions for its ratepayers on a date described in the notice (that is at least one hundred eighty (180) days after the notice in section II.B.2. is provided);

ii. Under this Agreement and the proposed amendment to the Financing Agreement, if DISTRICT elects to take over all or a portion of its billing and collection functions for its ratepayers, the DISTRICT will pledge to the CITY or the Bond Trustee its Net Revenues (as defined in the proposed amendment to the Financing Agreement) and DISTRICT will establish a wastewater fund, securing repayment of the 2006 Bonds, into which it shall be required to deposit all its Gross Revenues (as defined in the proposed amendment to the Financing Agreement) and from which it will agree to make District Payments as required under the Financing Agreement and to otherwise comply with the payment priorities required by Section 4.5(b) of the Installment Sales Agreement;

iii. The proposed amendment to the Financing Agreement will provide that ABAG, Syncora Guarantee, Inc., and Bond Trustee are third-party beneficiaries to the DISTRICT's pledge;

iv. No other amendments to the Financing Agreement are contemplated; and

v. DISTRICT and CITY request (1) written consent from Syncora to the proposed amendments to the Financing Agreement and the DISTRICT's assumption of billing and collection functions or operations and maintenance of its wastewater collection system, as authorized by this Agreement, (2) written confirmation from the ABAG and the Bond Trustee that the proposed amendments to the Financing Agreement and the DISTRICT's assumption of billing and collection functions or operations and maintenance of its wastewater system, as authorized by this Agreement will not materially adversely affect the interests of the Bond Owners in violation of Section 5.12 of the Installment Sale Agreement, and (3) a determination from each of the rating agencies that the proposed amendments to the Financing Agreement and the DISTRICT's assumption of billing and collection functions or operations and maintenance of its wastewater collection system, as authorized by this Agreement, will not, in and of themselves, cause any rating on the 2006 Bonds to be lowered, in each case, within sixty (60) days after the written notice was given. ABAG consent is not required, if ABAG has assigned its right to consent to changes to the Financing Agreement and the Participation Agreement to the Bond Trustee.

(b) CITY shall not intentionally encourage non-consent or an objection by rating agencies, ABAG, Syncora Guarantee, Inc. or the Bond Trustee. This shall not prohibit the CITY from responding accurately and completely to requests for information from the rating agencies, ABAG, Syncora Guarantee, Inc. or the Bond Trustee. All communications with the parties to whom notice is given under this provision shall at all times include both CITY and DISTRICT. The Parties shall make good faith efforts to obtain necessary consents.

(c) If the written consents/confirmations of Syncora Guarantee, Inc. and the Bond Trustee are obtained and a determination from each of the rating agencies has been made that the DISTRICT's assumption of billing and collection functions and/or the operation and maintenance of its wastewater collection system, as authorized by this Agreement, and the proposed amendments to the Financing Agreement will not, in and of themselves, cause any rating on the 2006 Bonds to be lowered, then CITY shall promptly execute the amendments to the Financing Agreement with the DISTRICT (to include any other covenants required by such entities and agencies, with the addition of any such covenants not to be unreasonably withheld by the Parties in consideration of the terms and purposes of this Agreement), which shall in any event be within thirty (30) days of receipt of such consents and rating agency determination.

(d) If the consents/confirmations of Syncora Guarantee, Inc. and the Bond Trustee are not obtained and a determination from each of the rating agencies has not been made that the DISTRICT's assumption of billing and collection functions or the operation and maintenance of its wastewater collection system, as authorized by this Agreement, and the proposed amendments to the Financing Agreement will not, in and of themselves, cause any rating on the 2006 Bonds to be lowered, and if the DISTRICT takes the position that such lack of consents or determination was unreasonable, the Parties shall, at DISTRICT's election, cooperate to facilitate a declaratory relief action or other legal determination on the subject by the DISTRICT with DISTRICT bearing all fees, costs, and expenses associated therewith, including fees of attorneys, experts, consultants, and investigators and all other litigation expenses of the DISTRICT and the CITY (provided that any such expenses incurred by the CITY are necessarily and reasonably incurred) and any other costs, damages or expenses incurred by the CITY in

cooperating with such an action. If any such determination or action cannot be brought, unless the CITY is named as a party, the CITY may be named as a party.

(e) In the absence of (1) written approval by Syncora Guarantee, Inc. and the Bond Trustee and the required determination by each of the rating agencies, or (2) a final, non-appealable Declaratory Judgment that such approvals and rating determinations were unreasonably withheld, DISTRICT may not take over its billing and collections or operation and maintenance of the DSS.

(f) If the required written consents / confirmations / determinations are given or obtained, and the DISTRICT elects to discontinue the CITY's billing and collection and/or operations and maintenance functions, the DISTRICT shall indemnify and defend the CITY from any subsequent claim or lawsuit by an owner or owners of 2006 Bonds, including any class claim on their behalf, which seeks damages or other legal remedies against the CITY based on the amendments to the Participation Agreement that allow and govern the DISTRICT's assumption of its billing and collection function or operation and maintenance of its wastewater collection facilities as authorized by this Agreement or the approved amendments to the Financing Agreement. Upon notice to DISTRICT of the claim or lawsuit from CITY, the DISTRICT shall assume and pay all costs, damages or liability arising out of any such claim or lawsuit. In the event that any such claim or lawsuit is filed or served on the CITY, the DISTRICT shall provide for the defense of that claim or lawsuit through legal counsel procured by DISTRICT and approved by CITY, which approval shall not be unreasonably withheld, and shall pay all of the defense costs, including, but not limited to, fees of attorneys, investigators, experts, and consultants, and all other litigation related expenses. CITY shall fully and promptly cooperate with DISTRICT in undertaking any such undertaking. The DISTRICT shall pay the full cost of any settlement or judgment resulting from any such claim or lawsuit. With respect to any other claim that the CITY breached section 5.12 of the 2006 Installment Sale Agreement by agreeing to the terms of this Agreement, the DISTRICT and CITY agree to share the costs of defense and payment of any settlement or judgment as they shall agree, subject to dispute resolution under section II.G.2.

3. Capital Improvement Costs.

a. **Shared Capital Improvement Costs.** Subject to section II.D.3.a.(1) and section II.D.1.b.(6), Capital Improvement costs for the CWWTP, DSS, or CSS that benefit both the DISTRICT and CITY shall be subject to allocation between the Parties as provided in this section II.D.3.a. Capital Improvement costs for the CWWTP may be included in the CITY's Sewer System Budget so long as they don't exceed \$200,000.00 in any fiscal year and reasonable Capital Improvement costs for the Trunk Line may be included in the CITY Combined Sewer Budget and/or DISTRICT Combined Sewer Budget, all in accordance with Section D.1. subject to cost allocation using the Allocation Methodology. Nothing in this section shall be deemed to modify section II.D.1.b.(6). Other Capital Improvements to the CWWTP ("Other CWWTP Capital Improvements"), other Trunk Line Capital Improvements, or any Capital Improvements to the DSS or CSS that are claimed to benefit both Parties shall be approved in writing before such costs are required to be shared. Absent such approval, either party may initiate the procedures in section II.D.3.a.(1) by providing written notice of the same to the other. Capital Improvement costs that are claimed to benefit both Parties and that are incurred in emergency or other circumstances, the

timing of which does not reasonably and practically allow for prior written approval, shall be resolved through the procedures in section II.D.3.a.(1), unless otherwise agreed.

(1) **Further Required Negotiations and Arbitration.** Prior to charging a party with any share of an unapproved Capital Improvement cost pursuant to section II.D.3.a, including Other CWWTP Capital Improvements, other Trunk Line Capital Improvements, or any Capital Improvements to the DSS or CSS that are claimed to benefit both Parties, the Parties shall promptly: exchange all information and materials associated with such Capital Improvement costs to allow the other to fully and completely review, evaluate, and analyze the Capital Improvement and its costs; and, subsequently, meet to negotiate the detailed terms for sharing the Capital Improvement cost in accordance with this Agreement. At the request of either party, the DISTRICT's Board and CITY's City Council shall meet in joint session(s), as they shall agree. If they fail to reach agreement within sixty (60) days, or such longer period as agreed by the Parties, of a written request from the party seeking to share the cost of the Capital Improvement, they shall undertake the dispute resolution procedure as provided in Section II.G.1.

b. **Capital Improvements to DSS and CSS.** Except as provided in this Agreement, any Capital Improvement to the DSS, regardless of the percentage increase in the asset's value or useful life, shall be entirely paid by the DISTRICT, unless the Parties agree otherwise as to a specific project, and a Capital Improvement to the CSS, regardless of the percentage increase in the asset's value or useful life, shall be paid entirely by the CITY, unless the parties agree otherwise as to a specific project. At least ninety (90) days prior to a party undertaking a Capital Improvement that such party intends will be paid in whole or part by the other party, or within ninety (90) days of performing the work in the case of emergencies or other circumstances, the timing of which does not reasonably and practically allow for prior written approval, the undertaking party shall give written notice to the other party. Where a party contends that a Capital Improvement to the DSS or CSS should not be undertaken as noticed or that it benefits both parties and should be jointly paid, resolution of any disagreement between the Parties concerning that Capital Improvement shall be subject to Section II.D.3.a.(1), above.

c. **Capital Improvements to the Trunk Line.** Capital Improvement costs to the Trunk Line shall be shared, regardless of the improvement's physical location, in accordance with the Allocation Methodology; i.e., such costs shall be shared notwithstanding that an improvement to the Trunk Line is within, or the majority of it is within, the Sewer services jurisdictional boundaries of one party as opposed to the other. However, the capital improvements must be approved in accordance with Section II.D.3.

4. **Reporting Allocated Costs.**

a. **Budgeted Costs.** Except as otherwise required by the Refinancing, within ten (10) days of the end of each month, commencing in the third full month following the Effective Date, the CITY shall give the DISTRICT a statement showing the approved expenses, actually incurred, in the preceding month under the CITY Combined Sewer Budget plus 1/12 of the DISTRICT's share of debt service on outstanding bonds, and the DISTRICT revenue received in that month. DISTRICT revenue shall be the sum of all sewer-related revenues received from Customers and Connections within the DISTRICT's sewer-service jurisdictional boundaries. By

the same deadline, the DISTRICT shall give the CITY a statement showing the approved expenses, actually incurred, in the preceding month under the DISTRICT Combined Sewer Budget. The respective statements shall append reports from the Parties accounting systems of the actual expenses incurred and percentage expended of each budgeted expense.

The DISTRICT's share of CITY's expenses shall be offset by the CITY's share of DISTRICT expenses as reported and then 1/12 of the DISTRICT's share of annual bond debt service shall be added to that figure. ("DISTRICT's Net Expenses"). The DISTRICT's Net Expenses shall be deducted from DISTRICT's revenue received in the same month. If a surplus results, the CITY shall remit and transfer the surplus sum to DISTRICT. If a deficiency results, the DISTRICT shall remit and transfer the deficient sum to CITY. All such remittances by the CITY or the DISTRICT must be calculated and paid quarterly, commencing January 1, 2019. The parties must receive the payments within 15 days of quarter end, even if they dispute the statement. Any disputes must be resolved during the true up process as provided in Section II.D.4. If either party fails to make a timely payment, it shall be liable for interest on the unpaid balance of the amount due until paid in full at a monthly rate of 1.5%, not to exceed the maximum rate allowed by law.

b. Actual Cost True Up. The purpose of this provision is to allow the Parties to verify whether the other party's claimed charges were budgeted and actually incurred. If a party disputes a statement from the other party, the dispute shall not excuse the party from paying the amount in the statement, and the Parties shall undertake the Fast Track dispute resolution process in section II.G.1. The party prevailing through dispute resolution shall receive a refund from the other party of any overpayment, including any interest earned on the overpaid amount, or the amount of earnings the prevailing party demonstrates was lost on the overpaid amount, from the date paid until refunded.

Not later than 180 days following the end of the fiscal year, CITY and DISTRICT shall each provide the other with copies of their respective audited financial statements. The deadline for exchanging audits may be extended not more than twice by either party for up to an additional 90 days for each of the two extensions. Further, each will provide financial reports on its respective portions of the Combined CITY/DISTRICT Sewer System, derived from its financial reporting system(s), after all end-of-year and audit adjustments have been recorded, along with supporting materials and information requested in accordance with Section D.5., the purpose of which is to determine and reconcile actual costs incurred on items budgeted in accordance with section II.D.1. and II.D.3. Each party shall have sixty (60) days to review the audit and all supporting materials and information. A reconciliation of actual costs expended on budgeted items shall occur whereby each party shall be reimbursed for any amounts paid on such budgeted items that exceed actual cost; and, pay additional amounts on items for which the actual cost exceeded the budget, to the extent not already done. Any credits due from CITY shall, at DISTRICT's discretion, either be applied to reduce the amount billed to the DISTRICT based on the approved budget for the current fiscal year or refunded in whole or in part to DISTRICT within fifteen (15) days, and any amounts due to CITY from DISTRICT shall increase the amount invoiced to the DISTRICT based on the approved budget for the current fiscal year payable in accordance with Section II.D.4.a. Disputes shall be subject to arbitration under section II.G.2.

c. While it continues the billing and collection functions for the DISTRICT, the CITY will apply DISTRICT revenue to DISTRICT's allocated share of costs under section II.D.1. and to DISTRICT's share of bond debt service, under section II.D.2., on a monthly basis, with payment of DISTRICT's share of bond debt service on a semi-annual basis unless otherwise required by the Refinancing. The provisions in this section II.D.4. shall continue to apply, except to the extent they are inconsistent with the terms of the Refinancing. DISTRICT funds held by the CITY shall receive a proportionate share of any returns earned on funds held by the CITY.

5. Information Sharing. Commencing six (6) months after the Effective Date, for all funds/accounts associated with revenue and expenditures, including transfers, of the Combined CITY/DISTRICT Sewer System, the Parties shall provide each other:

a. On a monthly basis with: (1) a summary general ledger report containing debit and credit balances of the current month and year-to-date; (2) a detail general ledger report for the month.

b. On a quarterly basis with a summary general ledger report with debit and credit balances of the current quarter and year-to-date; and,

c. On an annual basis with: (1) the combining trial balance through the reporting period; (2) basic financial statements, to include (i) statement of net assets, (ii) statement of revenues, expenses, and changes in fund net assets and (iii) statement of cash flows; (3) all adjusting, post-closing, and audit adjustment journal entries; (4) details of all adjusting, post-closing, and audit adjustments; and, (5) copy of draft and final audited financial statements, including the required communication regarding internal controls over financial reporting.

In addition to any other information sharing requirements in this Agreement, each party shall, within ten (10) business days of any request by the other, provide access to any information or materials within the requestee's knowledge, custody or control, as may be reasonably requested and adequately described, to enable the requesting party to timely and fully evaluate, analyze, and verify the other's invoices / expenditures for the requesting party's share of allocated costs as provided in this section II.D., including, but not limited to, Direct Costs, Indirect Costs, water consumption and relative strength of discharge, billing, collection, Customers, Connections, ESSUs, financing, bond indebtedness, Refinancing (if done), and Capital Improvements.

6. Rate Studies. Unless otherwise agreed by the Parties, in fiscal year 2019-2020, and every fifth fiscal year thereafter, the CITY and DISTRICT shall undertake and share equally the cost of a rate study for the Combined CITY/DISTRICT Sewer System using a qualified consultant with expertise in compliance with Proposition 218 (Cal. Const., Article XIII.D.)

E. ALLOCATION OF REMAINING CWWTP CAPACITY-PROJECT CAPACITY.

1. Capacity Allocation. In Amendment No. 2, the Parties agreed that the Capacity Project, inclusive of CEPT, increased the capacity of the CWWTP by 2,400 ESSUs of which DISTRICT is entitled to use sixty-five percent (65%), or 1,560 ESSUs (the "DISTRICT Dedicated Capacity"), and CITY is entitled to use thirty-five percent (35%), or 840 ESSUs (the "CITY Dedicated Capacity"). The Parties agree the DISTRICT owns the DISTRICT Dedicated Capacity

and the CITY owns the CITY Dedicated Capacity. The pre-Capacity Project wastewater treatment capacity (e.g. ESSUs) of the CWWTP has been used by the Parties, and the Parties agree to treat the unused Capacity Project ESSUs as the measure of the remaining wastewater treatment capacity in the CWWTP.

The Parties recognize that the North Coast Regional Water Quality Control Board (“NCRWQCB”) uses dry weather flow to determine the treatment capacity of the WWTP and has established its discharge limits, in part, based thereon. ESSUs are used to estimate the amount of treatment capacity consumed by a sewer connection. If the 2,400 ESSUs have been used, but the dry weather flow into the CWWTP is below the amount authorized in the Waste Discharge Permit for the CWWTP then in effect, the Parties shall meet and confer for not more than ninety (90) days, unless they agree to extend the time, to determine how to allocate any remaining treatment capacity between them. If they fail to agree within that time, either party may initiate dispute resolution under Section II.G.1. The purpose of this provision is to provide for allocation of any such additional remaining treatment capacity in a manner consistent with this Agreement.

A dispute between the Parties currently exists concerning (a) the quantity of ESSUs actually used to date by each party from the 2,400 ESSUs made available through the Capacity Project and, in turn, (b) the remaining ESSUs available to each party through the Capacity Project. Subject to the limits on the remedies available to the Parties as stated below in this Section II.E.1, this dispute is excluded from the waiver and release of claims resulting from the Settlement Agreement (Exhibit 1 hereto.) To resolve this dispute, the Parties shall promptly exchange all available information and materials related to the dispute and otherwise diligently work to resolve it. In the event a signed, written, agreement on this dispute is not reached within one hundred eighty (180) days of the Effective Date, the matter may be submitted by either or both parties to binding arbitration under section II.G.1. The resolution of the dispute by agreement or arbitration shall be limited to determining the remaining ESSUs available to each Party for new connections and to establishing a record of each Connection having a Capacity Project ESSU and the number of such ESSUs attributable to each such connection. All other remedies associated the resolution of this dispute, including damages and equitable relief are subject to the release of claims in accordance with the Settlement Agreement, except that, in the event actual ESSU capacity of the CITY or the DISTRICT, as determined by agreement or arbitration, exceeds its allocated quantity of Capacity Project ESSUs, then there shall be an adjustment of remaining Capacity Project ESSUs to maintain the ratio of such capacity to which each party is entitled as specified above. If such an adjustment is not possible, then the imbalance in ESSUs shall be treated as if it were a transfer under section II.F.4. with corresponding payments and reallocations.

Except as otherwise provided in this Agreement or agreed to in writing by the Parties, neither party may add new ESSUs for treatment in the CWWTP beyond their respective allocated share of remaining Capacity Project ESSUs as determined in the first paragraph of this section (or, regarding non-Capacity Project capacity, as determined in section II.F). The Parties may agree to transfer all or any portion of one party’s allocated share of remaining Capacity Project ESSUs to the other party with a corresponding adjustment to their respective remaining capacity in the CWWTP and reallocation of Installment Payments associated with the Capacity Project (subject to Refinancing agreements), and on terms and conditions otherwise agreed.

2. Calculating Consumption of Remaining ESSUs. Each party may add ESSUs for treatment in the CWWTP up to its remaining allocated share of Capacity Project ESSUs described in section II.E.1. ESSUs may be used by the creation of a new Connection within the sewer-service jurisdictional boundaries of either party or the remodel or change in use of a structure with an existing Connection within said boundaries. In most cases a remodel or change in use will increase the ESSUs consumed by the Connection (which increases the ESSUs then assigned to that Connection). Once the ESSU attributable to a new Connection or the remodel or change in use of a structure with an existing Connection is determined—in accordance with the procedures below—that party’s share of remaining ESSUs that may be added for treatment in the CWWTP shall be increased or reduced by a corresponding amount.

For residential properties, ESSUs will be calculated based on the number of bedrooms in the residence. ESSUs will be assigned as follows:

- One Bedroom Residence: 0.9 ESSUs
- Two Bedroom Residence: 1.0 ESSUs
- Three Bedroom Residence: 1.1 ESSUs
- For each additional bedroom: Additional 0.1 ESSUs

For commercial and industrial properties, all such new ESSUs shall be calculated using drainage fixture unit (DFU) values as set in Chapter 7 Sanitary Drainage, Table 702.1 of the 2016 California Plumbing Code. For commercial and industrial accounts 26 DFUs equal 1 ESSU.

Each party shall have the right to set the ESSUs to be assigned to such a new Connection, or to an existing Connection upon a remodel or change in use, in a manner that deviates from the referenced DFU calculation if reasonably required to properly capture the actual anticipated discharge characteristics of the Connection, such as flow, biochemical oxygen demand (BOD), total suspended solids, and other sewage characteristics. Any such deviations shall be based on ESSUs for commercial and industrial properties having an annual average daily wastewater flow of 210 gallons per day, with BOD and TSS concentrations of 200 mg/L. When ESSUs are to be calculated, the following formula shall be used:

$$\text{Calculated ESSUs} = [(\text{Expected TSS in mg/L}) / (200 \text{ mg/L}) * (1/3)] + [(\text{Expected BOD in mg/L}) / (200 \text{ mg/L}) * (1/3)] + [(\text{Expected annual average flow in gpd}) / (210 \text{ gpd}) * (1/3)]$$

For commercial and industrial Connections, at no point will the components used to calculate ESSUs be a value that is less than 200 mg-BOD/L, 200 mg TSS/L, or 210 gpd of annual average flow. Any deviations from the ESSU calculation method for commercial or industrial shall be considered on a case by case basis subject to the following process.

When a building permit application is filed with the CITY Building Department or the Mendocino County Building Department for a (1) project that will require the payment of a Connection fee, or (2) the remodel or change in use of a structure with an existing Connection, the building department will refer the application to the CITY to prepare an assessment of the number of ESSUs and the associated fee for that property. By the end of business on the day the assessment

is completed, the CITY shall forward by email a copy of the proposed permit and the assessment (inclusive of the calculation and all supporting details, facts, and information used to perform the calculation and all documents supporting and relating to the calculation) of ESSUs to the DISTRICT. CITY shall provide information to DISTRICT either by certified mail or tracked email in order to verify delivery and receipt. Within ten (10) business days of its receipt of the permit application and the assessment from the CITY, the DISTRICT shall respond to the CITY with any questions, disputes, or modifications to the assessment or Connection fee. If CITY and DISTRICT do not concur on the assessment or Connection fee, the CITY and DISTRICT shall meet and/or exchange information as necessary. If the Parties fail to resolve the dispute within ten (10) business days of the CITY's receipt of the DISTRICT's written questions or disputes, or such further time as the Parties may agree, the dispute shall be resolved as provided in Section II.G.1. Failure of the District to respond to the receipt of the assessment and Connection fee sent by the CITY will be assumed to mean that the DISTRICT does not object to the CITY's assessment or the Connection fee.

F. CHANGES OF ORGANIZATION AND DISTRICT REGIONAL WASTE WATER TREATMENT PLANTS (DRWWTP).

1. Changes of Organization. Subject to and in compliance with the requirements of the Refinancing and Refinancing agreements and, pending Refinancing, the agreements associated with the 2006 Bonds, either party may apply to and obtain a decision by the Mendocino Local Agency Formation Commission ("LAFCO") for a change of organization using the procedures in the District Reorganization Act ("DRA"; Gov't Code §56000 et seq., as amended) and as otherwise allowed by law, including, but not limited to, any and all amendments to a sphere of influence, annexations and detachments, including, but not limited to, detachment from the DISTRICT of all or any portion of the Overlap Area. The filing by the CITY of an application—by itself—to LAFCO to detach all or any portion of the Overlap Area shall not be deemed a breach of this Agreement or the Participation Agreement. Nothing in this Section II.F. excuses the Parties from exhausting their administrative or judicial remedies as required by law and nothing herein impairs the Parties' rights to seek relief as allowed by law. Nothing herein shall be deemed consent by DISTRICT of or for any such detachment or by either party of any other proposed change of organization by the other party. Except as otherwise determined by LAFCO in acting on a petition or application for a change of organization or by other lawful procedures, both Parties reserve their right to provide sewer service within their respective sewer-service boundaries as they now exist or may exist in the future.

2. DRWWTP Development. The DISTRICT does and shall have the right to apply for permits and take other action to establish one or more new wastewater treatment facilities and to construct, operate and maintain said facilities. Subject to and in compliance with the requirements of the Refinancing and Refinancing agreements, or once the Installment Payments allocated to DISTRICT are paid or defeased, the DISTRICT may divert DISTRICT Connections or Customers connected to the CWWTP to a DRWWTP or any other treatment facility in accordance with this Agreement.

3. Obligation to meet and confer. Both parties reserve their right to oppose the other party's application for a reorganization, including but not limited to detachment from the DISTRICT of all or any portion of the Overlap Area or the DISTRICT's development or operation of a DRWWTP, on any legal, equitable, or factual basis. Prior to taking action embraced by section II.F.1. or 2., the party intending to take such action shall give the other party at least sixty (60) days written notice of the same; such notice shall describe in detail the intended action and the anticipated effect of that action on this Agreement. If either party has objections or concerns about the other party's LAFCO application or the DISTRICT's proposal to establish a separate wastewater treatment facility, it will be required to notify the other party of those objections and concerns in writing and the Parties shall engage in good faith negotiations to resolve the other party's concerns. Either party may request and the Parties may schedule joint meetings of the DISTRICT's Board and CITY's City Council to address these concerns. However, those negotiations shall not delay or alter the LAFCO or DRWWTP process or procedures, except to the extent agreements are reached that affect the same. Subject to the legally required exhaustion of administrative or judicial remedies, unresolved disputes concerning reorganizations, which are not subject to the jurisdiction of LAFCO, or disputes concerning a DISTRICT proposal to establish or use a DRWWTP which are not subject to the jurisdiction of Mendocino County, the NCRWQCB or any other agency or regulatory body with approval authority over the project, shall be resolved according to the procedures in section II.G.2.

4. Transfer of Capacity Project ESSU-Connections Through a Change of Organization or to a DRWWTP. If a change in organization by one party ("Receiving Party") results in that party modifying its sewer-service jurisdictional boundaries to include, and which effectively transfers, Customers and Connections assigned Capacity Project ESSUs that were within the other party's ("Transferring Party") sewer-service jurisdictional boundaries, or if the DISTRICT transfers wastewater treatment services for a Connection assigned Capacity Project ESSUs within its sewer-service jurisdictional boundaries from the CWWTP to any DRWWTP (in which case DISTRICT is the Transferring Party and CITY the Receiving Party), and in either case assuming such a transfer is permitted under the terms of the Refinancing, or as to a transfer of a connection from the CWWTP to any DRWWTP, in the absence of Refinancing, upon payment or defeasement of the 2006 Bonds, then, subject to Section II.F.1.-2 and covenants imposed as part of the Refinancing, the following provisions shall apply.

a. ESSU Numerical Value. Each Connection so transferred shall be assigned a numerical ESSU value. As to an existing Connection, the number of ESSUs shall be as previously calculated, barring apparent error. The number of ESSUs assigned future connections shall be determined in accordance with section II.E.

b. Payment of Transferred Connections Assigned Capacity Project ESSUs. For any Connection assigned Capacity Project ESSUs transferred by the DISTRICT to a DRWWTP or other facility, the Receiving Party shall pay the Transferring Party the monetary sum ("the Calculated Amount") determined by multiplying (a) the number of ESSUs transferred by (b) the debt service paid for them by the Transferring Party to the date of transfer. If a Connection Fee was paid for the Capacity Project ESSUs before they are transferred, the Transferring Party shall pay the Receiving Party the amount by which the Connection Fee exceeds the Calculated Amount or the Receiving Party shall pay the Transferring Party the amount by which the

Calculated Amount exceeds the Connection Fee. Prior to any such transfer being effective, the Parties shall meet and confer in good faith to establish the terms on which such payment shall be made, with disputes concerning the same subject to binding Fast Track arbitration under section II.G.1. Regarding a change in organization, the Calculated Amount shall not apply to transfers of Connections assigned Capacity Project ESSUs. Nothing in this Agreement shall determine the Parties' right to payment or compensation otherwise upon a change in organization

c. Effect of Transfer on Cost Allocation. For any Customer or Connection so transferred, figures associated with any such Customer or Connection (water use and relative strength) that would otherwise be used in the Allocation Methodology to determine the Parties' respective share of costs subject to allocation, described in section II.D.1., and the adjustments to debt-service obligations (number of Capacity Project ESSUs assigned a transferred Connection), described in section II.D.2., shall be made and assigned to the Receiving Party, effective on, and prorated to, the date of transfer, subject to the terms of the agreements entered as part of the Refinancing (no such transfer shall be allowed unless permitted under, and done in accordance with, the terms of the Refinancing).

d. Effect of Transfer on Remaining CWWTP Capacity Project Capacity Allocation. Each Connection assigned a Capacity Project ESSU transferred by DISTRICT to a DRWWTP pursuant to this section II.F.4 shall result in a corresponding deduction to Transferring Party's allocated share, and an increase to Receiving Party's allocated share, of remaining CWWTP Capacity Project ESSUs as otherwise described in section II.E, effective on the date of transfer. A transfer of a Connection assigned a Capacity Project ESSUs resulting from a change in organization shall have *no effect* on the Parties' allocated share of the remaining CWWTP Capacity Project Allocation, including pursuant to section II.E.

e. DISTRICT's Transfer of ESSUs Within CITY Limits. In the event DISTRICT seeks to transfer a Connection (regardless of whether it is assigned Capacity Project ESSUs) that is within DISTRICT's sewer-service jurisdictional boundaries but also CITY's general jurisdictional boundaries (i.e. city limits), the transfer cannot occur unless the CITY approves the transfer, such approval not to be unreasonably withheld considering the advantages and disadvantages of using a DRWWTP to serve the connection against the impact of the transfer on the CITY's interest in providing sewer service within its city limits. The Parties shall promptly exchange all information and materials on the matter. If the CITY has failed to approve the transfer within sixty (60) days of DISTRICT giving the CITY a written request for such approval, the DISTRICT may commence dispute resolution under section II.G.1 so long as notice under said section II.G.1. is given within 120 days of the DISTRICT's written request for approval under this section.

5. Transfer of Non-Capacity Project ESSUs: If the DISTRICT transfers wastewater treatment services for a Connection *not* wholly assigned Capacity Project ESSUs within its sewer-service jurisdictional boundaries from the CWWTP to any DRWWTP or such a Connection is transferred from one party to the other through a change in organization, and in either case assuming such a transfer is permitted under the terms of the Refinancing, then, subject to section F.1-2 and the covenants imposed as part of the Refinancing, the following provisions shall apply:

a. **ESSU Numerical Value.** Each Connection so transferred shall be assigned a numerical ESSU value for purposes of determining remaining capacity in the CWWTP available to the party. That numerical value shall be determined in the same manner as for a Capacity Project ESSU in accordance with Section I.I.E. It is the Parties' understanding that there are no Non-Capacity Project Connections for which ESSUs have been calculated or assigned (to the extent the case is otherwise, as to an existing Connection, the number of ESSUs shall be as previously calculated, barring apparent error).

b. **Effect of Transfer on Cost Allocation.** To the extent a transfer is of *non*-Capacity Project ESSUs, figures associated with any such Customer or Connection (water use and relative strength) (prorated for non-Capacity Project ESSUs if the subject Connection is assigned both Capacity, and non-Capacity Project ESSUs) that would otherwise be used in the Allocation Methodology to determine the DISTRICT's respective share of costs subject to allocation, described in section II.D.1., shall be eliminated, and adjustments to debt-service obligations, described in section II.D.2, made, effective on, and prorated to, the date of transfer, subject to the terms of the agreements entered as part of the Refinancing (no such transfer shall be allowed unless permitted under, and done in accordance with, the terms of the Refinancing).

c. **Effect of Transfer on Remaining CWWTP Capacity Project Capacity.** Subject to section II.F.6., for any Customer or Connection so transferred, the number of *non*-Capacity Project ESSUs attributable to the same shall have *no effect* on the Parties' allocated share of the remaining CCWTP Capacity Project Allocation, including pursuant to section I.I.E.

6. **Use of CWWTP Capacity Following Transfers.** With respect to Capacity and non-Capacity Project ESSUs assigned to Connections or Customers transferred by DISTRICT to a DRWWTP ("Transferred ESSUs"), the resulting increased capacity of the CWWTP shall be allocated as follows. The remaining Capacity Project ESSUs of each party, not counting Transferred ESSUs, shall be used first by new Customers or Connections of the party. If a party has no more Capacity Project ESSUs to serve a Connection, the party may use Transferred ESSUs that have not been used by a new Connection. Transferred ESSUs may not be reserved by either party and shall be assigned and used in accordance with Section I.I.E.2. CITY shall pay DISTRICT for any Transferred ESSUs assigned to the new CITY connection the amount, if any, of debt service paid by DISTRICT for that ESSU (to the extent it is a Capacity Project ESSU or attributable to financing used to increase CWWTP plant capacity). Figures associated with any such Customer or Connection associated with a Transferred ESSU that would otherwise be used in the Allocation Methodology to determine the DISTRICT's share of costs subject to allocation, described in section II.D.1., and the adjustments to debt-service obligations, described in section II.D.2., shall be assigned to the CITY, effective on, and prorated to, the date of transfer, all of which are subject to the terms of the agreements entered as part of the Refinancing (no such transfer shall be allowed unless permitted under, and done in accordance with, the terms of the Refinancing or if the subject bond indebtedness is paid or defeased).

G. ARBITRATION

1. Fast-Track Alternative Dispute Resolution. In the event a dispute arises between the Parties concerning the matters to which this section II.G.1. applies as referenced above, and the Parties are unable to resolve the dispute within the prescribed time periods in such sections, then either party may commence the Fast-Track alternative dispute resolution process in this section II.G.1.

a. Notice. A Party may initiate this dispute resolution by a written notice delivered to the other Party. The notice shall identify in detail the issues that are the subject of the dispute. In the event the dispute concerns a matter for which a proposed resolution cannot be reasonably made (e.g. where information or materials underlying the matter were not properly exchanged), the notice shall state the same.

b. Response. Fifteen (15) days after written notice is given under section II.G.1.a., the Parties shall simultaneously exchange, in writing, a proposed resolution of the dispute, with reference to the reasons, information, and materials supporting the proposed resolution. Copies of all supporting materials shall accompany the counter-proposal. In the event the dispute concerns a matter for which a proposed resolution cannot be reasonably made (e.g. where information or materials underlying the matter were not properly exchanged), the exchange shall state the same.

c. Good-faith effort to resolve. Unless otherwise agreed in writing, within fifteen (15) days of the exchanges in section II.G.1.b., the Parties shall make good faith efforts to resolve the dispute.

d. Binding Arbitration. If the Parties are unable to resolve the dispute within fifteen (15) days of the exchanges in section II.G.1.b., then, absent written agreement otherwise, they shall submit the dispute to binding arbitration.

(1) Arbitrators. Within thirty (30) days of the exchanges in section II.G.1.b, each party shall select and submit to the other party in writing the name of one individual or entity to serve as the arbitrator. A selected arbitrator shall be completely neutral and, unless otherwise agreed by the Parties, shall not be, or have been: employed by the CITY or DISTRICT, other than as an arbitrator under this Agreement; have a family or business relationship with any person who is, or has been, employed by the CITY or DISTRICT; a customer of the CITY or DISTRICT; or, an owner or occupant of property located in the CSS or DSS. Proposed arbitrators shall be qualified to assess the subject matter of the dispute. If the Parties are unable to agree on an arbitrator, the two arbitrators shall, within seven (7) days, select a mutually-acceptable alternative arbitrator.

(2) Arbitration. Either party may initiate binding arbitration under this section II.G.1.d. by submitting a written request for dispute resolution to the arbitrator, with copy to the other party, containing the notice and exchanges, inclusive of all proposals, reasoning, and information and materials provided therewith, under section II.G.1.a-b. Within fifteen (15) days of the receipt of the written request for dispute resolution or such longer period as determined by

the arbitrator for good cause or as agreed by the Parties, the arbitrator shall conduct a hearing at which the parties and their representatives may appear and be heard. If the Parties fail to agree to a resolution of the dispute at the hearing or within any additional period of time allowed by the arbitrator for good cause or agreed by the Parties (“continued hearing”), within fifteen (15) days after the conclusion of the hearing, the arbitrator may issue and serve on each party a proposed decision that combines elements in each Party's proposal. If the Parties fail to agree to the suggested terms within ten (10) days of such written proposed decision, the arbitrator shall issue a final decision which may approve the proposal that the arbitrator determines to be the most reasonable or a combination of the proposals submitted by the Parties that the arbitrator determines represents a fair and reasonable resolution of the dispute. The arbitrator’s final decision shall be effective immediately and shall be binding and enforceable on the Parties. Notwithstanding that, either party may appeal or obtain relief from the courts otherwise on an arbitrator’s final decision if and only if it is contrary to the California Constitution or state law governing or limiting the exercise of local government powers by either the DISTRICT or the CITY. Each party shall pay one half the costs of arbitration under this section II.G.1.

2. Arbitration of other disputes. Any controversy or claim arising out of, seeking to enforce or interpret, or otherwise relating to this Agreement not subject to dispute resolution under Section II.G.1, shall be settled by binding arbitration administered by a single arbitrator or arbitration service approved by both Parties in accordance with the arbitration rules of the agreed upon arbitration service or contained in Code of Civil Procedure Sections 1280 et seq., if the Parties use a single arbitrator not provided through an arbitration service. If the Parties fail to agree on an arbitrator within thirty (30) days of a Party’s written notice for arbitration, either Party may apply to a court pursuant to Code Civ. Proc. §1281.6 to appoint an arbitrator. Judgment on the arbitration decision rendered may be entered in any court having jurisdiction thereof. Each party shall pay one-half of the fees and charges associated with arbitration under this section II.G.2. The arbitration shall be conducted in Ukiah, California, or as close thereto as reasonably practical. Any controversy or claim subject to arbitration must be made in the manner and within the time otherwise required by law, including, but not limited to the California Tort Claims Act (Gov. Code Sec. 810 et seq.), applicable statutes of limitation and other laws and judicial principles requiring the prompt adjudication of claims. Each party shall bear its own attorney’s fees, costs, and other expenses related to the arbitration proceeding.

H. MISCELLANEOUS

1. Entire Agreement Conditional. This Agreement is expressly conditioned on execution and full performance by the Parties of the Settlement Agreement and Mutual Release concerning the Action, a copy of which is attached hereto and incorporated herein by reference as **Exhibit 1**.

2. Effect on Participation Agreement, As Amended. To the extent this Agreement may conflict in any manner with the Participation Agreement, this Agreement supersedes and replaces any such conflicting provisions and shall control.

3. Indemnification. Each party shall indemnify and defend the other party from and against any claim for damages by a third party against the indemnified party caused by or due to

actions or inactions of the first party, including but not limited to fines or other financial penalties imposed by a regulatory agency and for any expenses or liability of any kind. Such expenses shall include defense costs incurred by the indemnified party, where the indemnifying party fails to provide an adequate or timely defense to any such claim. The obligation to indemnify and defend shall arise, when the claim, expense or liability is based on or arises out of the failure of the indemnifying party to perform its obligations in accordance with Section II.C.3.a of this Agreement.

4. **Duration of Agreement.** This Agreement shall remain in effect while any portion of the DISTRICT's allocated share of debt service on bonds issued to fund the CWWTP Rehabilitation/Upgrade and Capacity Projects remains outstanding. Thereafter, the Agreement may be terminated by either Party with five (5) years advance written notice to the other Party, where the notice is accompanied by a certified copy of a resolution adopted by the Party's governing body authorizing notice and termination of the Agreement.

5. **No Third-Party Beneficiaries.** The Parties intend this Agreement is for the sole benefit of the Parties and do not intend to confer any rights hereunder to any third party, except to the extent third party beneficiaries are required in connection with the Refinancing.

6. **Time is of the Essence.** Time is of the essence regarding the Parties' performance and other obligations under this Agreement.

7. **Integration Clause.** This Agreement, the Settlement Agreement attached hereto and incorporated herein by reference as Exhibit 1, the provisions of the Participation Agreement and Financing Agreement not effectively amended or replaced by the provisions of this Agreement, constitute the entire agreement between the Parties concerning the subject matter hereof. They supersede and replace any other or prior agreements, representations, statements or understanding concerning the same. This Agreement may only be amended by written agreement executed by the Parties.

8. **Cooperation Clause.** The Parties, and each of them, shall promptly take all steps reasonably required to perform and carry out the terms of this Agreement.

9. **Construction.** This Agreement shall be interpreted under the laws of the State of California, except that no law, statutory or otherwise, that construes a term in this Agreement against a drafting party shall be applied or effective. This Agreement shall be construed, and shall be deemed, drafted by each party hereto.

10. **Notices.** Whenever written notice is required or permitted by this Agreement, it shall be deemed given when actually received, if delivered by personal delivery, fax or email, when receipt of the fax or the email is acknowledged, registered or certified mail or overnight courier, or 48 hours after deposit in the United States Mail with proper first-class postage affixed thereto, when addressed or sent as follows:

CITY OF UKIAH
Attention: CITY Manager
Ukiah Civic Center
300 Seminary Avenue
Ukiah, CA. 95482
FAX:
Email:

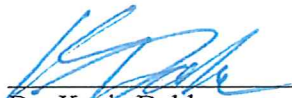
UKIAH VALLEY SANITATION
DISTRICT
Attn: General Manager
151 Laws Ave., Ste. B
Ukiah, CA 95482
FAX:
Email:

Either party may change the address, fax number or email address to which notices and other communications must be given by giving written notice as provided in this section.


11. **Counterparts.** Two or more copies of this agreement may be executed by the Parties. Each such copy, bearing the original signatures of the Parties, shall be considered an original, admissible in any administrative or judicial proceedings as evidence of the agreement between the Parties.

WHEREFORE, the Parties enter this Agreement effective on the date last executed below.


CITY OF UKIAH



By: Kevin Doble
Mayor
Dated: 3 Oct, 2018

UKIAH VALLEY SANITATION
DISTRICT

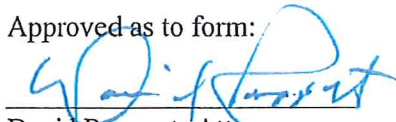

By: Theresa McNerlin
Chair
Dated: 3 Oct, 2018

ATTEST:


Kristine Lawler, City Clerk
Dated: Oct. 3, 2018


Attest: Chelsea Teague - District Clerk
10/03/2018

Approved as to form:


David Rapport, Attorney
CITY of Ukiah
Dated: 10/3, 2018

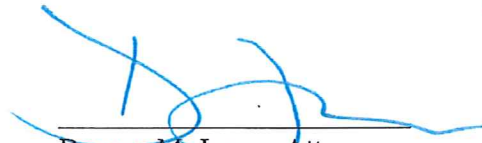

Duncan M. James, Attorney
Ukiah Valley Sanitation DISTRICT
Dated: 10/3, 2018

EXHIBIT 1

SETTLEMENT AGREEMENT AND RELEASE

This Settlement Agreement and Release ("Settlement Agreement") is entered on October 1, 2018 ("Effective Date") by and between UKIAH VALLEY SANITATION DISTRICT, a county sanitation district ("DISTRICT"), on the one hand, and CITY OF UKIAH, a general law municipal corporation ("CITY"), on the other hand. The parties are, at times, collectively referred to herein as the "Parties."

RECITALS

A. A proceeding between the Parties is presently pending in Sonoma County Superior Court entitled *Ukiah Valley Sanitation District v. City of Ukiah*, case no. SCV 256737 ("the Action").

B. In the Action, the DISTRICT filed a complaint against CITY, as amended, and CITY filed a cross complaint against DISTRICT, both of which are pending.

C. CITY filed an application(s) with Mendocino LAFCO for a change in organization, including detachment of portions of the DISTRICT commonly known as the "Overlap Area." Said proceeding(s) is referred to hereafter as "Detachment Proceedings."

D. The Parties intend to execute, contemporaneously with this Settlement Agreement, the document entitled the Operating Agreement for the Combined Sewer System Serving the Ukiah Valley Sanitation District and the City of Ukiah ("Operating Agreement"), a true and correct copy of which is attached hereto and incorporated herein by reference as **Exhibit 1** (this Settlement Agreement is in turn attached as Exhibit 1 to the Operating Agreement).

E. Except as described in this Settlement Agreement and in the Operating Agreement, the Parties desire and intend to resolve all claims either had or may have against the other related to the Action and to dismiss, discharge, and release all claims arising therefrom.

F. These Recitals shall be deemed incorporated by reference into all portions, including the Terms, of this Settlement Agreement.

NOW, THEREFORE, in consideration of the Recitals and Terms of this Settlement Agreement and for good and valuable consideration, the receipt and sufficiency of which is acknowledged, the Parties agree as follows.

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TERMS

1. **Operating Agreement.** Contemporaneous with execution of this Settlement Agreement, the Parties, and each of them, shall execute the Operating Agreement.

2. **CITY Payment to DISTRICT.** CITY shall transfer funds and pay to DISTRICT the monetary sum in combination totaling Seven Million Five Hundred Thousand Dollars (\$7,500,000.00), which is in addition to any other sums previously paid or transferred to DISTRICT, as follows:

a. **CITY Transfers and Payments**

(1) \$2,515,689.80 shall be transferred and deposited by the CITY for the DISTRICT's use and benefit within thirty (30) days of the Effective Date ("Payment Deadline") in accordance with section 2.b.(1);

(2) \$984,310.20 shall be paid by CITY directly to DISTRICT within thirty (30) days of the Payment Deadline as specified in section 2.b.(2);

(3) \$4,000,000 shall be paid by CITY directly to DISTRICT in equal annual installments commencing on the one-year anniversary of the Payment Deadline as specified in section 2.b.(3).

b. **Terms and Conditions of the Transfer and Payments Required by Section 2 (a).**

(1) The CITY maintains approximately \$4,837,865.13 in unspent proceeds of the 2006 Bonds, as defined in the Operating Agreement, including interest accrued on said funds through August 31, 2018. Those proceeds are presently reported by CITY in its Sewer Bond Debt Service Fund (Fund No. 841). Each party is entitled to the full use and benefit of a share of said funds for purposes of prepaying its share of the bond debt. As of August 31, 2018, the DISTRICT share is 52% of the funds in Fund 841, totaling \$2,515,689.80 ("DISTRICT Share") and the CITY share is 48%, totaling \$2,322,175.33 ("CITY Share"). The DISTRICT's and CITY's debt service obligation as of the Effective Date is 52% and 48%, respectively. The CITY shall transfer the entire balance in Fund 841 together with interest accrued as of August 31, 2018, totaling \$4,837,865.13, together with any additional interest properly credited to those funds through the date of transfer,¹ to the City of Ukiah 2006 Installment Payment Fund held by the Bond Trustee pursuant to Section 4.4(b)

¹The total amount transferred shall be finalized upon issuance of the 2017-18 audit but shall not affect the amount of the City's payment under Section 2.a(2). Said interest shall be applied to prepay bonds but shall not be credited to either the DISTRICT's or CITY's Share.

of the Installment Sales Agreement as defined in the Operating Agreement ("ISA"), to be used exclusively to make optional prepayments of the principal amount due on Installment Payments pursuant to Section 7.2 of the ISA in accordance with Section 2.03 of the Indenture of Trust between ABAG and Wells Fargo Bank, dated March 1, 2006 ("Indenture"). Other CITY and DISTRICT funds must be used to pay any accrued interest due on prepaid bonds. The Bond Trustee shall be irrevocably instructed not to disburse the deposited funds for any purpose or in any manner other than as specified herein. Bond prepayments shall occur in connection with a refinancing of the 2006 Bonds or, in the absence of a refinancing, at the earliest date specified by either the CITY or the DISTRICT. Notwithstanding the prepayment of bond debt as provided herein, the Parties shall share debt service as provided Section II.D.2.b of the Operating Agreement; provided, however, that in the event a reorganization is proposed, including through the Detachment Proceedings, the Parties shall ensure, as provided in Section 6.b, that the DISTRICT and CITY shall each receive the full benefit and use of the DISTRICT's Share and CITY's Share, respectively, against the total principal amount of bond debt for which that party is obligated.

(2) By no later than the Payment Deadline the monetary sum equal to (a) \$7,500,000 less (b) \$4,000,000 less (c) the sum transferred for the DISTRICT's Share (the sum of which equals \$984,310.20) shall be paid by the CITY directly to the DISTRICT from CITY funds in which CITY, and not DISTRICT, has the sole legal interest ("CITY funds").

(3) The CITY shall pay the DISTRICT \$4,000,000 in equal annual payments of \$1,000,000 each, commencing one year after the Payment Deadline and continuing on the same day and month each year thereafter until the balance plus interest is paid in full. So long as timely paid, interest shall accrue on the entire unpaid balance at the rate of three percent (3%) per annum commencing on the one-year anniversary of the Payment Deadline. CITY payments shall be made solely from CITY funds. If the initial installment is not paid when due, interest at the 3% annual percentage rate shall accrue on that installment from the Payment Deadline until that installment is paid in full. If any subsequent installment payment is not paid when due, interest on the unpaid portion of that installment payment shall accrue from the payment due date until that installment is paid in full at the legal rate.

3. **Dismissal of Action with Reservation of Jurisdiction.** Within five (5) business days of the Court entering an order on joint request of the Parties to maintain jurisdiction to enforce this Settlement Agreement notwithstanding dismissal, the Parties shall jointly execute a dismissal of the entire action with prejudice of all parties and all causes of action. The Parties agree that said dismissal shall not prejudice or otherwise affect either party's rights as provided in Section 6. Further, notwithstanding the dismissal, the court in which the Action is proceeding shall maintain jurisdiction, pursuant to *Code of Civil Procedure* section 664.6, to enforce the

terms of this Settlement Agreement to the extent dispute resolution is not otherwise provided in this Agreement.

4. **Releases.**

a. **CITY Release.** Except as otherwise provided in this Settlement Agreement and except with respect to DISTRICT's obligations under this Settlement Agreement and in the Operating Agreement, CITY (including its agents, representatives, officers, directors, employees, affiliates, principals, predecessors, successors, and assigns), hereby releases DISTRICT (and all its agents, representatives, officers, directors, employees, affiliates, principals, predecessors, successors, and assigns) from any and all claims, demands, obligations, costs, expenses, liabilities, causes of action, or rights or interests otherwise—however any of the same may be characterized ("Claims")—which CITY now has or may have against DISTRICT regarding, relating to, or arising from the Action.

b. **DISTRICT Release.** Except as otherwise provided in this Settlement Agreement and except with respect to CITY's obligations under this Settlement Agreement and in the Operating Agreement, DISTRICT (including its agents, representatives, officers, directors, employees, affiliates, principals, predecessors, successors, and assigns), hereby releases CITY (and all its agents, representatives, officers, directors, employees, affiliates, principals, predecessors, successors, and assigns) from any and all Claims which DISTRICT now has or may have against CITY regarding, relating to, or arising from the Action.

c. The releases contained herein are collectively referred to as "Released Claims."

5. **Unknown Claims.** Except as excluded in this Settlement Agreement and except with regard to the Parties' respective obligations under this Settlement Agreement and in the Operating Agreement, the Parties, and each of them, acknowledge reading and advisement of the provisions of California Civil Code section 1542 (and similar laws of other jurisdictions) and extend the Released Claims to unknown claims otherwise excluded by that section, which provides:

"A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS OR HER FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM OR HER MUST HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR."

With respect to the Released Claims, each party acknowledges there is a risk that, subsequent to the execution of this Settlement Agreement, it will or may incur damage or loss that it may deem in some way attributable to the Released Claims, but which are unknown and unanticipated at the time this Settlement Agreement is

executed, or that damages presently known may become progressive, greater, different, or more serious than is now known, expected or anticipated, or that facts related to the Released Claims are found hereafter to be in addition to or different from the facts now believed true. Each party accepts such risks and agrees this Settlement Agreement, including these releases, shall remain effective notwithstanding such risks should they materialize.

6. Exclusion from Releases.

The releases contained in this Settlement Agreement, including the Released Claims, shall not extend to:

a. any Claims based on matters revealed by, or adjusted in the process of producing, the 2016-2017 or 2017-2018 CITY audits of the CITY's Wastewater Enterprise, and which were not plainly revealed, in the absence of said audits, by financial or other records obtained by the DISTRICT prior to the Effective Date of this Settlement Agreement. The releases shall apply to and preclude Claims included in the Binder A-2 (Work Product Binder) produced by William Holder for his deposition and shall preclude Claims by either Party for revenue from sewer service fees paid by the County for sewer service to the County jail through fiscal year ending June 30, 2018 (CITY represents DISTRICT has been credited with such revenue from July 1, 2015-June 30, 2018);

b. either party exercising the provisions of the Operating Agreement that authorize them to oppose on any legal, equitable, or factual basis a reorganization proposed by either party, including the Detachment Proceedings and to prevent any diminution in the financial benefit to either party under Section 2.a(1) and 2.b(1) resulting from a proposed reorganization, including the Detachment Proceedings.

Any such dispute under Section 6.b shall be resolved as provided in Section F of the Operating Agreement and under Section 6.a pursuant to Section II.G.2 of the Operating Agreement.

Except as provided in the attached Exhibit 1, this release does not apply to or preclude any Claims by either party regarding any conduct, including conduct similar to or the same as that embraced by the Action, occurring after the Effective Date.

7. Attorney's Fees & Costs. CITY and DISTRICT shall each bear its own attorneys' fees, costs, and expenses incurred related to the Action.

8. Warranty of Authority. The Parties, and each of them, warrant and represent that it has not initiated or heretofore assigned or transferred, or purported to assign or transfer, to any person or entity not a party hereto, any Released Claim (or any part or portion thereof) and agrees to indemnify and hold the other harmless from and against any claim based on, related to, in connection with, or arising out of any such assignment or transfer or purported or claimed assignment or transfer. Individuals executing this Settlement Agreement represent and warrant they maintain

express authority of the party they represent to execute this Settlement Agreement and thereby bind said party to its terms.

9. **Disclaimer of Liability.** The Parties have entered this Agreement to avoid the further expense and uncertainty of litigation and acknowledge and agree that execution of this Settlement Agreement is the result of their compromise of disputed claims and defenses and shall not be considered or admissible as an admission of liability or wrongdoing for any purpose.

10. **Binding Effect.** This Settlement Agreement shall be binding on and inure to the benefit of the successors and assigns of the Parties hereto. Nothing in this Settlement Agreement, express or implied, is intended to confer upon any person or entity other than the Parties hereto or their respective successors and assigns, any rights or benefits under or by reason of this Settlement Agreement.

11. **Severability.** In the event a provision of this Settlement Agreement, or portion thereof, is determined unenforceable, the remainder hereof shall not be affected thereby and each remaining provision or portion thereof shall continue to be valid and effective and shall be enforceable to the fullest extent permitted by law, except that no release of any kind shall be effective absent compliance with sections 1-2 above.

12. **Cooperation.** The Parties, and each of them, shall promptly act to facilitate the provisions of this Settlement Agreement and will promptly comply with all reasonable requests necessary to carry out its terms.

13. **Survival of Rights.** Notwithstanding the releases contained herein, all rights and obligations of the Parties, and each of them, created under or pursuant to this Settlement Agreement and/or the Operating Agreement, shall survive execution of this Settlement Agreement.

14. **Integration Clause.** This Settlement Agreement represents and contains the entire agreement and understanding among the Parties hereto with respect to the subject matter of this Settlement Agreement, and supersedes any and all prior oral and written agreements and understandings, and no representation, warranty, condition, understanding or agreement of any kind with respect to the subject matter hereof shall be relied upon by the Parties unless incorporated herein or contained in the Operating Agreement. This Settlement Agreement may not be amended or modified except by an express written agreement signed by the Parties.

15. **Construction.** This Settlement Agreement shall be interpreted under the laws of the State of California, except that no law, statutory or otherwise, that would construe language against a drafting party shall be applied or effective. This Settlement Agreement shall be construed as, and shall be deemed, drafted by each party hereto.

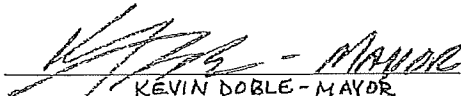
16. **Representation.** The Parties, and each of them, acknowledge entering this Settlement Agreement voluntarily and of their own free will, absent coercion or duress and, further, with legal representation of that party's choice.

17. **Execution.** This Settlement Agreement shall be executed in duplicate form thereby ensuring an original of it is maintained by each party.

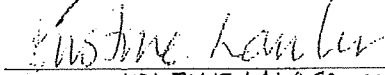
IN WITNESS WHEREOF, the Parties have entered this Settlement Agreement on the Effective Date and have executed this Settlement Agreement on the dates indicated below.

CITY OF UKIAH

Dated: October 2, 2018

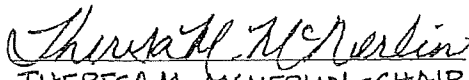

KEVIN DOBLE - MAYOR

Dated: October 2, 2018

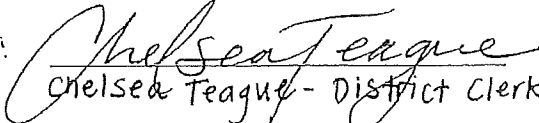
ATTEST: 
KRISTINE LAWLER - CITY CLERK

UKIAH VALLEY SANITATION DISTRICT

Dated: October 3, 2018


THERESA M. MCNERLIN - CHAIR

Dated: October 3, 2018

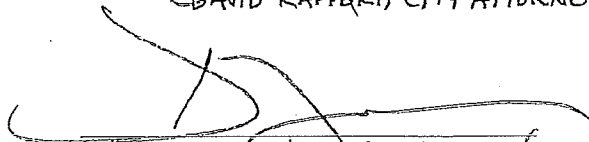
ATTEST: 
Chelsea Teague - District Clerk

Approved as to form:

Dated: October 2, 2018


DAVID RAPPART, CITY ATTORNEY

Dated: October 3, 2018


Duncan M. James, attorney for
Ukiah Valley Sanitation District