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September 20, 2016

Honorable Mayor Stephen G. Scalmanini and
Council Members
City of Ukiah
300 Seminary Avenue,
Ukiah CA 95482

Hand Delivered and by email

Re: *Ukiah Valley Sanitation District v. City of Ukiah*

Dear Honorable Mayor Scalmanini and Council Members:

Our apologies for the delay in responding to your letter dated September 14, 2016. The Ukiah Valley Sanitation District ("District") board needed to review and approve the mailing of this letter since it relates to pending litigation. Let me begin by noting that there is substantial background and other detail in this letter because the City of Ukiah ("City") has three (3) relatively new council members who may not be aware of critical details that impact the litigation.

Further, since the underlying issues in the lawsuit impact the so-called Purple Water project, it is our belief that the matter cannot be addressed properly absent reference to, and an understanding of, those underlying issues. The City requests the District dismiss the lawsuit, which, it should be noted, includes the City's *recent* counter-lawsuit against the District. The City states that the District's lawsuit should be dismissed because the state will not issue loans for the Purple Water project with that action pending. In this regard, I note that the request to dismiss the lawsuit so the state's concerns are alleviated, subject to the offered side agreement that would allow the District to simply re-file suit after the City receives loan funds, seems to me to border on fraud. In short, it would condone the City's misrepresentation to the state that a claim or lawsuit against the City does not exist. Consequently, the District will not participate in such activity, which would necessarily include substantial conditions, absent assurances from the state that it finds such conduct acceptable.

Background

The City and District operate as a joint venture of sorts. Under agreements in place for decades, the City owns the treatment facility and is for the most part charged with operating and maintaining the entire sewer system, including that portion of the system in the District's jurisdiction, which includes a portion of property within the City's city limits known as the Overlap Area.

Properties within both parties' jurisdictions place effluent, or waste, into the system, which requires treatment. One central design of the agreements was to allocate, or divide, the operating and maintenance costs for the sewer system between the parties. For simplicity, we'll

refer to that as O&M[1]. Basically, the idea is that each party pay O&M in proportion to the amount of effluent that party's properties place into the system.

Determining the amount of effluent placed into the system is not an easy task. Of course, properties connected to the system discharge effluent into it. But, there are no (or very few) installed meters that calculate the discharge into the system from each property. Over time, the parties' agreements handled this issue differently.

Before 1985, the agreements were designed to allocate O&M based on the number of connections within each party's jurisdiction. In short, if a property was physically hooked into the system, it counted as one connection. Thus, if the District had 45% and the City 55% of the total connections, then O&M would be paid by each party corresponding to that percentage.[2]

Pretty simple. However, allocating O&M based on connections is problematic; it doesn't come close to measuring the amount of waste a property discharges into the system. For example, the amount of waste a 2 bedroom, 1 bath, house typically places into the system is quite different from the amount placed into the system by a restaurant (think: sinks, dishwashing, bathrooms, and numerous employees and patrons all using its facilities on a daily basis). The issue is exacerbated when considering differences in user type. A brewery, for instance, discharges a far greater amount of solids down its drains than does a typical single-family dwelling; thus, the brewery's discharge requires more treatment.

To address these problems, beginning in 1985 the City and District agreed to allocate O&M based on Equivalent Sewer Service Units ("ESSUs"), within each party's jurisdiction. (4th Supp. Agmt., 2/6/1985, pp. 1-2, § 1.) The concept was to establish a central standard by which all connected parcels, irrespective of type, could be fairly measured. Therefore, one ESSU was considered to be the equivalent amount of waste characteristically discharged by a single-family dwelling.

But, again, there are no meters currently installed to measure discharge. To handle that problem, formulas were developed (or, at least were supposed to be developed) to approximate a connected-user's discharge by reference to the amount of water--which is metered--consumed by a property.[3] Since the concept was to measure this use by reference to a standard--a single-

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[1] This more broadly includes "annual costs for treatment, including maintenance, operation, administration, repair and replacement, expansion, upgrading, debt service, insurance and financial services of the entire sewer system (treatment plant, trunk sewer, and collection system)." (Amend. 1 to Part. Agmt, p. 1, 2nd full ¶.) This language deviated somewhat between agreements. (See, 4th Supp. Agmt., 2/6/1985, p. 1, § 1; Part. Agmt., 7/19/1995, p. 1, § 1.)

[2] For the sake of practicality, the City projected each party's connections from 1967 through 1984. (3rd Supp. Agmt., 12/14/1966, p. 1, § 2.) The agreement provided that if the actual ratio deviated from the projected ratio by more than 10% in any given year, then the percentage allocation of O&M would be adjusted accordingly. (*Id.*, p. 2, § 2.) As discussed below, that didn't happen.

[3] Of course, not all water used by a property enters the sewer system. Again, these are approximations. But, that fact was considered and addressed. For example, property owners use metered water to irrigate. Irrigated water does not discharge from the property into the sewer system. Then again, property owners typically don't irrigate in the winter. Considering that, only metered water use during winter months is applied to determine a property's discharge.

family dwelling--it was necessary to establish the amount of water typically consumed by such a property. With some deviation, that amount was established at 250 gallons per day (GPD).

Of course, establishing that standard did not address the differences in type of user, and thus type of waste, discharged into the system. To address that issue, formulas were developed to equate the standard one ESSU with water consumption or some other methodology depending on the type of connected user (e.g. different methods are applied for restaurants as opposed to office buildings or light industrial).

Application - Expense & Revenue Allocation

Although technically a separate entity, until 2008/2009 the District's board was comprised of two (2) members of the Mendocino County Board of Supervisors, one of whom was always the supervisor of the district in which the City lies, plus one Ukiah City Council member. In fact, until about 2004, the District had no employees , and today the District only has a part-time manager and staff. Historically, there was little need for employees given the City's obligation to provide all system-related personnel. (See Supp. Agmt., 10/20/1958, p. 1, § 11.) This led to problems.

The City was and is responsible for actually operating the system and undertaking system maintenance and repair. (See, e.g., Part. Agmt., p. 2, § 9.) It was and is also charged with allocating system expenditures and, thus, determining the number of connections or ESSUs, as the case may be, within each party's jurisdictional boundaries. The City was and is also tasked with collecting revenue from all system ratepayers--both those within the City and those within District territory. As far back as 1958 the City agreed to "maintain complete records and account relating to [system] costs and expenditures...in connection with [the system] and of all sewer...revenues...." (Supp. Agmt., 10/20/1958, p. 2, § 18; see also, Part. Agmt., 7/19/1995, p. 3, § 13 [same].) Indeed, the City was and is still "the paying and receiving agent for all District operation and maintenance funds." (Part. Agmt., p. 1, § 1.)

In theory, payments by ratepayers within the City's jurisdiction (excluding the Over-lap area) are placed into one bucket (for simplicity, "City Bucket") and revenue sourced from the District's jurisdiction (including the Over-lap area) is placed into another bucket ("District Bucket"). From there, the City pays the entire sewer system's O&M based on the allocation that *it* determines.

However, as far back as 1966, the City did not properly count and adjust the number of *connections* within each party's jurisdiction. As noted in footnote two, in 1966 the City projected the proportionate number of connections for the years 1967 through 1984. The projections served as a baseline of sorts. If, in any given year, the actual number of connections deviated from those baseline projections by more than 10%, the City was required to adjust the allocation based on the number of *actual* connections. For eighteen (18) years (1967-1985) it didn't. Consequently, the District was overcharged.

Then, beginning in 1985, the City was responsible for allocating O&M based on *ESSUs*. This continued with the parties' 1995 Participation Agreement. Again, this annual allocation was based on the ratio of ESSUs each party had within its jurisdiction to the system-wide ESSU

count. That count was simply the ESSUs "on record as of March 31 each year." (4th Supp. Agmt., 2/6/1985, p. 2, § 1, last ¶; Part. Agmt., 7/19/1995, p. 1, § 1, last line.) As was its responsibility, the City kept and determined that record.

However, the City's reported ESSUs vary from its annual internal ESSU documentation, which shows the total of all ESSUs added to the system each year. It further differs from the actual ESSUs subscribed to a property in building permits. What's more, the City wrongly charged the District a variety of costs, ostensibly as O&M. By way of illustration, the City improperly charged the District for: depreciation on "District lines and equipment," as well as a City "utility plant charge"; and, a percentage of the City's "General Government Services." In short, the City treated District revenue as a slush fund to supplement its ever-growing institutional overhead.

As an aside, these issues must be addressed and corrected now. Not only has the District been damaged historically, but absent correction, the future harm, even in the near term, will be substantial. And, the proposed Purple Water project, discussed below, will only exacerbate the problem if these issues are left unabated.

The discussion above in this section relates mainly to system *expenses*. We now turn to *revenue* . Here, too, misallocations persist. Remember, the City is the collection agent for the District, and this is a relatively simple issue. The key inquiry is to simply determine the jurisdiction in which a given property is physically situated; revenue sourced from City properties should be placed in the City Bucket and revenue from District properties should be placed in the District Bucket. For whatever reason, that has not happened.

A couple examples illustrate the point. The Brookside Retirement Residences are located in the District's jurisdiction. Revenue generated from that property has been collected by the City in accordance with the agreements. However, that revenue has been placed in the City's Bucket. The City admitted the error and promised to correct it. (Newell (City) email, 11/23/2011). According to District records, it appears that didn't happen. Likewise, the City itself admitted that revenue from 44 District parcels were improperly deposited into the City Bucket. (UVSD Min., 6/19/2012, p. 2, middle.) Yet, despite all this and the District's requests to correct the problems, the City has refused to do so.

The District has been given no reason for the City's actions and, more importantly, refusal to correct the problems. Rather, the City is steadfastly silent and unwilling to act on the matter.

The Capacity and Rehabilitation / Upgrade Projects

By the early 2000's the existing treatment plant was dated and exceeded capacity. The City was under a moratorium because it exceeded plant capacity of 9,800 ESSUs. As a temporary fix, the City was allowed to implement a chemical enhancement program (CEPT) to treat effluent until the remodeled plant went on line. During that time, environmental laws tightened regarding allowable nitrate and ammonia levels present in treated water discharged by the plant into the Russian River. The parties entered an agreement to undertake a project to address these problems.

The 2004 agreement articulates two parts to the "Project": (1) the "Capacity Project"; and, (2) the "Upgrade/Rehabilitation Project". (Amend. 2 to Part. Agmt., 12/15/2004.) As the names imply, the Capacity Project was designed to increase the treatment plant capacity--the ability to treat additional waste--and the Upgrade Project was designed to upgrade and rehabilitate the existing plant. (*Id.*, p. 2, item 7.) The agreement also broke down responsibility for Project costs.

Regarding the Upgrade/Rehabilitation Project, the cost sharing term is straightforward: allocation of these costs is based on the annual ratio of ESSUs between the parties, commencing the year in which the costs are first incurred. The idea here was to track the Participation Agreement. (Amend. 2 to Part. Agmt., 12/15/2004, p. 3, § 2.2.)

The agreement for the Capacity Project costs, on the other hand, was not a model of clarity. Obviously, it was necessary to determine the ratio of the anticipated increased capacity that each party would consume. Initially, an estimate was generated by reference to the ratio of ESSUs the City and District would each need through 2020. That ratio was established as 65% District and 35% City (Amend. 2 to Part. Agmt., 12/15/2004, p. 3, § 2.2.). The ratio serves as a baseline of sorts. Actual allocation of Capacity Project costs was to be reviewed annually, commencing 12 months after the Project was completed.[4] (*Ibid.*) Here is where it gets jumbled. The annual adjustment of that baseline ratio--which again, was grounded in *ESSUs*--is to be based on the "actual proportion of new *connections* in the City and the District."[5] (*Ibid.*, emphasis added.) As discussed above, connections and ESSUs are not the same. They are more or less the proverbial apples and oranges. Therefore, adjusting an allocation grounded in ESSUs by virtue of changes in connections presents difficulties.

In any event, the City's own internal documents demonstrate it has never adjusted the allocation since 2004. This, despite the fact its own records show the need. Even assuming the City has been correctly calculating ESSUs in the first instance, according to the City's own building permits, ESSU reports, and ESSU worksheets, there have been additions and changes to ESSUs and connections that necessitate reallocation.

There are other problems with the Project allocation. As noted above, the initial, or baseline, ESSU distributions (65%/35%) were generated based on representations made by the City, as would be expected. Recall that the City was the District's agent, maintaining all books and records and, in that role, was necessarily responsible for calculating connections and ESSUs for the entire system and then allocating costs and revenue. In formulating the agreement, the City represented that historical connections data suggested a divide of 77% District and 23% City. However, based on City documents, the District later learned that the ratio of system ESSUs was never more than 47%. In other words, the underlying basis for the Project cost

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[4] The Project was not completed until approximately 2009.

[5] The agreement goes on to provide that the annual adjustment should take "into account the number of new service connections within each party during the previous twelve months, the total number of new connections within each party's jurisdiction since [12/15/2004], the likely number of new connections in the next one, three and five year time periods, any changes in organization, including annexations and detachments...and any other facts or conditions the Parties consider relevant." (Amend. 2 to Part. Agmt., 12/15/2004, p. 3, § 2.2.)

allocation was false and does not reflect reality. Despite that, the City has refused to properly adjust the allocation.

Again, these issues must be addressed and corrected now or the District will continue paying more than required or agreed. After all, the City is in control of the District's checkbook, so to speak. In addition to the historical damage caused by over allocation of these expenses to the District, the future harm the District will suffer absent correction is substantial. This includes the Purple Water project.

The City Refuses to Give the District Its *Own* Revenue

We discussed above the fact that District revenue has been improperly deposited into the City Bucket. But, there is an additional revenue issue that must be addressed--the District's net revenue currently being held by the City.

This is how it breaks down. As noted above, the City collects revenue for the entire system. City property revenue goes into the City Bucket and District property revenue goes to the District Bucket. From there, O&M and Project expenses are paid by the City from each bucket according to the allocation determined by the City.[6] The balance left in each bucket constitutes net revenue.

The District has sought an accounting of its bucket, but the City has refused. In this vein, it may be recalled that the City is the District's "paying and receiving agent," making the District the principal party. There is no sound legal basis for an agent to deny its principal an accounting under these circumstances.

In any event, the District has discovered that the City holds *millions* of dollars in District revenue. This figure is sourced from the City's own financial statements, namely a statement of what it calls "Fiduciary Funds." According to an independent audit, the amount due to District on June 30, 2014, over two years ago, is **$6,999,374**. (See, e.g., City of Ukiah Combining Statement of Fiduciary Net Position, Fiduciary Funds, 6/30/2014, attached as **Exhibit # 1**.)

Despite the District's requests, the City refuses to give the District its own net revenue. The City offered a number of reasons over time, but the central one is simply that it can't. The reasoning is without justification and flies in the face of its own conduct.

The City's position is grounded in what are known as the Installment Agreement and Financing Agreement. The Installment Agreement was entered into on March 1, 2006, by the City, the Association of Bay Area Governments ("ABAG"), and Wells Fargo bank. The District was *not* a party to it. In short, the Installment Agreement memorialized the transaction by which the City obtained and agreed to repay $75 million in bond financing for the Project. The document states that the City pledged the *entire* sewer system's net revenue as security. (Inst. Agmt., 3/1/2006, p. 1, item 4 & p. 12, § 4.5 (a)-(d).) As will later be seen, this becomes important when we address purple water issues.

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[6] See Financing Agreement, 3/2/2006, regarding Project-bond expense obligations. It is also discussed below.

However, the Installment Agreement also expressly allows use of the net revenue for "any [ ] lawful purposes," so long as no "Event of Default" has occurred. There has been no Event of Default. In fact, the District specifically asked the City for any information or materials related to such an event, and the City provided none. Additionally, the Installment Agreement allows the City to at any time deposit revenue, including net revenue, in a "rate stabilization" fund for purposes of stabilizing sewer rates imposed by the City. What's more, the City is permitted to "at any time [ ] withdraw any or all amounts on deposit in the Rate Stabilization Fund...for any [ ] lawful purposes of the City." (Inst. Agmt., p. 13, § 4.6)

Again, the District was not a party to the Installment Agreement. That said, on March 2, 2006, the District and City entered into the Financing Agreement. At this juncture, it may be recalled that the parties had agreed in 2004 to allocate Project costs; and, the bonds constitute such a cost. (Amend. 2 to Part. Agmt., 12/15/2004; Inst. Agmt, 3/1/2006, p. 5, "Project".) The purpose of the Financing Agreement was to ensure the District established rates sufficient to enable it to pay its share of Project costs and, thus, to secure the financing costs allocated to the District under the Participation Agreement, as amended. The security was given "in the same manner in which the City's allocable share...is secured under the Installment Agreement. (See Fin. Agmt., 3/2/2006, p. 1, items 2-6.) In other words, the District is permitted to handle that portion of its revenue that exceeds expenses and the reserve required by the Finance Agreement; and, most certainly, the its is permitted to use such revenue for any lawful purposes of the District, including establishing its own rate stabilization fund, which would benefit its ratepayers.

In October 2013, the City released $2,871,814.49 to the District from a rate stabilization fund. With no further progress over the intervening couple years, in November 2015, the District filed a motion with the court to, in part, force the City to release the funds. Ultimately, the City agreed to give the District $1,500,000 of the funds now, with the District preserving its right to pursue the balance of its net revenues if the matter could not be informally resolved. It remains a looming issue in the case. Despite all that, the City refuses to release the balance of the District's money. As discussed above, this position is not justified. It also belies the City's own conduct.

The City holds millions of dollars in District money, including net revenue. As noted above, as of June 2014, the figure was at approximately $7,000,000 according to the City's own statements. These monies are sourced from District properties. All O&M and Project payments allocated to the District (even those improperly allocated), have been paid from District revenues. Indeed, over the last several years, District revenue generated an ample surplus; thus, the millions of dollars of District net revenue that is being held by the City.

Pre and Pending Lawsuit Efforts to Resolve Issues

As noted above, only since 2009 has the District been independently run. Unlike its predecessors, that independent board did not wear "two hats." Its focus and duty was not divided. The District, in light of the agreements, continued to rely on the City as its agent, but discrepancies with the City's accounting, at first insignificant, began coming to light. When questions were raised, answers were either not forthcoming or simply could not be provided. Promises to correct misallocations were never carried out. Something was off. The District undertook an investigation. And, that investigation revealed much of what is discussed above. The wrongs needed to be addressed.

From even before the District's lawsuit was filed, the District was willing to make efforts with the City to resolve the issues underlying this litigation on mutually agreeable terms. For example, on September 6, 2013, the District's counsel, Duncan M. James, provided the City 's attorney with a draft copy of the District's proposed complaint. In the cover letter accompanying that draft, Mr. James stated in part:

> "The DISTRICT is willing to meet and confer and reach a resolution of this matter without the formality of the Complaint being filed if the CITY demonstrates a similar willingness. If that is to be agreed upon, one condition of the agreement would be a waiver of any potential statutes of limitations (and similar legal and equitable defenses based on timing) that might run during the course of our attempts to resolve the matter. [¶] [...] In the event I do not have an agreement in place on or before October 4, 2013, between the CITY and DISTRICT to attempt to resolve the matter, then I have been instructed by the DISTRICT Board to file the Complaint."

Not only did the City fail to agree to the proposal to waive timing defenses "that might run during the course of our attempts to resolve the matter," there was total silence on the City's part. Therefore, it was necessary for the District to formally take action in the form of a lawsuit.

After the lawsuit was filed by the District, mediation was suggested. The City ultimately agreed to mediation in late December 2013. The mediation did not begin until August 13, 2014. In an effort to be as transparent as possible prior to mediation, on June 18, 2014, the District provided the City, through its attorney, a flash drive containing a copy of every related document the District had located up to that point in time. That included approximately 38,000 pages of material, Bates stamped: ESSU 001-0025; UVSD 3000-36,769; and, UKCC0001-4955. It was a one-sided gesture; the City did not similarly respond.[7] As an aside, the only additional documents the District has been able to obtain is what little material has been disclosed by the City in response to the District's information requests through discovery or Public Records Act Requests processes, some materials sourced from third-party subpoena efforts with which the City was copied, or what is posted online. Even obtaining City responses to formal discovery or Public Record Act Requests has presented a unnecessary battle; for example, the District served requests for documents in March 2016 and has yet to receive complete responses. Even the most basic requests have gone unanswered (e.g. information and material showing *how* the City determined the ESSU calculations). Absent compliance, the District is left with no choice but to take action to compel compliance. This will only unnecessarily drive up costs, in our view.

Mediation took place on August 13-14 and November 12, 2014. During mediation it was the District's belief that significant progress toward settlement had occurred. Eventually, the mediator (Judge Wm. Bettinelli) sent us home with a recommendation that the City put their offer in writing to enable a formal written response by the District. In the meantime, the lawsuit was placed on hold.

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[7] The City only provided a few documents related to the nitrate issue.

The District did not receive the City's formal written settlement offer, which was dated January 16, 2015, until January 20, 2015. Further, the offer was amended in part on March 12, 2015. After reviewing the offer, the District concluded that, if it agreed to the proposed terms, it would have been placed in an even worse position.

With that, the District was left with no choice but to pursue its claims. Up to this point in time, the City has showed little willingness to address the core issues. It appears--based on all legal maneuvering to date--that the City seeks to escape its wrongs by relying on technical defenses, such as the statute of limitations. As an aside, even if successful, such a defense would only go back so far, leaving open claims spanning the last near decade in the very least, not to mention the future. Further, the court already once rejected the City's efforts in this regard. In our view, this is a poor maneuver in matters involving public trust.

Further, the City appealed the trial judge's ruling against it involving the City's effort to detach (basically, swallow), the District's Overlap Area. Detachment, if appropriate, must proceed through Mendocino LAFCO, and as far as the District is aware, there are no such detachment proceedings in process with LAFCO. This begs the question: why is the City pursuing the appeal and pushing up costs?

Additionally, as explained above, the City has yet to adjust its ESSU allocations to accurately reflect the actual ratios. What's more, the City for the last several years claimed it was unable to provide the District with its ESSU calculations. Then, during a very recent public City Council meeting, the City's engineer volunteered that the information does exist and goes back for years. (City Council Mtg., 6/1/2016, video at time stamp 1:27:40.) This was news to the District. Based on that public comment, the District again requested the information under a Public Records Act request. In response, the City provided an ESSU summary going back to 2005, but it failed to provide material showing how the calculation was generated--i.e. what was the source of information used to actually generate the summary? After all, in order to assess the accuracy of the summary, it is necessary to evaluate the information on which the summary is based. Notwithstanding that, as noted above, when the City's other internal summary records are compared to the ESSU figures reported by the City on its Sewer Statistics report, there are substantial differences, some of which are discussed above.

The point in all of this is that the District is, and has always been, willing and eager to work out these issues with the City. The perception otherwise is not grounded in fact. Finally, the implication that the City is concerned about the effect on District ratepayers of the lawsuit is disingenuous at best. The City, it should be pointed out, charges its customers a base rate that is approximately $11 per month higher than the District's base rates. There should be no difference in base rate. All told, the District estimates the City collects approximately $750,000 annually in additional base rate revenue from its ratepayers.

In short, the District's actions seek to redress wrongs committed by the City that have resulted in substantial losses to District ratepayers. Absent abatement now, those losses will grow and continue indefinitely. Finally, the District's efforts here are genuine: funds generated by this lawsuit will, indeed, be for the benefit of District ratepayers.

Purple Water

As discussed above, in the early 2000's the treatment plant was producing treated waste water that was near or beyond standards for, among other things, nitrate and ammonia content. The City, who was charged with overseeing design and construction of the Project, was well aware of these issues and the future environmental water standards. The City secured $75 million in financing to construct the Project. However, it now appears, the Project was deficient and nearing capacity almost as soon as it was finished.

Now, the City proposes a $50+ million (the numbers vary) fix in the form of the recycled water program, commonly referred to as the Purple Water project. On the other hand, it appears $10-25 million would permit a sufficient plant upgrade for the nitrate and ammonia problem. The City is concerned that such a fix to the plant will be a band aid of sorts, speculating that future environmental restrictions will render any newly-upgraded plant out of compliance in short order.

The District does have concerns with the Purple Water project. First, on the City's watch, in 2006, system ratepayers assumed $75 million in debt for the expansion and upgrade of the existing plant, which when completed, was almost immediately rendered obsolete. Now, the City proposes to expend another $50+ million to essentially fix the relatively new plant.

Second, it is unclear whether the Purple Water project would handle all, or simply a portion of, the plant's discharge capacity. That said, during a presentation given to the District board by the City's Shawn White in April 2016, Mr. White stated that contracts in place to use the recycled water were not sufficient to handle all of the plant's treated water. (UVSD Bd. Mtg., 4/21/2016, video time stamp 11:20.) This is important because if any treated water is discharged into the river, it remains subject to environmental regulations, namely the nitrate and ammonia limits. The District's concern widens when it considers the fact there may be insufficient avenues to discharge the purple water from October through May (i.e. farmers, parks, and and the golf course don't typically use the same volume of water in cooler months as they do in warmer months and storage ponds can only hold so much water). In short, while the project would help the current situation--and may provide benefits in the form of a source of irrigation water--the issues with nitrate and ammonia levels in any remaining water the plant would need to discharge in the river must still be addressed. Lastly on this point, the City's statement in its September 14, 2016, letter that "...it is highly likely that no discharge whatsoever into the river will be allowed in the foreseeable future" appears to be speculation.

Third, and significantly, the plant itself is at or near capacity. Absent additional capacity, there is little to no room for development. According to the most recent report prepared by the City and provided to the District, for the time period ending March 31, 2016, there are 12,006.71 ESSUs being used by system customers (**Exhibit # 2**). But, as of March 2004, the City's reported ESSU allocation was as follows:

CITY:	6603 (54.8% of total)
DISTRICT inside CITY:	2543 (21.1% of total)
DISTRICT outside CITY	2898 (24.1% of total)
Total ESSUs	12,044 (**Exhibit # 3**)

It seems rather unlikely that there would be a reduction of ESSUs during this time period. In fact, other City documents recently obtained by the District from the City as a result of a Public Records Request reflect that from April 1, 2005, through March 31, 2016, there were actually 388.57 new ESSUs added to the system. If that statistical information is correct, based on the March 31, 2004, ESSU count of 12,044 ESSUs, then the treatment plant currently has a total of 12,432.57 ESSUs, which puts it *significantly over capacity* and in a position similar to that which the parties faced in the early 2000's.

Other documents show that while in 2002 the reported ESSUs were 13,211, in 2003 they dropped to approximately 11,500, only to increase to 14,400 or so in 2006 and then back down again to under 12,000 in 2007. The District can only scratch its head and say to itself "what is true?" Even by reference to the City's March 31, 2016, ESSU numbers, the plant remains over capacity. The ESSU calculations are therefore unreliable and untrustworthy. Consequently, the District is in a dilemma--they are unable to determine whether there exists sufficient capacity to meet current demand and desired development. The point is, it seems logical and wise to address these issues before there is commitment to another $50+ million project.

Fourth, the City has made it clear that any water generated by the Purple Water program belongs exclusively to the City and that the District will not share in any revenue generated from the program. (Rodin (City Mayor) letter, 10/13/2011, p. 9, § 14-**Exhibit # 4.**) That said, since the Purple Water project will handle waste generated by District properties too, it appears the City will attempt to allocate the additional infrastructure and O&M costs to the District. Thus, another reason presents itself for fixing the allocation problem now.

Moving on, there has been considerable public discussion associated with the effect of the District's lawsuit on City's ability to obtain financing for the Purple Water project. According to the City's September 14, 2016, letter to the District--which was made public-- it appears the City was already awarded approximately $10 million in *grants* for the project, and it may seek an additional $13 million in grants. The problem apparently arises with regard to *loans* for the Purple Water project. In any event, according to the letter, on April 18, 2016, the City, through its attorney, communicated telephonically with Sergio Rudin, an attorney representing the State Water Resources Control Board ("SWRCB"), the entity who controls the loan funding. During that call, the City was informed that it would be required to confirm, through its counsel, that there is no lawsuit pending affecting the City's sewer system. The letter goes on to say that, during a further telephone call on June 28, 2016, SWRCB raised the issue of the District's lawsuit and stated that it will prevent SWRCB from entering into a loan agreement with the City.

Again, the *facts* shed light on the issue. During a District board meeting on April 21, 2016--three days *after* the City was apparently initially contacted by the State regarding the issue--the City's Sean White made a presentation to the District board regarding the Purple Water project and handed out a power point packet to aid in the presentation.

During his presentation, Mr. White made absolutely no reference to any issues with loan funding, grants, or, for that matter, any issues at all regarding the lawsuit. In fact, his presentation made it quite clear that the City had *already received* funding for the Purple Water

project. In particular, the power point packet, which Mr. White orally discussed as well, conveyed the following with respect to the "Project History":

a. "Summer 2013 and 2014- Prop 84 Grant Funds awarded in the amount of $2,090,191 to begin Phases 1 and 2"; and,

...

b. "November 14, 2015-City applies for and receives Prop 1A Funds totaling $35,560,000 for Phases 1-3" (**Exhibit # 5**, p. "8".)

In the portion of the presentation entitled "Project Funding," the following appears:

a. "Total Grants received:

- $2,090,191- Prop 84
- $9,996,000- Prop 1A

b. Financing Received- SRF Loan at 1% Interest
- $25,564,000"

(*Id.*, p. "9," emphasis added.) In other words, as far as the District knew, the City had already received needed funding.

On Friday, September 16, 2016, two of the District's attorneys, Donald McMullen and Giny Chandler, reached out to Sergio Rudin, counsel for SWRCB. Mr. Rudin's initial statements regarding loan status was that his client and the City were still in the negotiation phase--there had been *no funding approval*. Mr. Rudin confirmed that it was the City who decided to offer the sewer system revenue as security for the loan and the Department of Water Resources evaluated that offered security. But, as previously noted, the City *already pledged* all system revenue as security for repayment of the $75 million in bonds. The District presumes there is an explanation for this, but none has been given to it. In any event, Mr. Rudin did state that one of the issues his client has with the proposed security is the lawsuit. The District, through counsel, offered to meet and work with Mr. Rudin, his client, and the City in good faith in order to consider a resolution or workable conditions to allow the loan to fund. This was done without any request by the City to do so.

A Final Point on the Issue: The City Itself Filed A Lawsuit Against the District

A fact that has received little, or no, attention is that the City has perpetuated the lawsuit; this, in the face of the City's claims that the lawsuit is hamstringing its efforts to obtain Purple Water financing. Here are the facts. On June 30, 2016--two days *after* the City claims it was told by SWRCB for the second time that the lawsuit would prevent loan funding--it filed its own lawsuit against the District. The action was taken in the District's lawsuit and is called a Cross Complaint.

It is through this Cross Complaint, in allegations buried deep within it, that the District was told for the *first time* that the lawsuit might affect the City's loan financing for the Purple Water project. This is significant. On the one hand, the City asserts the lawsuit will preclude

loan funding, yet it perpetuates the suit by filing its own claims--claims that are unmeritorious at best. Further, and again, at no prior point in time did the City inform the District of this funding issue. At no time has it sought to address the issues in this litigation in an effort to secure the loan. Rather, the City simply suggests the District dismiss its lawsuit so funding may occur. As noted, however, doing so will only prolong and exacerbate the underlying problems.

The City should take this funding issue as an impetus to sit down with the District, actually work through the underlying issues, and remedy past wrongs. In this, a complete resolution may result as to all issues affecting the parties. Even if the only issue resolved in the discussions is purple water, it will be progress.

Summary

In sum, the District has been left almost completely out of the loop on the Purple Water project. As expressed above, this is apparently the case because the City claims exclusive rights to the water and revenue to be generated by the project. The District cannot be expected to idly sit by and have another deficient project constructed, its costs improperly increased, and its ratepayers harmed.

Therefore, unless the allocation, revenue, and other issues addressed above are not abated, not only will the District continue to see its already-significant losses related to the existing sewer system grow into the future, but the problem will only persist and deepen with the Purple Water project.

Very truly yours,

DONALD J. McMULLEN
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