

RESOLUTION NO. 2017-01

A RESOLUTION OF THE SAN JOSE/SANTA CLARA TREATMENT PLANT ADVISORY COMMITTEE SETTING FORTH THE COMMITTEE REPORT, INCLUDING FINDINGS AND RECOMMENDATIONS ON THE CLAIMS OF BREACH OF AGREEMENT AND INEQUITIES FILED ON SEPTEMBER 7, 2016 BY WEST VALLEY SANITATION DISTRICT, BURBANK SANITARY DISTRICT, CUPERTINO SANITARY DISTRICT, SANTA CLARA COUNTY SANITATION DISTRICT NO. 2-3, AND THE CITY OF MILPITAS

WHEREAS, the Cities of San José and Santa Clara (collectively, "Co-Owners") own the San José - Santa Clara Regional Wastewater Facility ("RWF" or "Plant"); and

WHEREAS, the City of San José ("San José") operates the RWF as Administering Agency under an agreement with the City of Santa Clara that dates back to 1959 ("San José/Santa Clara Master Agreement"); and

WHEREAS, West Valley Sanitation District, Burbank Sanitary District, Cupertino Sanitary District, Santa Clara County Sanitation District No. 2-3 ("CSD 2-3"), and the City of Milpitas ("Tributary Agencies"), each have agreements with the Cities of San José and Santa Clara ("Master Agreements") under which the Tributary Agencies discharge wastewater for treatment and disposal by the RWF; and

WHEREAS, each of the Master Agreements contains provisions requiring that if any party to the Master Agreement has a claim that the other party has in any way breached or is breaching the Agreement, or that the Agreement is inequitable, the complaining party shall file a written claim of said breach or inequity with the Co-Owners' legislative bodies and with the San José/Santa Clara Treatment Plant Advisory Committee ("TPAC") for the RWE; and

WHEREAS, the Master Agreements further provide that TPAC shall, within two (2) months of receiving a claim of breach or inequities, give all concerned parties full opportunity to be heard on the matter of the claim of breach or inequities, and shall

upon the conclusion of said hearing give the legislative bodies of the parties a full report of its findings and recommendation; and

WHEREAS, on January 25, 2016, the Tributary Agencies, pursuant to the terms of the Master Agreements, individually and jointly filed a "Claims of Breach of Agreement and Inequities" ("Claim No. 1"), which relates to Plant Master Plan capital costs; and

WHEREAS, on March 24, 2016, TPAC provided the Tributary Agencies and Co-Owners full opportunity to be heard on Claim No. 1, in accordance with the Master Agreements; and

WHEREAS, on March 24, 2016, after considering the written arguments, hearing presentations and the supporting documents submitted by the Tributary Agencies and Co-Owners, and testimony from witnesses, TPAC adopted Resolution No. 2016-01¹ finding that:

1. The Administering Agency's methodology for allocating Plant Master Plan capital costs to each Agency is not a breach of the Master Agreements or inequitable;
2. The Agencies' payment obligation for Plant Master Plan capital projects is enforceable;
3. Co-Owners have not breached the Master Agreements or acted inequitably with respect to the proposed amendments to the Master Agreements;
4. The Agencies' allegations related to the lack of transparency are unsupported; and
5. The Agencies' claims with respect to payment for legal services are moot.

WHEREAS, the Tributary Agencies objected to the findings in Resolution No. 2016-01 and the Parties agreed to mediate the Tributary Agencies' objection to the findings; and

¹ Co-Owner's Response to Claim No. 2 (Response to Claim) and an index of documents submitted by Co-Owners in response to Claim No. 2, are collectively attached hereto and incorporated herein by this reference as "Attachment A". See Attachment A, Ex. A.

WHEREAS, on September 7, 2016, the Tributary Agencies individually and jointly filed a second "Claims of Breach of Agreement and Inequities" ("Claim No. 2") with Co-Owners and TPAC²; and

WHEREAS, Claim No.2, alleges San José breached the Master Agreements by mismanaging the RWF and taking financial advantage of the Tributary Agencies. Co-Owners received Claim No.2 seven days before the Tributary Agencies and Co-Owners (collectively "Parties") were scheduled to start mediation on Claim No. 1³; and

WHEREAS, the Parties attended mediation sessions held on September 14, October 6, December 9, 2016, and March 29, 2017; and

WHEREAS, on March 30, 2017, the Tributary Agencies withdrew from mediation and requested a hearing before TPAC on Claim No.2.⁴ The Tributary Agencies also requested a joint meeting of all the legislative bodies of all Parties concerned⁵ for the purpose of resolving the differences between the Tributary Agencies and Co-Owners regarding Claim No. 1, as permitted under the Master Agreements; and

WHEREAS, at the April 13, 2017 TPAC meeting, Co-Owners offered to waive the hearing requirement for Claim No. 2, but the Tributary Agencies did not accept the offer; and

WHEREAS, on May 10, 2017, Co-Owners submitted a written response to TPAC and the Tributary Agencies regarding Claim No. 2 ("Response to Claim No. 2")⁶; and

WHEREAS, on May 18, 2017, TPAC provided the Tributary Agencies and Co-Owners with full opportunity to be heard on Claim No. 2, in accordance with the Master Agreements. David Mehretu, Special Counsel from Meyers Nave appeared on behalf

² The Tributary Agencies' Claim No. 2 (Claim No. 2) and an index of documents submitted by the Tributary Agencies in support of Claim No. 2 are collectively attached hereto and incorporated herein by this reference as "Attachment B".

³ Attachment A, Response to Claim, p. 2.

⁴ Id.

⁵ All the legislative bodies for purposes of the dispute as to Claim No. 1 and Claim No. 2 are each of the legislative bodies of the Tributary Agencies and Co-Owners.

⁶ Attachment A, Response to Claim.

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of the Tributary Agencies. Rosa Tsongtaarii, Senior Deputy City Attorney from the San José City Attorney's Office appeared on behalf of Co-Owners; and

WHEREAS, TPAC has considered the written arguments, hearing presentations and the supporting documents submitted by the Tributary Agencies and Co-Owners, and testimony from witnesses;⁷ and

WHEREAS, at the conclusion of the May 18, 2017 hearing, TPAC acted by a 6-3 vote to deny Claim No. 2;

NOW, THEREFORE, BE IT RESOLVED THAT THE SAN JOSE/SANTA CLARA TREATMENT PLANT ADVISORY COMMITTEE FINDS AND RECOMMENDS AS FOLLOWS WITH RESPECT TO THE TRIBUTARY AGENCIES' CLAIM NO. 2:

SECTION 1. FINDINGS

A. Charging the Tributary Agencies for CIP Projects is Not a Breach of the Master Agreements Because Such Costs are Authorized Under the Agreements.

1. The express terms of the Master Agreements authorize future improvements and the payment of capital cost for the future improvements.

The Tributary Agencies' allege that the Master Agreements must be amended before Co-Owners can proceed with future improvements to the RWF. In support of this position they argue that "[t]he Agencies are under no obligation to make these payments because such costs are not authorized by the Master Agreements."⁸ They contend that the Master Agreements, which govern the parties' respective rights and responsibilities concerning the RWF, do not authorize major capital

⁷ A transcript of the May 18, 2017 hearing prepared by City vendor Vitac from the audio recording of the hearing is attached hereto and incorporated herein by this reference as "Attachment C". The Power Point presentation provided by Ms. Tsongtaarii at the May 18, 2017 hearing is attached hereto and incorporated herein by this reference as "Attachment D".

⁸ Claim No. 2, p.6.

improvement projects beyond those for "Intermediate Improvements," the "First Stage Expansion", and "Plant expansions".⁹

The Tributary Agencies also contend that their only obligations to pay for major capital improvements are set forth in the "sparse" "future improvements" provisions of the Master Agreements which in their view, are the specific provisions of the Master Agreements authorizing major capital improvements.¹⁰

The "future improvements" provision states:

"C. Payments for Future Improvements.

1. All payments associated with future improvements at the Plant shall be made on the basis of Agency's existing capacity rights. Final payment shall be determined based upon actual project cost. This payment shall be a proportional share in accordance with a Revised Exhibit "A".
2. First Parties, shall, not later than March 1st of any fiscal year, provide Agency with a preliminary estimate of the amount of the amount of money required from Agency for future improvements or replacements from the ensuing fiscal year."¹¹

Contrary to the Tributary Agencies' claims, as set forth by Co-Owners, the obligation to pay for capital projects is comprehensively addressed in the Master Agreements which expressly authorize San José, as the Administering Agency, to implement capital projects for the RWF.¹² Co-Owners further contend that historic practice supports the Tributary Agencies' obligation.¹³

⁹ Attachment B, Claim No. 2, p. 9.

¹⁰ Attachment B, Claim No.2, p. 7.

¹¹ Attachment B, Ex. 1, Master Agreement for Wastewater Treatment, Part V, Section C (1)-(2).

¹² Attachment A, Response to Claim, pgs. 4-5.

¹³ Attachment A, Claim No. 2, p.4.

Although the Master Agreements do not contain a definition for the term “future improvements”, Exhibit E of the Master Agreements entitled “Administering Agency” states that the “Administering Agency shall have the following powers and duties:¹⁴

1. “To maintain, repair, expand, replace, improve and operate the Treatment Plant, and to do any and all things which it shall find to be reasonably necessary, with respect to its maintenance, repair, expansion, replacement, improvement and operation (subject to the provision of funds therefor in accordance with the provisions of this Agreement), to treat and dispose of all sewage (and by-products thereof) of San Jose and Santa Clara and of any and all “Outside Users” now or hereafter authorized to discharge or convey sewage into or to said treatment plant or any sewer lines leading thereto, so that said sewage and all effluent from said Plant will not pollute the waters of San Francisco Bay, or any other waters, and so that said sewage will be disposed of in a manner authorize by law.
2. To make, award and enter into contracts with third parties for the construction, improvement, replacement, expansion, or repair of the Treatment Plant or any part or parts thereof.
3. To acquire, by purchase, condemnation or otherwise, any and all real or personal property which it should find to be reasonably necessary for Treatment Plant purposes.
4. To receive, be the depository for, expend and disburse, for the purposes of this Agreement, any and all funds or monies advanced, contributed or paid by the parties hereto to said Administering Agency pursuant to the provisions of this Agreement,

¹⁴ Attachment B, Exhibit 1, Master Agreement for Wastewater Treatment, Ex. E., Sections 1-9.

together with all income collected from "Outside Users", all other Treatment Plan income, and all other Treatment Plant funds.

5. To keep accurate accounts of all receipts and disbursements of the above-mentioned funds and monies.
6. To provide and supply any and all personnel and services, including, but not limited to, legal, engineering and accounting services, which it should find to be reasonably necessary for the maintenance, repair, expansion, replacement, improvement and operation of said Treatment Plant, the cost and expense of providing such personnel and services to be charged to and shared by San Jose and Santa Clara as part of operating or other Treatment Plant costs as elsewhere provided in this Agreement.
7. To exercise any and all other powers, common to both San Jose and Santa Clara, with respect to the maintenance, repair, expansion, replacement, improvement and operation of the Treatment Plant.
8. To do any and all things reasonably necessary to treatment and dispose of all sewage entering the Treatment Plant in such manner as will comply with all applicable laws and regulations.
9. To do any and all other things which the Administering Agency is required or authorized to do by other provisions of this Agreement."

The Master Agreements also expressly require the Tributary Agencies to pay for the capital cost of future improvements as particularly described in Attachment A, Master Agreements for Wastewater Treatment, Part V, Sections C (1)-(2).

The processes to bill and pay for capital costs are also specifically described:

"E. Method of Payment.

1. Capital and Land Acquisition. All payments for capital and land acquisition shall be on a quarterly basis. The first quarter beginning July 1st. These invoices shall be presented at the beginning of the quarter in which the obligation is anticipated to occur. The date of financial obligations for capital expenses and land acquisitions shall be the date of the award of the contract. These payments shall be based upon the budget for capital costs for the Plant as recommended by TPAC and approved by the Administering Agency...

10. General Information.

- a. All bills shall be paid to the Administering Agency within forty-five (45) days from presentation...
- b. Adjustments in any payment described above shall be on the basis of actual payment to actual expenditures and shall be made no later than the third quarter billing of the following fiscal year. A statement outlining the method of adjusting costs and actual adjustments shall be included."¹⁵

2. Amendments to Master Agreements have not been required to authorize future improvements except for an expansion of RWF design capacity, participation in financing, or sale of capacity.

According to the Tributary Agencies the capital improvements under the CIP are comprised of projects to "rebuild the Plant and not expand it."¹⁶ This rebuilding does not fall within the capital improvements authorized under the Master Agreements, which means that amendments to the Master Agreements are necessary in order for this work to proceed.

¹⁵ Attachment B, Claim No. 2, Ex. 1, Master Agreement for Wastewater Treatment, Part V, Sections E.1., and E.2.

¹⁶ Attachment B, Claim No.2, p.6.

Co-Owners take the position that the Master Agreements distinguish between the methodology for calculating the payments for future improvements from facility expansion or for transfer of capacity rights.¹⁷ They point out that the Master Agreements have only been amended in limited circumstances: when the RWF has expanded, to reflect whether a Tributary Agency participated in the expansion; to document repayment for financing capital projects; and to reflect the sale of contract capacity between Tributary Agencies.¹⁸ Listed below are all the amendments to the Master Agreements identified by Co-Owners since 1983:

1. First Amendments to Master Agreements to reflect participation in treatment plant capacity expansion;¹⁹
2. Second Amendments to Master Agreements to reflect cost share between Agencies for development of the South Bay Water Recycling Program ("SBWR") as required by the Regional Water Quality Control Board before issuance of bonds to finance the program;²⁰
3. Third Amendment to West Valley Master Agreement to sell one million gallons per day (1mgd) contract capacity to the City of Milpitas;²¹
4. Third Amendment to City of Milpitas Master Agreement to purchase one million gallons per day (1 mgd) contract capacity from West Valley Sanitation District;²²

¹⁷ Attachment A, Response to Claim, p. 5.

¹⁸ Id.

¹⁹ With Tributary Agencies in December 1985.

²⁰ With Tributary Agencies in December 1995.

²¹ With West Valley Sanitation District in August 2006.

²² With City of Milpitas in July 2006.

5. Third Amendment to Cupertino Sanitary District Master Agreement to sell seven hundred and fifty thousand gallons per day (.75 mgd) of contract capacity to the City of Milpitas;²³
 6. Fourth Amendment to City of Milpitas Master Agreement to purchase seven hundred and fifty thousand gallons per day (.75 mgd) of contract capacity from Cupertino Sanitary District.²⁴
- 3. Co-Owners have previously completed improvements at the RWF comparable to proposed projects in the CIP.**

The Tributary Agencies claim that the "...the parties have *never* undertaken large capital improvement programs to carry out major rehabilitations, or enhancements."²⁵ (Emphasis in the original.) However, Co-Owners point out that since 1983, the RWF has completed improvements that are major rehabilitations without amendments to the Master Agreements. The projects required design by multi-disciplinary licensed professionals and public contract bidding. According to Co-Owners, none of these projects were due to a new permit requirement, or in response to a regulatory agency order. The improvements include:

- WPCP Reliability Improvement Projects (\$85M) FY 08-09;
- Electrical Reliability Improvements (\$11.8M) FY 13-14, FY 14-15;
- Alternative Disinfection Facility (\$10.9M) FY 12-13;
- Handrail Replacement (\$4M) FY 08-09 to FY 15-16; and
- Fire Main Replacement (\$3.65M) FY 07-08 to FY 14-15.²⁶

²³ With Cupertino Sanitary District in August 2009.

²⁴ With City of Milpitas in August 2009.

²⁵ Attachment B, Claim No. 2, p. 9.

²⁶ Attachment A, Response to Claim, pgs. 6-7.

4. The Master Agreements do not require an engineering study for future improvements that do not expand RWF design capacity.

The Tributary Agencies seek to require an engineering study for each project. According to Co-Owners, this interpretation of the requirement is incorrect because under the Master Agreements, an engineering study is only required to plan for an expansion if the RWF has reached 85% or 142 mgd of the 167 mgd design capacity.²⁷ Neither the Tributary Agencies, nor Co-Owners dispute that the CIP would not expand the RWF design capacity.²⁸

5. The Master Agreements do not require amendments for future improvements, and it is impractical to condition the payment for these projects on an amendment.

The Tributary Agencies want to condition the payment for each project on an amendment that would include a construction timetable, an estimate of total project cost, and an estimate of each participating agency's share of project cost. Co-Owners object to this requirement on the basis that the phasing of the CIP is driven by facility safety considerations and treatment interactions. Capital costs may need to be incurred over the course of many years for activities that precede award of construction and financing such as planning, feasibility studies, environmental review, and engineering design. The project schedules and costs are also refined at each stage of development from feasibility to the award of the construction contract. It's Co-Owners position that the Tributary Agencies' demand is not only contrary to the express provisions of the Master Agreements but impractical from a project implementation perspective.²⁹

Co-Owners also contend that there is no factual basis or precedent for the Tributary Agencies' claim that San José would arbitrarily change course

²⁷ Attachment B, Claim No. 2, Ex. 1, Master Agreements for Wastewater Treatment at Part I, Section F.

²⁸ Attachment A, Response to Claim No. 2, p.7.

²⁹ Attachment A, Response to Claim, p.7.

on a project that has been financed. According to Co-Owners, San José has a mutual if not greater financial interest in minimizing risk and cost to ratepayers.³⁰ San José practices best industry standards to manage the scope, schedule and costs of CIP Projects.³¹ Detailed project information is provided to the Tributary Agencies at each stage through approvals for contract services, studies and reports, monthly CIP and semi-annual CIP status reports, and annual capital budgets.³²

Summary of Findings

Based on the express language of the Master Agreements, and the other arguments made by Co-Owners above, we find that the Master Agreements require that the Tributary Agencies pay their proportionate share of the capital cost for future improvements at the RWF.

Additionally, since the CIP will not expand the RWF design capacity, we find that an engineering study for the CIP is not required. We further find that Tributary Agencies' obligations to contribute their respective costs for capital improvements at the RWF, was already resolved in favor of Co-Owners in our Resolution No. 2016-01, wherein we determined that the Tributary Agencies' payment obligations for PMP capital projects is enforceable under the Master Agreements.

B. San José Has Not Breached the Master Agreements Because San José Has Maintained and Provided Sufficient Records to the Tributary Agencies to Enable Them to Substantiate Shared Plant Costs and Proceeds.

The Tributary Agencies contend they are not able to confirm RWF costs and revenues from the records that have been provided to them by Co-Owners.³³

³⁰ Attachment A, Response to Claim, p. 7; and Attachment A, Exhibit C, Table of Treatment Capacity Fiscal Year 2015-2016.

³¹ Attachment A, Response to Claim, p. 7; and Attachment A, Exhibit D, Summary of Cost Control Measures, and Exhibit E CIP Cost Controls and Estimates.

³² Attachment A, Response to Claim, p. 8; and Attachment A, Exhibit F, sample of the Monthly CIP Status Report, Exhibit G, sample of the Semi-Annual CIP Status Report, Exhibits H for 2015-2016 RWF CIP Capital Budget and 2016-2020 RWF Capital Improvement Program.

³³ Attachment B, Claim No. 2, pgs. 11-12.

We find these contentions to be unsubstantiated. Co-Owners state in their Response to Claim No. 2, that the following records are routinely provided to the Tributary Agencies as part of the annual budget, invoicing, and reconciliation processes:

Budget Timeline

- December - Annual Revenue Program Timeline: San José requests information from the Tributary Agencies for an estimate of their "actual" discharges to RWF, and provides proposed capital projects costs for upcoming fiscal year.³⁴
- February – Treatment Plant Capital Cost and State Revolving Fund Loan Repayments Allocation: San José provides the capital cost allocation and State Revolving Fund (SRF) payment obligations for the upcoming fiscal year.³⁵
- March – Current Fiscal Year Revenue Program: San José uses the information from the Tributary Agencies for "actual" discharge to allocate Operation and Maintenance costs for the upcoming fiscal year.³⁶

Invoicing and Reconciliation Timeline

- July 1, October 1, January 1, and April 1: the Tributary Agencies receive quarterly O&M and Capital billing each quarter for the current fiscal year.³⁷
- Bi-Annual Debt Service billing is sent to the Tributary Agencies with participation and repayment schedules for SRF Loans and Sewer Revenue Bonds.³⁸
- November – O&M Actuals Reporting: San José requests information from Tributary Agencies on "actual" discharge based on driest week of the year

³⁴ Attachment A, Response to Claim, Exhibit I, sample Annual Revenue Program Timeline.

³⁵ Attachment A, Response to Claim, Exhibit J, sample CIP and SRF Repayments Allocation.

³⁶ Id. at Exhibit K, sample Current Fiscal Year Revenue Program.

³⁷ Id. at Exhibits L-1 and L-2, sample of quarterly O&M and CIP invoices, respectively.

³⁸ Id. at Exhibit M, sample of Bi-Annual Debt Service billing.

to reconcile the operation and maintenance cost invoiced with the audited expenditures from Comprehensive Financial Audit Report (“CAFR”) for the Third Quarter Reconciliation.

- November – Annual Plant Capacity Report: San José brings the report to TPAC for approval.³⁹
- January – Third Quarter Reconciliation: The Tributary Agencies are provided an Annual Transaction Report and Cost Allocations for O&M and CIP following the CAFR, and information from the Tributary Agencies’ revenues and expenditures for the prior fiscal year are reconciled based on final accounting reports.⁴⁰

In addition, the San José 2016-2020 Adopted Capital Improvement Program Budget⁴¹ discusses the RWF - CIP program in detail including:

1. Program overview;
2. Source of funds and use of funds; and
3. Detailed project sheets for each construction project including estimated cost, schedule, and timing of expenditures by the various project development stages.

The source of funds and use of funds is the basis from which the Tributary Agencies are billed each quarter for their proportional share.

Co-Owners also allege that the Tributary Agencies received the working reports for the above documents following an extensive California Public Records Act request (PRA)⁴² and that many of these reports could have been used to validate

³⁹ Id. at Exhibits N-1 and N-2, sample of O&M Actuals, and Annual Plant Capacity Report, respectively.

⁴⁰ Attachment A, Response to Claim, Exhibit O, sample of Third Quarter Reconciliation.

⁴¹ Id. at Exhibit H, 2015-2016 RWF CIP Capital Budget and 2016-2020 RWF Capital Improvement Program.

⁴² Id. at Exhibit P, excerpt index of records provided in response to Tributary Agencies’ Public Records Act requests dated January 12 and February 18, 2016. Review and bates stamping of Set 9 was not complete until September 14, 2016.

figures used in the Third Quarter Reconciliation.⁴³ Counsel for Co-Owners Ms. Tsongtaatarii stated at the hearing that "around 50,000" pages of documents had been provided in response to the Tributary Agencies' PRA.⁴⁴ Ms. Tsongtaatarii, also indicated that the Tributary Agencies could make follow up inquiries for additional documentation if an agency had questions about expenditures for a particular project.⁴⁵

San José met with Hemming Morse, LLP, the Tributary Agencies' forensic accountant, on May 18 and June 8, 2016 to discuss the cost allocation plan, cost pools, overall methodology, and overhead. Following these meetings, San José provided additional working records.⁴⁶

Furthermore, San José conducts the following audits on an annual basis:⁴⁷

1. All of the City of San Jose's funds are audited annually by a third-party firm following the year-end close of the City's books/financial documents for a specific fiscal year; and
2. The Clean Water Financing Authority's ("CWFA") financial documents are audited annually by a third-party firm. The report is posted publicly and discussed at CWFA meetings. The CWFA issued the bonds to finance the SBWR for which San José and all Agencies except the City of Milpitas pay debt service.

Summary of Findings

Given the extensive nature of documents already provided to the Tributary Agencies, coupled with the opportunity to obtain additional documentations, we find that Co-Owners have given sufficient records to the Tributary Agencies to enable them to substantiate shared RWF costs and proceeds. As a result, we find there is no breach of the Master Agreement by Co-Owners.

⁴³ Id. at Exhibit Q, overview of how the records provided to the Tributary Agencies relate to the budget, invoicing and reconciliation processes.

⁴⁴ Attachment C, pgs. 23-24.

⁴⁵ Id.

⁴⁶ Attachment A, Response to Claim, pgs. 13-14.

⁴⁷ Id.

C. San José Has Not Breached the Master Agreements by the Diversion of Plant Proceeds and Use of Plant Funds for Non-Waste Water Purposes in Connection with Plant Lands.

The Tributary Agencies allege that they have “credible reasons” to believe that San José has entered into various transactions concerning Plant lands under which proceeds that should have been shared with the Tributary Agencies have been diverted and/or Plant funds have been used for non-waste water purposes.⁴⁸ The Tributary Agencies contend that these actions constitute breaches of the express terms of the Master Agreements, as well as the implied covenant of good faith and fair dealing.⁴⁹

1. The diversion of RWF proceeds from land surrounding the RWF is not a breach of the Master Agreements.

The Tributary Agencies argue that under the Master Agreements, the Tributary Agencies’ have the right to a proportional share in proceeds from land surrounding the RWF, known as Plant lands.⁵⁰ They recognize that San José has discretion in how to make the best use of Plant lands, subject to an obligation to exercise such discretion under the implied covenant of good faith.⁵¹ They contend that entering into transactions that result in benefits enjoyed solely by San José is a breach of the implied covenant of good faith because such transactions would not have been within the Parties’ reasonable contemplation when entering into the Agreements.⁵²

According to the Co-Owners, the Tributary Agencies do not have a fee interest in RWF real property nor the same authority as the Co-Owners to

⁴⁸ Attachment B, Claim No. 2, p. 12.

⁴⁹ Id.

⁵⁰ Id.

⁵¹ Id.

⁵² Attachment B, Claim No. 2, pgs. 12-13.

make decisions regarding leases or other disposition of land.⁵³ The Tributary Agencies have participation interest in revenues from the disposition of land and sale of products under the Master Agreements.⁵⁴

Co-Owners also allege that Milpitas and Burbank have not fully paid San José to date for their participation rights in land acquired on or before 1982, a fact which is undisputed by the Tributary Agencies. The parcels acquired on or after 1983, the Mosley Tract, the McCarthy Tract, and Cargill Pond A-18, were acquired and continue to be used for the waste water treatment program, which is also undisputed by the Tributary Agencies.⁵⁵

Summary of Findings

The Tributary Agencies did not identify any transaction or other facts to support their allegation that San José has in some manner received income or revenue that was not shared with the Tributary Agencies, or that San José has inappropriately disposed of Plant lands or abused its discretion under the Master Agreements to make best use of Plant lands. As such, the facts and arguments submitted by the Tributary Agencies do not demonstrate a breach of the Master Agreements by Co-Owners, and accordingly we find that there was no such breach.

2. The specific transactions identified by the Tributary Agencies as violations of the Master Agreements by San José are not a breach of San José's obligations under the Master Agreements.

The Tributary Agencies identified the following specific transactions in which they allege San José has breached its obligations by diverting Plant proceeds and/or using Plants funds for non-wastewater purposes:

⁵³ Attachment A, Response to Claim, p. 10.

⁵⁴ Id.

⁵⁵ Attachment A, Response to Claim, pgs. 10-11.

a. South Bay Water Recycling Program

The Tributary Agencies object to applying their share of the RWF revenues to the SBWR including the Advanced Water Treatment Facility (“AWTF”). The SBWR program is a reclamation facility that was required by the National Pollution Discharge Elimination System (“NPDES”) permit to cap the effluent at 120 mgd in order to protect the San Francisco saltwater habitat. The Tributary Agencies financed the cost of the reclamation facility through long term bonds and SRF, and agreed to pay for the ongoing cost to maintain SBWR.⁵⁶ In 2014, the State Water Resources Control Board denied San José’s request to remove SBWR as a requirement in the new NPDES permit. While West Valley, Cupertino, Burbank and CSD 2-3 now object because they do not receive a benefit as retailers, this does not diminish the obligation to comply with NPDES permit requirements and finance covenants through the end of repayment in 2021.⁵⁷

The Tributary Agencies contend the AWTF is not a legitimate wastewater treatment cost, because “the average dry weather effluent flow has never exceeded 100 mgd in the past 10 years” which is less than the 120 mgd cap under the NPDES permit.⁵⁸ For the Tributary Agencies, this means, “as a practical matter the RWF does not presently need the SBWR system *at all*.”⁵⁹ (Emphasis in the original.)

In 2010, San José, as the Administering Agency, entered into an agreement with the Santa Clara Valley Water District (“SCVWD”) to

⁵⁶ Attachment B, Claim No. 2, Exhibit 7, Second Amendments to Master Agreements in December 1995.

⁵⁷ Attachment A, Response to Claim, p. 11.

⁵⁸ Attachment B, Claim No. 2, p. 15.

⁵⁹ *Id.*

build the AWTF that would further treat the recycled water.⁶⁰ The associated costs to maintain the existing reclamation facility and debt service are a cost for wastewater treatment services under Proposition 218, because all of the effluent treated by the AWTF is provided back to the RWF before distribution.

San José has been clear that it does not intend to use SBWR revenue to expand the system. The Tributary Agencies cite to a proposed \$3.9M referenced in the FY 2015-2016 CIP for expansion as evidence of malfeasance. In fact, the source of these funds is the SCVWD. As part of the Integration Agreement with the SCVWD to construct and operate the AWTF, the SCVWD agreed to pay \$1M each year until the AWTF came online but the funds could only be used "to support expanding the usage of water produced by SBWR."⁶¹

In 2012, the Tributary Agencies selected West Valley Sanitary District to participate in the peer review working group that developed the goals for the Strategic Master Plan. On April 19, 2015, TPAC unanimously approved the Strategic Master Plan including the near term reliability projects on a motion by the representative from West Valley. The proposed reliability projects with an estimated total cost of \$5M are prioritized based on number of customers that could be impacted by a failure, likelihood of failure, and the current expense to maintain and repair existing equipment.

The Tributary Agencies now contend the proposed reliability projects are not necessary because SBWR does not need to operate except in the summer for three months to meet wastewater

⁶⁰ Attachment A, Response to Claim, p. 11, FN 32. The AWTF project and agreements were recommended for approval by TPAC on February 25, 2010 with only one objection from Cupertino Sanitary District.

⁶¹ Attachment A, Response to Claim, p. 12.

objectives.⁶² Co-Owners response is that this approach is similar to the Tributary Agencies' previous position that the RWF did not need the Cogeneration Facility because the RWF could simply plan for the sewage to spill over until power is restored in emergency situations. Co-Owners state that "[t]he Tributary Agencies seek to limit cost to only activities necessary to meet minimum requirements. But no reputable program should plan for unpredictability in its production."⁶³

Although the Tributary Agencies dispute the necessity of the SBWR program, there is nothing in the Tributary Agencies' submissions in support of Claim No. 2, which indicate that the SBWR program is no longer an NPDES permit requirement or that San José, as the Administering Agency for the RWF, is otherwise entitled to, or has the regulatory authority to, unilaterally discontinue the SBWR program. An attempt was made by San José in 2014 to remove the SBWR program as a requirement in the NPDES permit, however, that request was denied the State Water Resources Control Board. The program is apparently still mandated by the permit since no evidence was submitted by either Party to the contrary.⁶⁴

In light of the NPDES permit requirement and San José's obligations under the Master Agreements to do "any and all things...to treat and dispose of all sewage (and all by-products thereof)..." so that said sewage and all effluent from said Plant will not pollute the waters of San Francisco Bay, or any other waters and so that said sewage will be disposed of in a manner authorized by law", we find San José and Co-Owners have not breached the Master Agreements because San José is taking reasonably

⁶² Attachment B, Claim No. 2, p. 15.

⁶³ Attachment A, Response to Claim, p. 12.

⁶⁴ Attachment A, Response to Claim, p. 11.

necessary actions under the Master Agreements by implementing the SBWR program, including the ATWF and near term reliability projects” to dispose of the RWF sewage and effluent as required by law.

b. Billing related to RWF overhead

The Master Agreements require San José to be reimbursed from RWF “funds for all costs and expenses incurred by it as Administering Agency” which includes, but is not limited to, salaries and wages paid by San José to its officers and employees for services rendered by them for Treatment Plant purposes.⁶⁵ In addition to reimbursement for such expenses, San José is entitled to be reimbursed 17.313% of all such expenses to pay for overhead expenses incurred by San José in furnishing the services and administering the Master Agreement, including: payments made by San José for retirement benefits, payments made by San José for medical and hospital insurance covering officers and employees, miscellaneous overhead of the auditing, purchasing and engineering departments of San José.

The Master Agreements, however, limit San José from double charging the RWF for overhead and expenses. San José is only entitled to reimbursement “...to the extent that such costs and expenses are not included in other items of cost or expense for which San José is otherwise reimbursed from Treatment Plant funds.”⁶⁶

The Tributary Agencies argue that that the Agencies are currently being charged overhead in multiple ways. By example, they contend that they are being charged for overhead in both the operating budget and the capital budget for the RWF during

⁶⁵ Attachment B, Claim No. 2, Exhibit 1, Master Agreement for Wastewater Treatment, Ex. E, Section D.

⁶⁶ *Id.*

FY2015-206. However, the Tributary Agencies admittedly make this argument without offering evidence or facts to support the argument. Instead they conclude that the charges appear on their face to constitute proscribed double billing, because they have been unable to know about the “attendant circumstances” of the charges due to Co-Owners alleged lack of transparency.⁶⁷

As discussed in Section 1.B. above, the Tributary Agencies have been given an extensive number of documents and have had several opportunities to identify facts to support their claim of double billing. We find that the Tributary Agencies’ claim of double billing is speculative or “suspicious” at this point and not supported by facts. As a result, we find that San José has not breached the Master Agreements with respect to double charging for overhead.

c. Payments for Public Art Programs in San José

In 2008, TPAC unanimously recommended including the RWF in San José’s 1% capital budget allocation program for public art projects.⁶⁸ The funds collected from the Tributary Agencies were intended for public art in the RWF service areas that would communicate messages about wastewater treatment and potentially enhance some of the newer facilities at the RWF. Since 2011, the majority of RWF projects were deemed to be rehabilitation projects and exempt from San Jose’s public art allocation ordinance.⁶⁹

In response to the Tributary Agencies’ desire to reduce capital cost, San José’s Administration recommended to the San José City Council that the City Council adopt an ordinance to exempt all projects at the RWF from the public art allocation effective Fiscal

⁶⁷ Attachment B, Claim No. 2, p. 17.

⁶⁸ Attachment A, Response to Claim, p. 12.

⁶⁹ Id.

Year 2017-2018. Ordinance No. 29950 was approved by the City Council on June 6, 2017 and became effective on July 20, 2017.

Public Art FY 2007/08 to FY 2015/16			
	Collected	Credits	Total Paid
Total	\$ 1,381,000.00	\$ (719,000.00)	\$ 662,000.00
Co-Owners	\$ 1,108,681.00	\$ (576,462.00)	\$ 532,219.00
Agencies	\$ 272,319.00	\$ (142,538.00)	\$ 129,781.00

We find that our unanimous approval of including the RWF in San José's 1% capital budget allocation program for public art projects, along with the San Jose's discretion under the Master Agreements to allocate funds for public art at the RWF is not unreasonable and further find that such action does not constitute a breach of the Master Agreements. We also note that the RWF is exempt from the public art allocation for projects at the RWF effective July 20, 2017, which should alleviate the Tributary Agencies concerns regarding use of RWF funds for public art.

d. Plant Funds Used for Holiday Programs in San José City Park

The Tributary Agencies object to having contributed collectively \$2,500 from 2011 through 2015 to Christmas in the Park. The month-long holiday event at Plaza de Cesar Chavez in downtown San José attracts approximately 500,000 people each year, with roughly 40% of the visitors coming from surrounding cities.⁷⁰ This is a regional event that provides an opportunity for outreach related to wastewater treatment.⁷¹ A breakdown of the sources of the wastewater treatment is shown in the table below:

⁷⁰ Attachment A, Response to Claim, p. 13.

⁷¹ Id.

Year	Sponsorship Amount	Owner Share (approx.)	Trib Share (approx.)
2011	\$ 7,500	\$ 6,000	\$ 1,500
2012	\$ -	\$ -	\$ -
2013	\$ 1,890	\$ 1,512	\$ 378
2014	\$ 1,645	\$ 1,316	\$ 329
2015	\$ 1,500	\$ 1,200	\$ 300
Total	\$ 12,535	\$ 10,028	\$ 2,507

We believe that regional public outreach related to wastewater treatment is within the scope of San José's responsibilities under the Master Agreements "to do any and all things which it shall find to be reasonably necessary, with respect to its maintenance, repair, expansion, replacement, improvement and operation" to treat and dispose of sewage, including that of any and all Outside Users". As such we find that San José has not breached the Master Agreements by using Plant funds for outreach conducted during Christmas in the Park.

e. Improper Charges for the Costs of Unfunded Pension Liability of San José Employees

The Tributary Agencies allege that San José appears to be improperly charging the RWF for the unfunded pension liability of San José employees. However, the Tributary Agencies admit that further information is necessary to determine whether this practice results in the agency being overcharged.⁷²

As the Administering Agency, San José is entitled to recover actual overhead under the express provisions of the Master Agreements, including costs such as payments for retirement benefits.⁷³ The

⁷² Attachment B, Claim No. 2, p.19.

⁷³ Attachment B, Claim No. 2, Exhibit 1, Master Agreement at Exhibit E, Section D.

Master Agreements specifically contemplate funding for these benefits as follows:

"D. Expenses of Administering Agency. It is mutually agreed that the City of San Jose shall be reimbursed from Treatment Plant funds for all costs and expenses incurred by it as Administering Agency of this Agreement, including, but not limited to, salaries and wages paid by San José to its officers and employees for services rendered by them for Treatment Plant Purposes. It is further agreed that San Jose shall be paid, from Treatment Plant funds, an amount equal to seventeen and three hundred thirteenth one thousandths per cent (17.313%) of all the mentioned salaries and wages as and for the following overhead expenses incurred by San Jose in furnishing said services and in administering this Agreement, to wit: payments made by San Jose for retirement benefits, payments made by San José for medical and hospital insurance covering officers and employees, miscellaneous overhead expenses of the auditing, purchasing and engineering departments of San Jose...[t]he percentage or amount of overhead allowance or expense payable to San José shall be increased or decreased from year to year to reflect actual overhead and incidental costs and expenses incurred by San Jose for Treatment Plant purposes to the extent that such costs and expenses are not included in other items of cost or expense for which San Jose is otherwise reimbursed from Treatment Plant Funds."⁷⁴

The language in the Master Agreements is clear. San José is entitled to recover the costs of administering the RWF and the Master Agreements which expressly includes "payments made by San José for retirement benefits..." Therefore, we find no breach of

⁷⁴ Id.

the Master Agreements by Co-Owners for using RWF to pay for the retirement benefits of San José's officers and employees.

Additionally, when questioned by TPAC Chair Mayor Sam Liccardo regarding the payment of retirement benefits at the hearing, counsel for the Tributary Agencies Mr. Mehretu admitted that the pension liability issue is "more of an example, more than anything to show" that the Tributary Agencies don't have enough transparency in terms of what's going on at the RWF. He also stated that it's "an example of a *potential* misuse of funds."⁷⁵ (Emphasis added.)

We further find that in light of our determination that Co-Owners have not breached the Master Agreements for failing to provide sufficient records relating to the revenues and costs for the RWF, taken in conjunction with the Tributary Agencies' acknowledgment that they do not have a factual basis to support their allegations regarding retirement benefits, there has been no breach of the Master Agreements in this regard.

D. San José Did Not Fail to Provide the Tributary Agencies with the Annual Budget By March 1st.

Finally, the Tributary Agencies claim a breach of contract because they received the draft Fiscal Year 2016-2017 budget on March 25 instead of March 1, 2016. The claim fails to disclose that the delay was due to the bids for the Digester and Thickener Rehabilitation project coming in significantly higher than estimates which required revising the budget to avoid impact on the Tributary Agencies. Moreover, the Tributary Agencies were informed in advance that the draft budget would not be issued on March 1. If a draft budget had been issued on March 1, it would have required revisions a couple of weeks later.

⁷⁵ Ex. C, p.17.

We find that while Co-Owners may have not given the Tributary Agencies the budget on March 1, 2016, as required by the Master Agreements, the Tributary Agencies were on notice that the budget would be delayed and were given the reasons for the delay.⁷⁶ Since there no facts or evidence submitted by the Tributary Agencies that such delay resulted in prejudice to the Tributary Agencies, we further find there was no breach of the Master Agreements by the Co-Owners for distributing the budget several weeks beyond the March 1st deadline.

SECTION 2. REPORT OF THE TREATMENT PLANT ADVISORY COMMITTEE

- A. This Resolution, including its recitals, constitutes the report, findings and recommendations of the Treatment Plant Advisory Committee, as required by Part 7.G of the Master Agreements (Report).
- B. The Secretary to this Committee is hereby directed to distribute the Report to the Tributary Agencies' legislative bodies and to the legislative bodies of Co-Owners.

SECTION 3. RECOMMENDATIONS

The Treatment Plant Advisory Committee recommends that discussion continue among Tributary Agencies' and Co-Owners' staff on an informal basis in order to arrive at a mutually agreeable amendment to the Master Agreements that focuses on the parties' common concern regarding financing the projects included in the CIP.

⁷⁶ Ex. C, p.14.

RD:JLP
10/10/2017

ADOPTED this 14th day of September, 2017, by the following vote:

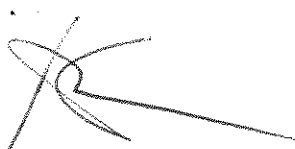
AYES: Diep, Davis, Grilli, Kolstad, Leonardis,
Liccardo, Sykes, Watanabe

NOES: NONE.

ABSENT: NONE.

ABSTAIN: Gatto

ATTEST:



Secretary



SAM LICCARDO
Chair

ATTACHMENT A
CO-OWNERS' RESPONSE TO CLAIM NO. 2 and
INDEX OF SUPPORTING DOCUMENTS

- ** Co-Owners' May 10, 2017, Response to Tributary Agencies' Claim No. 2
- A. Resolution No. 2016-01
- A1. Project Packages
- B1. February 2, 1983 letter from San Jose/Santa Clara Water Pollution Control Plant to Milpitas Mayor James Rogers re: Master Agreement
- B2. March 18, 1983 memo to San Jose City Council from Director of Water Pollution Control re: Approval of Master Agreements for Wastewater Treatment
- C. Exhibit C – Tables showing the amount of used and underutilized wastewater treatment contract capacity for FY 2015-2016 between Co-Owners and Agencies
- D. Summary of CIP Cost Control Measures
- E. CIP Financial Controls; Project Delivery Model from San Jose – Santa Clara Regional Wastewater Facility
- F. Capital Improvement Program; Monthly Status Report: February 2017 from San Jose – Santa Clara Regional Wastewater Facility
- G. Transportation and Environment Committee memo dated April 12, 2017 re: San Jose – Santa Clara Regional Wastewater Facility CIP Semi-Annual Status Report
- H. Proposed San Jose / Santa Clara Water Pollution Control Plant Five- Year 2016-2020 Capital Improvement Program, submitted by Kerrie Romanow, Director
- I. Letter to Tributary Agencies dated December 14, 2015 from ESD re: Timetable for Completion of 2016-2017 Revenue Program
- J. Letter to Tributary Agencies dated February 25, 2015 from ESD re: FY 2015-16 Treatment Plant Capital Cost and State Revolving Fund Loan Repayments Allocation
- K. Letter to Tributary Agencies dated March 4, 2015 from ESD re: FY 2015-16 Revenue Program

- L1. Sample of O&M Invoices
- L2. Sample of CIP Invoices
- M. Sample of Debt Service Invoices
- N1. Letter to Tributary Agencies dated November 12, 2015 from ESD re:
Revised FY 2014-15 Operating & Maintenance Cost Sharing
- N2. Letter to Treatment Plant Advisory Committee dated November 16, 2015
from ESD Director re: Tributary Agencies Available Plant Capacity – 2015
- O. Letter to West Valley Sanitation District dated December 20, 2016 from
ESD re: Third Quarter Invoices for FY16-17 / Adjustments for O&M and
CIP for FY 15-16
- P. Index of Document Set from PRA
- Q. Fiscal Process chart

ATTACHMENT B
TRIBUTARY AGENCIES' CLAIM NO. 2 and
INDEX OF SUPPORTING EXHIBITS

- ** Tributary Agencies' September 7, 2017, Claims of Breach and Inequities
1. Master Agreement for Wastewater Treatment Between City of San Jose, City of Santa Clara and County Sanitation District #4, dated March 1, 1983
 2. California Regional Water Quality Control Board, San Francisco Bay Region Order No. 80-20, dated April 15, 1980
 3. Settlement Agreement By and Between The Cities of San Jose, Santa Clara, and County Sanitation District No. 4 of Santa Clara County, dated January 14, 1981
 4. Letter to Tributary Agencies from ESD re: FY 2016-17 Treatment Plant Capital Cost and SRF Loan Repayments Allocation, with Attachments I and II, dated March 10, 2016
 5. 2014-2015 Capital Budget; 2015-2019 Capital Improvement Program; Water Pollution Control; Detail of Construction Projects; Detail of Non-Construction Projects
 6. First Amendment to Master Agreement for Wastewater Treatment Between City of San Jose, City of Santa Clara and County Sanitation District No. 4, dated December 17, 1985
 7. Second Amendment to Master Agreement for Wastewater Treatment Between City of San Jose, City of Santa Clara and West Valley Sanitation District, dated December 4, 1995
 8. Agreement Between Cities of San Jose and Santa Clara and County Sanitation District No. 4 Relating to Sewage Treatment Plant, dated April 1, 1965
 9. Transportation and Environment Committee memo from Director of ESD re: South Bay Water Recycling Strategic Master Plan Report, dated March 19, 2015
 10. Report to the City Council, City of San Jose, from Office of the City Auditor re: South Bay Water Recycling: Better Information and Renegotiation of Contractual Obligations will Increase Transparency and Aid Program Success, dated March 2016

11. 2016-2017 Capital Budget; 2017-2021 Capital Improvement Program; Water Pollution Control; Source of Funds; Use of Funds
12. San Francisco Bay Regional Water Quality Control Board Order No. R2-2014-0034, NPDES No. CA0037842, dated September 15, 2014
13. Recycled Water Facilities and Programs Integration Agreement between the City of San Jose and the Santa Clara Valley Water District, dated March 2, 2010
14. Response to Previous Action Item, issued September 3, 2015
15. City of San Jose invoices for Santa Clara Valley Water District:

Invoice 233448 dated September 3, 2015;
Invoice 216712 dated June 4, 2014;
Invoice 204473 dated June 5, 2013;
Invoice 193434 dated June 19, 2012;
Invoice 181060 dated July 12, 2011; and
Invoice 167723 dated September 28, 2010.
16. SBWR Strategic and Master Plan, Appendix 6D: Concentrate Management
17. 2015-2016 Operating Budget; Environmental and Utility Services CSA; Statement of Source and Use of Funds
18. Federated City Employees' Retirement System; Final Valuation Results, dated December 17, 2015
19. Letter to Tributary Agencies from ESD re: FY 2014-15 Treatment Plant Capital Cost and SRF Loan Repayments Allocation, dated February 19, 2014
20. Cupertino Sanitary District Memorandum dated January 12, 2011 with list of topics from meeting with San Jose City staff
21. City of San Jose, Transaction Detail Report; Fund 513-SJ-SC Treatment Plant Operating Fund

RD:JLP
9/7/2017

ATTACHMENT C

**TRANSCRIPT PREPARED BY VITAC FROM AUDIO RECORDING OF THE
May 18, 2017 HEARING BEFORE TPAC**

TPAC Second Administrative Claim Hearing

May 18, 2017

>> SAM LICCARDO: Administrative hearing for claim two, and we're going to conduct this hearing on the issue of claim for breach of contract inequities, filed by Tributary Agencies against San José and Santa Clara. We'll first begin our presentations from the Tributary Agencies, who have 10 minutes to present. And then we'll return to the co-owners. John?

>> JOHN GATTO: Yeah, before we start, can we have somebody explain what the problem or possible outcome to this would be and what the ramifications of that outcome might be?

>> SAM LICCARDO: Uh... Trying to figure out who would be in the best authoritative position to answer that. That'd be Rosa or...? Okay.

>> What was the question?

>> SAM LICCARDO: Let me get her attention.

>> Oh. I'm -- I'm sorry.

>> SAM LICCARDO: John, you want to repeat the question?

>> JOHN GATTO: Yeah. Can you tell us what the possible outcomes of this hearing might be and what the ramifications of those outcomes would be?

>> Uh, well...

>> JOHN GATTO: I mean, it's either yes or no? Is that...?

>> TPAC will make a decision under the master agreement. There is a report and a resolution that follows. Any part that objects to the resolution or finding of TPAC has the opportunity to appeal it. That's just the procedural process that's in the master agreement.

>> JOHN GATTO: But we can vote yes or no on the -- What is the -- the vote that we would be taking?

>> Whatever you decide. It's, you know, based on our presentations. You vote however, you know, you believe the claim should fall.

>> JOHN GATTO: But then, is it -- Is it a recommendation that goes to -- to the next level?

>> It is a TPAC resolution that then can go to the next level if there is an appeal, yes.

>> So, yes, just to add, I will be recommending that TPAC recommend to the owners settlement of our claims. So I think that's the appropriate action item.

>> SAM LICCARDO: Well, I think what we're determining is whether or not there's a finding of breach. Is that -- Is that right?

>> Yes.

>> SAM LICCARDO: Yeah, so... This -- This body is responsible for determining/making/finding was there a breached contract or not.

>> JOHN GATTO: And if we determine yes, is that the end of it, or what happens?

>> Well, the body needs to make a recommendation. It needs to do a report and a recommendation.

>> JOHN GATTO: And then that would go to the Council?

>> That would go to the owners.

>> JOHN GATTO: To the owners, okay. And then they would do what? Either accept that or not accept that?

>> It would actually go to the...

>> So I think David would agree. [Laughs] It's my understanding in the master agreement that once TPAC makes a decision that any of the agencies can object to the decision, and they can appeal. That goes to a joint meeting of all the legislative bodies akin to what's still pending from the first claim, which was an objection from the Trib Agencies, and we are attempting to schedule a joint meeting of the legislative bodies on the first claim.

>> JOHN GATTO: Okay. So, the -- whatever the decision is of this body, that's the decision that either is accepted or appealed. And then, if it's not accepted, then it goes to the -- to the larger group?

>> Yes, to the -- Under the contract, it's a joint legislative meetings of all the agencies.

>> Hypothetically, it could be accepted.

>> JOHN GATTO: Yeah. No, I'm saying --

>> And that would be the end of it.

>> JOHN GATTO: But it doesn't go to the Council. It goes to the next group.

>> Yes.

>> JOHN GATTO: Okay.

>> Okay. Ready to proceed?

>> DAVID MEHRETU: Yes. So, thank you. Good afternoon. My name is David Mehretu. I'm from Meyers Nave. I'm special counsel to the Tributary Agencies. So, today's hearing concerns the Agencies' second claim for breaches of the master agreements between the owners and the Agencies. Given the short time period I have here today -- just 10 minutes -- I'm going to address three main issues. Before I do that, I want to start off by clarifying what this dispute is not about. It's not about the Agencies trying to avoid paying their share. It's not about preventing anyone from pursuing environmentally beneficial or socially beneficial projects. And it's not about preventing San José from exercising its discretion to manage the plant in accordance with the master agreements. Thank you. Rather, the dispute comes down to transparency, ensuring that our repair funds are used for legitimate purposes, and being able to plan, budget, and pay for plant costs. So, first, I'm going to address the lack of contractual authorization for the capital improvement plan, or the CIP. As a legal matter, large improvements like the \$1.5 billion CIP are not authorized under the master agreements, as detailed in our claim. This does not mean that the Agencies don't support the CIP. We do. The problem is that, because the master agreements don't contemplate major capital improvements, except those expressly agreed by the parties, or for expansion, the master agreements don't have the terms to facilitate the CIP. For example, there are no terms that will ensure that the Agencies can effectively plan, budget, and pay for large capital improvements. We, therefore, support amending the master agreements to authorize the CIP and to include the provisions to allow us to do this -- to allow -- to allow the Tributary Agencies to plan, budget, and pay for the CIP. Contrary to the owners' response, we're not suggesting that the master agreements should be amended in a piecemeal fashion before embarking on each CIP program. Rather, the master agreement should be amended once to authorize all the CIP projects and to add the provisions to allow the Agencies to adequately plan, budget, and pay for the CIP. An example of the appropriate provisions that would accomplish this -- but there are a number of options -- would be for the parties to participate in common financing under fair terms. San José will probably point to one instance where the plan underwent an \$84 million or \$85 million capital improvement unrelated to expansion and without amending the master agreements. What you

should know is that such improvement occurred in the aftermath of a major spill at the plant. We, therefore, did not insist on an amendment to the master agreement. Next, I'm going to address transparency. As a legal matter, the Agencies have the right to audit San José's compliance with the master agreement. San José incurs tens of millions of dollars on behalf of the Agencies every year, so, of course, we're entitled to know where that money goes and how it's spent. The owners will likely cite a laundry list of documents and information they provide to us. What's provided to us, however voluminous it might be, does not contain the necessary and required information to confirm compliance in many areas. For example, we cannot determine that our bills are correct, because key information has been withheld, such as the underlying records supporting the line items in bills. For example, in the instance of actual costs, the Tributary Agencies are not provided with a detail of actual costs incurred for a project with a clear audit trail to the city's general ledger. True-up statements, which are necessary for reconciling budgets with actual expenses, contain undefined line items, such as "rebudgeted," and we don't know what "rebudgeted" refers to. Oftentimes, the rebudgeted amounts are the most significant items in the third-quarter billing. And when we find inconsistencies in bills, which exist, we have no way of determining why, because San José doesn't give us the policies or practices it employs to true-up the bills. This is a clear breach of the master agreements. San José is required to provide us with a statement outlining the methods of adjusting costs and actual adjustments. It doesn't provide this. Contrary to the owners' response, the citywide audit is not designed to test compliance with the master agreements. For example, it would not test whether San José properly allocates the cost to the Agencies according to the allocation methods in the master agreements. It's hard to imagine why San José would be opposed to a compliance audit. Such transparency is not only good public policy, it's San José's public policy, and the Agencies are willing to bear the substantial cost of planning such an audit. I'm going to move next to the evidence of misuse of funds that we've seen, which substantiates our concerns. We discussed many of these issues in our claim, and I'm going to address them here. There's six of them. First, San José plans to charge the Agencies tens of millions of dollars to expand the recycled water facility. Although the existing facility is used to comply with our permit, San José is not authorized to expand the facility without our consent. The owners seem to try to legitimize this cost by casting them, or the costs -- as casting them as reliability improvements. But this is belied by San José's own planning documents, which make clear that

the improvements are needed to expand capacity to meet increasing demand. Second, San José has already charged the Agencies tens of millions of dollars for an advanced treatment facility to provide ultra-purified water. This facility is entirely unnecessary for the plant, nor owned or operated by the plant. The owners are wrong that the cost of this advanced treatment facility are legitimate, simply because the facility discharges back to the plant. According to that reasoning, the Agencies would have to pay for any use San José allows to discharge to the plant, which is obviously not true. Third, San José has charged the plant millions of dollars for public art, purportedly through an ordinance that does not legally apply to plant costs. Public art for the city of San José is clearly not a legitimate wastewater expense. Contrary to the owners' response, this doesn't change simply because some of the art could possibly be used to convey messages about wastewater, whatever that exactly means. Fourth, San José has used the plant funds to sponsor holiday programs in San José parks. Again, it's hard to see how holiday programs are a legitimate wastewater cost, however small the costs might be in the bigger picture. The owners try to legitimize this by saying the sponsorship provided opportunities for outreach, but they point to no evidence that this was the actual intention or that any outreach was actually done. Fifth, San José has not provided records to validate whether the plant pays more than its share of pension liability for San José employees, although this is a very plausible outcome and would clearly be a serious breach of the master agreements. The owners fail to even respond to this in their claim, except to simply state that San José is entitled to be reimbursed for overhead, which is a generic point that nobody refutes. Finally, we've learned from a senior San José employee that San José essentially double bills the Agencies, or I should say the plant, for overhead costs related to San José's staff who manage investment funds for the plant. The owners, again, don't bother to respond to this specific claim in their response, which either shows bad faith, gamesmanship in the hearing process, or suggests that this claim is actually valid.

>> SAM LICCARDO: Thank you. I'm sorry. Did you say 10? No, no, we still have time, don't we?

>> Yes.

>> SAM LICCARDO: Okay. Forgive me. Please proceed. I'm sorry.

>> About 1 1/2.

>> DAVID MEHRETU: Thank you. So, I'm actually wrapping up now.

>> SAM LICCARDO: Okay.

>> DAVID MEHRETU: For all these reasons and those discussed in our papers, we request that the committee recommend to the owners that they settle our claims on the reasonable terms we requested and find the breaches of the master agreements we've identified. Thank you.

>> SAM LICCARDO: Forgive me for cutting you off.

>> DAVID MEHRETU: No problem. I was close to being done.

>> SAM LICCARDO: Okay. Okay. So, the co-owners have 10 minutes, as well.

>> So, thank you for the opportunity to respond on behalf of San José and Santa Clara, the co-owners of the facility. Instead of a formal response, I'm going to focus on what I think are the critical issues in the claim. We were before March of last year on the first claim. The issues raised by the second claim are substantially similar, except the interpretation of the master agreement in support of the claim have evolved over time. These were the claims from the first claim, the allegations from the first claim, and TPAC's findings. In the master agreement, the administering agency's authority is very clear, and the Agencies don't dispute that. This includes the obligation to make improvements to the facility. And they approved the 1983 agreements with the Agencies. The councilmembers' full support and approving the master agreements were also very clear that these master agreements supercede all other prior agreements, including the settling agreement. It is the intent to update new information through the exhibits of the master agreements versus revising the entire agreement each time there was a project. This was intended for long-term viability of the facility and stability and funding. The

master agreement amendments are very clear. The conditions under which they are amended are related to when there's an expansion in design capacity to realize participation in financing, which could conceivably occur here, if we have call on financing on the projects. That's when the amendments would be done. And to document the...which is a capacity between the Agencies, which also occurred in 2006 and 2009. So, the definitions are clear, because...to the second claim is there no concept now that future improvements in the master agreement, the definition of future improvements and what capital costs could be charged for could not possibly include the types of projects in the CIP. But the definitions in the master agreements are essentially identical to what's in the state revenue guidelines. And these guidelines dictate what kinds of costs can be charged to residents and businesses. They're identical to what's in the master agreements, in terms of what we can charge the Agencies for authorization and maintenance and for capital costs. So, in the master agreement...be the charge for capital costs for future improvements, and they have to be based on the adopted budget. And the reason for capital costs for improvements is associated with the reserve capacity is the concept that there's allowed use for life we put in place in improvement that is amortized over time for the benefit of future users. And examples of improvements that have occurred in the past that is...in many of the projects that are in the current CIP is listed here in this slide. For example, the...building improvement, which was Headworks 2. There are two projects in the current CIP that would also repair the Headworks -- save Headworks and make Headworks improvement. The alternative disinfection facility, which allowed the facility to transition from the gaseous chlorine using the railcars, there's one project similar to that, which is the Iron Salt Feed Station in the current CIP. They both involve similar work. The electrical reliability improvements that was previous done, there are latter projects in the current CIP that also intend to address reliability and energy management. This is a...facility, the emergency diesel generator, and the switchgears. Fire Main replacement, same thing. There's a...water systems improvement in the current CIP that would replace water piping systems throughout the facility. Hand rail replacement that was previously there. There was a nearly identical project that is for support building improvements for the same purpose, which is to address improvements in fire...system upgrades. So, as you can see, the past improvements we've made are very much akin to the improvements that are in the current CIP. Those two pages illustrate the 33 packages that were confirmed after the validation process. I would like to point out the master agreement provides

that even if we can't come to an agreement on a new term, as long as the Agencies discharge to the plant, there is an obligation to reimburse the owners for the cost of treating the sewage. And the cost of treating the sewage includes the costs to operate and maintain the facility includes the cost to put in new improvements. So, there's really no way to get around the fact that these are going to be real costs to the owners. The second claim...speaks to the fact that they are being double billed for overhead. That's certainly not the case. And overhead does include the town benefits, because that is the cost of personnel. The personnel that is necessary to properly administer and operate the plant. The master agreements recognize that pension and other benefits are part of employee costs. Their...in the second claim that overhead due to retirement is higher than it should be is entirely speculative. In fact, the Agencies acknowledge that portion amount might be underestimated. The opinion is that the facility are part of the federal-aided retirement system, not a separate system for plant employees... The retirement boards sets the pension contributions. San José does not control the determination of the portion contribution. And this is not a bill that the city can simply decline to pay. The Agencies should understand this since they also receive a bill from... ..retirement is not an issue that is unique to San José. With respect to records, my written response will provide examples of information that are sent to the Agencies throughout the year. ...records but careful study as we have tried to do in exhibit P and Q, you can track how these public records from the public records request can inform the periodic communications we provide to the Agencies. The wastewater treatment program is a large and complex program, and the process for understanding how it works must be iterative. But it isn't overreach to assume that the records that were provided are insufficient and to accuse us of fraud and malfeasance just because understanding records requires investment in time and resources. ...the master agreement charges for...capital costs must benefit the treatment program. The Agencies agree to pay for the costs of...under the master agreement of 1995. This...continues until it is...a permit requirement and a debt is paid off. And because the water that's treated by AWTF does, in fact, come back to the facility, it has been...distributed as recycled water, the AWTF is part of the treatment process. The reliability projects that would address current...operation during peak hours is also a legitimate operational cost for the South Bay. Example -- the TPS upgrade would provide a backup dump to ensure...in case the main pump fails. If the main pump fails and there isn't a backup pump, there's gonna be a reduction in pressure in the entire system.

Public art...capital projects. If they are included as part of the physical structure, that becomes a cost to the structure. And it is not millions of dollars that the Agencies have been charged. In fact, it's \$129,000, which is more smaller now, the money, but its uses are legitimate.

>> One minute.

>> We would urge TPAC to make the following findings -- that the Agencies are required to pay their share, which they've acknowledged they're willing to do. The Agencies have been provided sufficient records and that they were properly charged for overhead, recycled water, public art, and educational outreach. Here I would like to take this opportunity to say what gets lost in the dispute, we have an incredibly dedicated group of public servants whose first priority is to ensure the safe operation of this facility. Every day, plant staff work with...personnel to manage a facility that could fail with each delay. In these times, it's much easier to criticize than to be part of the solution. We should all be hopeful that the capital program will be a success and provide staff with the resources we all need to succeed.

>> Time.

>> Thank you.

>> SAM LICCARDO: Thank you. Okay. We have two members of the community that would like to speak, so I'm gonna ask them to come forward now, and then we'll proceed to the discussion from the board. Ken Colson is the director of the Burbank Sanitary District and Rebecca Yoder, who, I believe, also works at Burbank.

>> KEN COLSON: Yeah, I'm Ken Colson, Director of Burbank Sanitary District. I have three points I'd like to make. To get to the topic of claim number two, I have to introduce how we were informed as a -- as a non-member of TPAC. On May the 5th, the mayor sent a letter to us, addressed to TPAC, asking for a waiver of the remainder of the administrative hearings. And what interested me was the fact that, although we are recognized as participating members of TPAC for the plant, we are not recognized at this table. So our voice is -- is not heard other

than being a guest, and I think that's unconscionable. It's just...schizophrenic. You can't have it both ways. We're either on this, or we're not. The second point I want to make is, uh... the Tributary Agencies believe that our claim is legitimate and valid. I've heard over and over again two conversations here, that the Agencies don't want to pay, are not willing to pay it at the same time, your attorneys said, were trying to get around it. Which is it? Are we willing to pay? Yes. We are not trying to avoid anything. Um... The accusation that the -- the plant has paid for things like Christmas in the Park are valid. I don't know how you could sell that to anyone out there paying taxes. I really don't. So, um... I think that the issue of invoicing is a valid part of our claim. If we can't -- If the city can't get the invoice clear of what you're spending it on and you have refused or been unable to present it to us, and the claim that the reason we don't understand is because we haven't taken the time or the energy to read hundreds of documents is nonsense talk.

>> SAM LICCARDO: Thank you, Mr. Colson.

>> KEN COLSON: Thank you very much.

>> SAM LICCARDO: Thank you. Rebecca Yoder.

>> REBECCA YODER: Hi. I'm Rebecca Yoder, President of the Burbank Sanitary District board of directors. Louder? Sorry. I just want to say, in 1983, when the master agreement was drafted, all I wanted for Christmas was my two front teeth. I was playing music on a Fisher-Price record player. Those words are still controlling how we operate today, and I think they need to be updated. There were no...programs, there was no water recycling, there was no public art, and none of this is reflected in our master agreement, and I don't think it's fair for people in Burbank Sanitary District who don't vote for mayor, don't vote in city elections, don't get city police, don't get city services to be responsible for paying for art and Christmas in the Park and all of these other things. I have to answer to the people who voted for me, and it's their money that is being spent here, and I need you guys to be accountable. Furthermore, I'd like some voice. I'd like to be able to sit at the table instead of in the peanut gallery. I think we have that responsibility to the people in our district, as small as it may be. It's real. As far as

the audits go, you guys have audits, but those audits are not for us. They are not for making sure that we are paying what we're supposed to be paying, and I think that's important. It's like me asking you guys how to get to Starbucks and you hand me the white pages from New York City. Lots of information -- not relevant. That's my point. Thank you.

>> SAM LICCARDO: Thank you. Michelle? Michelle Kaelker-Boor from Burbank Sanitary District.

>> MICHELLE KAELKER-BOOR: Hello. My name is Michelle Kaelker-Boor, from the Burbank Sanitary District. There has been, and continues to be, a huge disconnect between ownership of the wastewater treatment plant and the Tributary Agencies, in my opinion. We have been trying to find concrete answers so that we can all move forward and do what needs to be done. We need a solution, and quickly, so we continue to support the effort to improve this treatment plant. We understand it's important. From the beginning, and for more than a year now, the Tributaries have been on board to pay their fair share. I can't stress that enough. We want to pay our fair share. Please don't mistake that again. We have continued to pay it throughout this time of trying to negotiate our master agreement contracts. Our main goal is to make sure that these outdated agreements with the ownership are solid and adequate to sustain ongoing and future projects. The current contracts are extremely vague and do not provide enough clear definition to encompass the enormous task of rehabilitating the wastewater treatment plant. We need a clear solution. Also, the city-level audit may look -- it may work fine just for most situations, but when it comes to being accountable to our rate payers, as Becky has said, for our share of a \$1.3 billion project, they want and deserve complete transparency to know that we have the ability to track their hard-earned dollars. The Tributary Agencies even went as far -- as far to hire two separate, nationally recognized auditors to go through those piles of paper that we received, and they were unable to see clearly how our districts funds were being used and managed. So we need a transparent solution. We also have been asking for a cohesive team. As it stands now, there are only three out of five Tributary Agencies that have representation at the TPAC to be able to discuss relevant terms that are important to the wastewater treatment facility. For example, as elected officials at the Burbank

Sanitary District, we have to ask our rate payers to pay into this project, yet there's no ability for our district to openly discuss and ask questions and voice our concerns.

>> SAM LICCARDO: Thank you, Michelle.

>> MICHELLE KAELKER-BOOR: I have one other thing I'd like to say.

>> SAM LICCARDO: If you could wrap it up.

>> MICHELLE KAELKER-BOOR: Yep. So, we need a cooperative solution, but, really, we need more. We need a complete solution. We need a clear, transparent, cooperative, reasonable solution, and we need a seat at this table. Thank you.

>> SAM LICCARDO: Okay. We turn now to the TPAC members for discussion.

>> JENNIFER POU SHO: Excuse me, Mayor. Jennifer Pousho from the city attorney's office. Just for the record, I have a clarification. I think you've mentioned that you want to -- that you're gonna ask the committee to settle the Trib's claims, and just for the record, I'm just trying to get clarification that it's not set forth here in the claim, so --

>> Well, I think the claim asks for the relief that we want.

>> JENNIFER POU SHO: Okay. Just wanted to...

>> So I want the board-- the committee to recommend that.

>> JENNIFER POU SHO: And to uphold the claim.

>> Yes.

>> JENNIFER POU SHO: Thank you.

>> SAM LICCARDO: Okay.

>> JENNIFER POU SHO: Thank you.

>> SAM LICCARDO: Okay. So, our decision is whether we uphold the claim or deny it. All right, discussion. John?

>> JOHN GATTO: Well, no, I think the claim is valid, and I would make a motion that we uphold it.

>> SAM LICCARDO: Okay. There's a motion. Is there a second?

>> Second.

>> SAM LICCARDO: Okay. Motion and second. Discussion. I just had a couple quick questions myself. This issue about whether the advanced treatment facility is really necessary for plant operations. My understanding is, to some extent, that's not really up to us. I believe, in 2014, didn't we ask State Water Resources Control Board to remove the SBWR requirement from -- from the permit?

>> Yes. We did. We tried to get it removed as a requirement.

>> SAM LICCARDO: Yes, I'm sorry. Remove the program as a requirement. Forgive me.

>> Right. And they would not do that...

>> SAM LICCARDO: Okay.

>> ...in the 2014 renewal.

>> SAM LICCARDO: So, as far as the state's concerned, it's part of what we pay for in operations of the plant.

>> \$10 million worth.

>> It is a requirement of the permit to maintain the South Bay system.

>> SAM LICCARDO: Okay. On the issue of the programs that ESD ran in the parks -- I believe it was Christmas in the Park -- you want to explain what that was about?

>> It's my understanding that, over the course of the many years, there was about \$2,500 that were allocated to the Agencies to fund Christmas in the Park. They do outreach and education to visitors to Christmas in the Park about the wastewater program. And, um... 40% of the visitors that come to Christmas in the Park, in fact, come from surrounding cities. So it's safe to say that the residents of these service areas likely benefited from the education and outreach about the program.

>> SAM LICCARDO: Okay. So, Rosa, the amount, you say, was \$2,500?

>> That's correct -- \$2,500.

>> SAM LICCARDO: Okay. And was that in multiple years, or...?

>> Yes, that's in all of the years.

>> SAM LICCARDO: In total.

>> Cumulative.

>> Cumulative.

>> SAM LICCARDO: Okay. So that's the total amount. And then the public art, I understand -- I think you clarified -- it was a hundred and...

>> \$129,781.

>> SAM LICCARDO: The \$129,000... I recall a few years ago, we were doing our best to characterize projects as rehabilitation rather than capital so we'd avoid that charge. Is that right?

>> That's correct.

>> SAM LICCARDO: Okay. We, I believe, are taking this back to the council to essentially eliminate the requirement altogether. Is that right?

>> Prospectively, yes. Or, there is a proposed ordinance that will be before the city council to eliminate projects at the art...and the public art allocation.

>> SAM LICCARDO: Okay. Thank you for all that. Just a question, I guess, the counsel for the Tributaries. I'm trying to understand the concern about whether the plant pays an excessive share of the pension liabilities. It seems to me we publish lots of information about our pension liabilities, and we have a lot of public scrutiny over that issue, both at the council level and at the pension-board level. We have outside auditors that determine the exact amount. We certainly know and can calculate the number of employees and how long they've been working there. So, help us understand what is not -- what is not seen, what is not transparent.

>> DAVID MEHRETU: The concern here is that the plant includes other stakeholders, so it's not just about San José. So we don't necessarily have any doubt that pension, as a general matter, pension liability is handled in an improper way, citywide. We have no basis to know one way or the other. What we know is that the plant is a separate unit, and the profile of the plant employees might be different from the average employees of the city. So, as the Tributary Agencies, we don't share in San José's overarching employee structure. We only are concerned

with those related to the plant. And so, if their profile is different from your average employee in San José, then we might be overpaying for pension liability for the plant.

>> SAM LICCARDO: Okay.

>> DAVID MEHRETU: And so it goes back to transparency, and it's more of an example, more than anything, to show that we just don't have enough transparency, in terms of what's going on with the plant.

>> Okay. I heard you describe a list of six items that were evidence of misuse of funds. It sounds like what you're saying is you don't know whether or not these dollars are misused.

>> DAVID MEHRETU: That's an example of a potential misuse of funds.

>> Okay. So, it seems to me that's a fairly easy problem to figure out -- that is, identifying X number of employees and calculating -- We're obviously calculating the pension cost ourselves.

>> If I may, the retirement board sets the pension contributions...

>> Right.

>> ...and gives the bill to the city. We don't dictate how they come to that number.

>> Agreed.

>> And that number is based on the entire demographic of the city.

>> Okay.

>> And that is the case for...as well. It's of the pool. There isn't a specific actuarial that is done for plant employees.

>> SAM LICCARDO: Right.

>> They don't have a separate retirement system. Just like in...any city that participates in it doesn't have its own actuarial for that particular city, in terms of their pension contribution. That's just not how it works.

>> SAM LICCARDO: Right. So, I guess, then, for counsel, then, is your assertion that the average life duration of members who work at the plant is half a year shorter than the rest of the city's, we should be somehow doing separate actuarial calculations for every employee to figure that out?

>> DAVID MEHRETU: Well, the city -- It's my understanding that there is a citywide actuarial study.

>> SAM LICCARDO: Yes.

>> Yes.

>> SAM LICCARDO: Yep. And that's published.

>> DAVID MEHRETU: Yes. And so the plant might be an exact replica of that, in terms of its profile.

>> SAM LICCARDO: Right.

>> DAVID MEHRETU: Okay. That's possible.

>> SAM LICCARDO: Right.

>> DAVID MEHRETU: But it's very unlikely.

>> SAM LICCARDO: Yeah.

>> DAVID MEHRETU: So, to the extent that it's different, we're either being overcharged or potentially undercharged.

>> SAM LICCARDO: Right. But they might be getting a bargain.

>> DAVID MEHRETU: But the bottom line is that the city has other stakeholders involved. So it's not as easy to just say, "Well, let's just kind of X these things out and cancel them out, let them net out." It's an example of where the plant is being operated as just an extension of the city, and that's not appropriate for the Tributary Agencies.

>> SAM LICCARDO: Is there some legal basis for concluding that? I'm trying to understand.

>> DAVID MEHRETU: Well, just the contract that we have. So... That would be the legal basis.

>> SAM LICCARDO: Okay.

>> And I would dispute that based on the exact language of the master agreement, which is that the administering agency provides the personnel. The personnel costs includes the retirement benefits. It's whatever retirement benefits are actually paid. This is reimbursement. No one's making a profit out of this endeavor.

>> SAM LICCARDO: Mm-hmm. Okay. Other questions or comments? Yeah. Pat?

>> I -- I think you adequately responded to the public-art issue. That's been remedied. I think that the educational outreach was pretty minimal, and if you brought it up today, I'd support it. Um... And the issues of perceived or suspected misconduct, the only thing I can say is, if we have strong physical evidence to support these allegations, then maybe we could investigate

them, but absent proof, physical evidence, that some of these six things occurred, I don't know how we can proceed. But I do have one -- one question about -- about who is -- represents the individual members on that, on the TPAC committee, the advisory committee. Is that enumerated in the agreement...

>> Yes.

>> ...who will be on? Okay. That's -- That was my only question.

>> SAM LICCARDO: Okay.

>> Yes.

>> That's set forth in the M.A.

>> SAM LICCARDO: Member Davis.

>> And my... David... He brought up -- Well, the art, that was answered. And also, this Christmas in the Park, but you also brought an opposition to an audit? You said something that they will not -- their -- that we have an opposite to an audit.

>> DAVID MEHRETU: No, I said I can't imagine why San José would be opposed to an audit.

>> So -- And then you said this rebudgeted item, what is -- Can someone just explain that to me?

>> DAVID MEHRETU: Sure. There's a budget, and that's how the Tributary Agencies are initially charged. And then there's a true-up, where, basically, the plant looks at the actual costs and says, "Okay. We told you we're gonna pay \$100 million or whatever, \$1 million. Actually, the cost was \$900,000. So you get \$200,000 back." That's the true-up. When we get the true-up, it's supposed to represent actual costs, but sometimes there are line items that say

"rebudgeted." There's no explanation for what that means. There's no explanation for what it is. There's no underlying documents for that. And the problem is, unlike perhaps the public art that, you know, has, essentially, to me, sort of been explained away, these are large items. They're sometimes the largest items in the third-quarter billing, and it's just vague. We don't know what it means, and our public accountants cannot figure out what it means. There's no underlying documents. And there's no description of how the true-up is prepared, which is an express requirement in the master agreement. This is not sort of a fuzzy "we can choose to do it or not."

>> So that's where this transparency issue comes into. Can you answer that question, or...?

>> Yes, and my position would be the reconciliation documents. Those, in fact, set forth the basis for rebudget. In fact, the Agencies were provided far more than that. They were provided the backup accounting documents for that. And...to test each transaction, then the appropriate forum would have been to meet together and say, "I want the invoices for this specific transaction," and we would have been happy to provide that. But the fact of the matter is, if you want every single invoice for every single receipt for every single transaction that crosses half a dozen departments, in terms of this city, you know auditors don't function that way. What they do is, they look at these accounting reports, and then they test the transactions. We then track down those invoices, and they verified that that was the case. If there was a question about a rebudget in the third-quarter reconciliation, then they locate the records that support the rebudgeted amount, where did this filing come from, where did it go, and they follow the documents, and we provided those documents to the Agencies.

>> Okay. Well, David seems to think you're not doing that job, so, okay. All right. And then the other thing was... You said something about an audit --

>> SAM LICCARDO: Could you pull the microphone closer?

>> Oh, sorry.

>> SAM LICCARDO: Yep.

>> Oh, my gosh. I keep forgetting about this microphone stuff here. You also said something about a concern with... I think I wrote this down. Concern with financing audits. So, I kind of --

>> DAVID MEHRETU: Citywide audit.

>> You were speaking, and I was kind of writing really fast. So, something about a -- I guess a concern for financing audits. So, is that where -- Is it part of this rebudgeting thing? Was that in that same vein?

>> DAVID MEHRETU: Well, I think what you're referring to is the citywide audit. I hope I didn't refer to it as the financing audit, but maybe I did.

>> Okay. All right.

>> DAVID MEHRETU: But the --

>> The finance audit. That's it. Okay.

>> DAVID MEHRETU: Well, the city has an audit conducted on the city. It's a citywide audit. And the owners's response has been that, "Listen, you can look to the citywide audit to figure out whether we're doing things -- or, we're complying with the master agreements at the plant." The citywide audit is not designed to test compliance with the master agreements. The master agreements have numerous provisions that say, "Do X, Y, and Z." The citywide audit is not looking at that at all. So it just doesn't -- It just doesn't relate to the master agreements. That's just our point.

>> So, are you looking -- Are you looking for a deeper dive, separating the plant from city business?

>> DAVID MEHRETU: That -- Well, those are -- I think those are two different things. We're looking for a separate audit.

>> Okay.

>> DAVID MEHRETU: A separate issue. And as Rosa noted, audits don't just look at everything. They test. They do deep dives into specific transactions. But to suggest that the Tributary Agencies, on their own, kind of have to do these ad hoc audits and sort of beg for extra information, it's my understanding, actually, that we have already done that, and we haven't gotten anywhere. I think it's inappropriate. We are entitled to audit compliance.

>> Okay.

>> DAVID MEHRETU: That's a legal requirement.

>> Okay. Thank you.

>> SAM LICCARDO: Rosa, could I ask, how many pages of documents have been provided so far in response to PRAs and other requests over the last couple of years in this dispute?

>> Around 50,000. But I would like to point out that there isn't actually an audit requirement in the master agreement. We are required to keep proper records, and the Agencies, even though the master agreement doesn't expressly provide it, are free to come in and audit our records. And I'm not at liberty to disclose the extensive discussions we've had, but the devil is always in the detail, in terms of what each agency is willing to do. So...

>> SAM LICCARDO: Right. So, just to understand it. So, we've produced 50,000 pages of documents so far. And if any agency had questions about, "Hey, this issue about recycled water infrastructure, is this really about rehabilitation, or is it about expansion? Show me additional

documents that substantiate what exactly you're spending money on," they could come in and give them a couple boxes of receipts, and they can look at all those documents?

>> Well, I think what happens with the reliability projects, as an example, is you have a strategic master plan. But in order for any of these projects to go forward, there has to be a contract or a project that's associated with it, and at that point in time, they have to describe, "What is the purpose of this project? Is it, in fact, for reliability?" And it comes before TPAC, and that's when the conversation is, "Well, if TPAC doesn't believe it's for reliability, then your recommendation is to not proceed." But there's usually extensive council meetings, technical meetings. That is available to the Agencies as to the purpose of each project before the money is actually spent.

>> SAM LICCARDO: So you're saying... Let me go back for a moment. First, what we're saying is, the information would be available before the decision's made. Now I'm asking you, after the decision is made, is there any reason why a particular agency can't come to you and say, "Hey, can we look at the invoices on that project to make sure the dollars were spent the way they were supposed to be spent?"

>> There is no reason why. They would all be public records.

>> SAM LICCARDO: Okay. All right. Questions? Anything more? All right. So, we have a motion, I believe, to uphold the claim of breach. That was by member Gatto, and it was seconded, I believe, by member Grilli. I'm gonna post that motion. Any other comments? All right. On the motion, all in favor?

>> JOHN GATTO: Aye.

>> Aye.

>> Aye.

>> SAM LICCARDO: There are three ayes.

>> I want to uphold it. If I uphold this, are they still gonna work this out? Is that what we're doing? Not shutting them down? There's still a conversation going on here?

>> SAM LICCARDO: [Chuckles] I don't know exactly how to answer that question. There's gonna be negotiations before, after, and during all this, but, Rosa, do you want to respond?

>> Upholding the claim would be basically saying that they have no obligation to pay for the capital improvement project, because the second claim expressly says that the master agreement does not authorize San José and Santa Clara for charging them for the projects. It also would uphold their claim that they've been mischarged for public art, for the recycled-water program -

>> Okay. Then I have to change -- Okay. So long as the dialogue is still going and we're still going to have a conversation, but, okay. So I can't uphold it because you did explain a lot of this away. In my view. But I still think that there's room for some conversation with them.

>> SAM LICCARDO: Mm-hmm.

>> Because they don't have a place at the table. I just kind of think that it would be fair that they have information to them, for them. It's just -- I look at fair and balanced, so... That's just how I feel.

>> SAM LICCARDO: Okay. Let's take it back again. Let's make sure everyone's clear about the vote. The motion is to uphold the claim for breach of contract. All in favor?

>> JOHN GATTO: Aye.

>> Aye.

>> SAM LICCARDO: Okay. Three aye. All opposed? No.

>> No.

>> No.

>> No.

>> No.

>> No.

>> SAM LICCARDO: Okay. 2, 3, 4, 5, 6 opposed. All right. That motion fails. Entertain another motion?

>> Motion to deny this claim.

>> SAM LICCARDO: All right. Motion to deny.

>> Second.

>> SAM LICCARDO: All in favor?

>> Aye.

>> Aye.

>> Aye.

>> Aye.

>> SAM LICCARDO: All opposed?

>> Aye.

>> No.

>> SAM LICCARDO: Okay. [Laughter] We'll take that as a no.

>> Yeah, a no.

>> SAM LICCARDO: 6 to 3 -- that passes.

>> I'm not leaving 'cause I lost the no vote.

>> SAM LICCARDO: I understand. [Laughter] I understand. You're not storming out.
Understood. Good luck. Good luck.

RD:JLP
10/10/2017

ATTACHMENT D
SAN JOSÉ/SANTA CLARA REGIONAL WASTEWATER FACILITY
SECOND ADMINISTRATIVE CLAIM HEARING, DATED MAY 18, 2017



**San José-Santa Clara
Regional Wastewater Facility**
Second Administrative Claim Hearing
May 18, 2017



TPAC Findings: First Administrative Claim

- Master Agreements require Agencies to pay for future improvements.
- Agencies have not been overcharged for future improvements.
- Co-Owners have not breached the Master Agreements or acted inequitably in seeking amendments to the Master Agreements to confirm participation in financing.
- The Agencies' allegations related to lack of transparency is unsupported.

Administering Agency

- “[M]aintain, repair, expand, replace, improve and operate the treatment Plant, and to do any and all things which it shall find to be reasonably necessary, with respect to its maintenance, repair, expansion, replacement, improvement and operation.” (Exhibit E, Section B(1))
- “To make, award and enter into contracts with third parties for the construction, improvement, replacement, expansion, or repair of the Treatment Plant.” (Exhibit E, Section B(2))

Legislative History

It was the intent of the representatives in drafting this Agreement to provide a document that could be easily revised and updated as necessary. To that end, the Agreement is substantially comprised of Exhibits. These Exhibits will be updated as necessary so current information can be easily incorporated without the necessity of revising the entire Agreement. This Agreement replaces the original Master Agreements, the Settlement Agreement, and various other agreements that have been executed by the Agencies over the last fifteen years.

History of Amendments to the Master Agreements

- First Amendments to Master Agreements to reflect participation in treatment plant capacity expansion (December 1985);
- Second Amendments to Master Agreements to reflect cost share between Agencies for development of a reclamation program (SBWR) as required by the Regional Water Quality Control Board before issuance of bonds to finance the program (December 1995);
- Third Amendment to West Valley Master Agreement to sell one million gallons per day (1mgd) contract capacity to the City of Milpitas (August 2006);
- Third Amendment to City of Milpitas Master Agreement to purchase one million gallons per day (1 mgd) contract capacity from West Valley Sanitation District (July 2006);
- Third Amendment to Cupertino Sanitary District Master Agreement to sell seven hundred and fifty thousand gallons per day (.75 mgd) of contract capacity to the City of Milpitas (August 2009); and
- Fourth Amendment to City of Milpitas Master Agreement to purchase seven hundred and fifty thousand gallons per day (.75 mgd) of contract capacity from Cupertino Sanitary District (August 2009).

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Compare Definitions

- California State Revenue Guidelines
(State Water Resource Control Board March 1998 Edition Appendix G)
- Operation and Maintenance, including Replacement Costs
 - “[I]nclude the costs of labor, power, chemicals, supplies, laboratory control and monitoring, general administration, billing, and incidental items incurred during operation...replacement and other administrative costs, such as overhead and accounting which are directly related to the O.M.&R.”
 - Replacement
 - » “[I]nclude all expenditures required for a facility to operate for its design life. Replacement cost does not include the following capital costs:”
- Capital Costs
 - “Major rehabilitations which may be needed as individual unit processes near the end of their useful life;
 - Structural rehabilitations; or
 - Facility expansions or upgrades to meet future users demands or upgrade treatment.”

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Compare Definitions

- Master Agreements
- Operation and Maintenance Costs (Part I, Section K)
 - “[A]ny and all costs and expenses incurred by the Administering Agency, for the administration, operation, maintenance and repair of the Plant, including but not limited to supplies and materials, labor, services, power, laboratory control and monitoring, insurance, general administration and incidental items incurred during normal operations. Also included are those expenditures for ordinary repairs necessary to keep the facilities in proper operating conditions.”
- Replacement Costs (Part I, Section N)
 - “[A]ll capital expenditures for obtaining and installing equipment, accessories or appurtenances which are necessary during the service life of the Plant to maintain the capacity and performance for which the Plant was designed and constructed except:
 - » Major rehabilitations which may be needed as individual unit processes near the end of their useful life;
 - » Structural rehabilitations; or
 - » Facility expansions or upgrades to meet future users demands or upgrade treatment.”

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Section C Payment For Future Improvements

- “All payments associated with future improvements at the Plant shall be made on the basis of Agency’s existing capacity rights.” (Part V, Section C “Payment for Future Improvements”)
- “All payments for capital... shall be on a quarterly basis... These invoices shall be presented at the beginning of the quarter in which the obligation is anticipated to occur... These payments shall be based upon the budget for capital costs for the Plant as recommended by TPAC and approved by the Administering Agency.” (Part V, Section E(1) “Capital and Land Acquisition”)

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Examples of Improvements

- WPCP Reliability Improvements Project (\$85M) FY08-09
- Electrical Reliability Improvements (\$23M) FY13-14, FY14-15
- Alternative Disinfection Facility (\$10.9M) FY 12-13
- Handrail Replacement (\$4M) FY08-09 to FY 15-16
- Fire Main Replacement (\$3.65M) FY 07-08 to FY 14-15

Project Packages

#	Package	Project	Estimated Start
1	Energy & Automation	Cogeneration Facilities	November 2013
2	Energy & Automation	Digester Gas Compressor	November 2013
3	Energy & Automation	Digester Gas Holder	November 2013
4	Energy & Automation	Electrical Reliability	November 2013
5	Energy & Automation	Emergency Generators	November 2013
6	Facilities	Handrail Replacement	November 2013
7	Primary Treatment	Iron Salt Facilities	November 2013
8	Solids Processing	Digester & DAFT Facilities Upgrades	November 2013
9	Facilities	Instrumentation Air	December 2013
10	Energy & Automation	Advanced Facility Control	February 2014
11	Filtration & Disinfection	Outfall R&R	March 2014
12	Facilities	Facility Wide Water Systems	July 2014
13	Headworks	Near-Term Headworks Improvements Package	July 2014
14	Headworks	New Headworks	July 2014
15	Secondary Treatment	Final Clarifier Rehabilitation & Repair	July 2014
16	Solids Processing	Digested Sludge Dewatering Facility	July 2014
17	Filtration & Disinfection	Filter R&R	September 14

Project Packages

#	Package	Project	Estimated Start
18	Facilities	Record Drawings Standardization of P&ID Documents	January 2015
18	Secondary Treatment	Aeration Tanks Rehabilitation & Repair	January 2015
19	Facilities	Support Building Improvements	March 2015
20	Facilities	Tunnel Rehabilitation	June 2015
21	Facilities	Yard Piping & Road Improvements	June 2015
22	Primary Treatment	East Primaries Rehabilitation & Repair	January 2016
23	Solids Processing	Lagoons & Drying Bed Retirement	January 2016
24	Secondary Treatment	BNR1 Clarifier Rehab Demonstration	January 2017
25	Solids Processing	Thermal Dryer Facility	January 2019
26	Filtration & Disinfection	New Disinfection Package	April 2019
27	Filtration & Disinfection	Alternative Filter Technology Field Verification	July 2019
28	Filtration & Disinfection	Alternative Filter Technology Field Verification	July 2019
29	Filtration & Disinfection	Final Effluent Pump Station & Stormwater Channel Improvements	July 2019
30	Secondary Treatment	Aeration Basin Future Modifications	July 2019
31	Solids Processing	Additional Digester Facility Upgrade	July 2019
32	Solids Processing	FOG Receiving	July 2019
33	Solids Processing	Greenhouse Demonstration	January 2020

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Treatment Contingent on Payment of Costs

- "If for any reason the contract cannot be renewed in the year 2031, or subsequent to the termination date, the discharging Agency shall have the right to continue discharging to the Plant, provided all payments of Agency's share of Plant costs are made. All other rights under this Agreement shall cease." (Part VII, Section C "Use of Treatment After Expiration of Term")

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Treatment Contingent on Payment of Costs

- "City of San Jose shall be reimbursed from Treatment Plant funds for all costs and expenses incurred by it as Administering Agency of this Agreement, including, but not limited to, salaries and wages paid by San Jose to its officers and employees..."
- "[o]verhead expenses incurred by San Jose in furnishing said services and in administering this Agreement, to wit: payments made by San Jose for retirement benefits, payments made by San Jose for medical and hospital insurance covering officers and employees, miscellaneous overhead expenses of the auditing, purchasing and engineering departments of San Jose."
- "The percentage or amount of overhead allowance or expense payable to San Jose shall be increase or decreased from year to year to truly reflect actual overhead and incidental costs and expenses incurred by San Jose..." (Exhibit E, Section D)

Records

- Budget
- Invoices
- Reconciliation
- Public Records Act

Wastewater Treatment Costs

- SBWR/AWTF
- Capital Project Art Element
- Program Outreach (Christmas in the Park)

Findings to Second Administrative Claim

- The Agencies are required to pay their proportionate share of the capital cost for future improvements under the Master Agreements.
- The Agencies have been provided sufficient records relating to accounting of revenues and costs for the Wastewater Treatment Program.
- The Agencies were properly charged for overhead, SBWR/AWTF, public art, and educational outreach.