

RESOLUTION 2005---+1 2+-7 ::R

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF SAN MARCOS, TEXAS, APPROVING THE TERMS AND CONDITIONS OF A SERVICE CONTRACT FOR WATER TREATMENT FACILITIES OPERATIONS AND ASSET MANAGEMENT BETWEEN THE CITY AND THE GUADALUPE-BLANCO RIVER AUTHORITY; AUTHORIZING THE CITY MANAGER TO EXECUTE THIS AGREEMENT ON BEHALF OF THE CITY AND DECLARING AN EFFECTIVE DATE.

RECITALS:

1. The City has determined that it is in the City's best interests to contract with a third-party operator on a long-term basis to operate and maintain certain water treatment facilities assets and to meet the requirements of applicable law.

2. The City issued a request for proposals on January 11, 2004 to certain firms for the provision of water treatment facilities operations, and set forth in the RFP the criteria for selection of the preferred proponent. Four addenda to the RFP were issued on February 20, 2004, February 23, 2004, February 26, 2004 and March 3, 2004 respectively.

3. Proposals submitted in response to the RFP were received on March 11, 2004.

4. A Request for Clarification was issued on September 21, 2004. Three addenda to the Request for Clarification were issued on October 5, 2004, November 1, 2004 and November 15, 2004 respectively. Proposal clarification submittals were received on November 29, 2004.

5. Based on an evaluation utilizing the evaluation factors and selection criteria and following the review and selection process identified in the RFP, the City selected the proposal submitted by the Guadalupe-Blanco River Authority as the most advantageous proposal received in response to the City's RFP with respect to water treatment system operations.

6. In February 2005 the City initiated the contract negotiations with the Guadalupe-Blanco River Authority which have concluded with the Service Contract for Water Treatment Facilities Operations and Asset Management attached to this Resolution.

BE IT RESOLVED BY THE CITY COUNCIL OF THE CITY OF SAN MARCOS, TEXAS:

PART 1. The terms and conditions of the attached Service Contract for Water Treatment Facilities Operations and Asset Management between the City of San Marcos and the Guadalupe-Blanco River Authority is approved.

PART 2. The City Manager, Dan O'Leary, is authorized to execute the agreement on behalf of the City.

PART 3. This Resolution shall be in full force and effect immediately from and after its passage.

ADOPTED this the 20th day of September, 2005.

r:Fo-
Mayor

Attest
CV -jf.
-
:

Janis K. Womack
City Clerk

SERVICE CONTRACT
FOR
WATER TREATMENT FACILITIES OPERATIONS
AND ASSET MANAGEMENT

between

THE CITY OF SAN MARCOS, TEXAS

and

GUADALUPE-BLANCO RIVER AUTHORITY

Dated

September 20, 2005

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City Utility Contracts

1. Amended and Restated Water Transportation Agreement Between the City of San Marcos, Texas and the City of Kyle, Texas, dated August 6, 2002
2. Agreement for Financial Participation in Surface Water Treatment Plant Project between the Edwards Aquifer Authority and the City of San Marcos dated March 12, 1992, as amended by Amendment No. 1 effective June 1, 2000

SERVICE CONTRACT
FOR
WATER TREATMENT FACILITIES OPERATIONS
AND ASSET MANAGEMENT

THIS SERVICE CONTRACT FOR WATER TREATMENT FACILITIES OPERATIONS AND ASSET MANAGEMENT ("Service Contract") is made and entered into as of this 20th day of September, 2005 in Hays County, Texas between the City of San Marcos, Texas, a municipal corporation organized and existing under the laws of the State of Texas (the "City"), and Guadalupe-Blanco River Authority, a conservation and reclamation district and political subdivision of the State of Texas created pursuant to Article XVI, Section 59 of the Texas Constitution by special act of the Legislature, formerly compiled at Article 8280-106, Vernon's Annotated Civil Statutes (the "Authority") .

RECITALS

(A) The City currently owns the City of San Marcos, Texas water treatment system.

(B) The City is responsible for the treatment and distribution of potable water in the City's service area.

(C) The City's water treatment system consists of a surface water treatment plant (the "Plant"), water wells, storage reservoirs, pipes, mains, valves, and treatment equipment owned by the City.

(D) The Authority has operated and maintained the Plant since the time the Plant first became operational, under a contract between the parties dated May 11, 1999, and the Authority is familiar with the design, layout, operation and condition of the Plant.

[E] The City has determined that it is in the City's best interests to contract with a third-party operator on a long-term basis to operate, maintain, repair, replace and manage certain water treatment system assets and to meet the requirements of applicable law.

(F) The City issued a request for qualifications and expressions of interests ("RFQEI") to entities interested in providing water treatment system operations and asset management services to the City.

(G) The City, based on the technical and financial qualifications set forth in the RFQEI, determined Guadalupe-Blanco River Authority and OMI, Inc. to be qualified.

(H) The City issued a request for proposals on January 11, 2004 (the "RFP") to the prequalified firms to provide water treatment system operations, and set forth in the RFP the criteria for selection of the preferred proposer. Four addenda to the RFP were issued on February 20, 2004, February 23, 2004, February 26, 2004, and March 3, 2004, respectively. The City provided potential proposers with reasonable access to the water treatment system to allow them the opportunity to review documentation and to conduct such inspections and

reviews as they deemed necessary to become familiar with the water treatment system prior to submission of the proposals.

(I) Proposals submitted in response to the RFP were received on March 11, 2004 from the Authority and OMI, Inc.

(J) A Request for Clarification was issued on September 21, 2004. Three addenda to the Request for Clarification were issued on October 5, 2004, November 1, 2004 and November 15, 2004, respectively. Proposal clarification submittals were received from each of the proposers on November 29, 2004.

(K) Based on an evaluation utilizing the evaluation factors and selection criteria and following the review and selection process identified in the RFP, the City selected the proposal submitted by the Authority as the most advantageous proposal received in response to the City's RFP with respect to water treatment system operations.

(L) In February 2005, the City initiated the contract negotiations with the Authority which have concluded with this Service Contract.

(M) On September 20, 2005, the City Council adopted a resolution authorizing the execution and delivery of this Service Contract.

[N] The water treatment system will continue to be owned by the City and certain water assets will be operated, maintained, repaired, replaced and managed by the Authority.

[O] The Authority owns and operates a delivery system that delivers Raw Water to the Plant (the "San Marcos Raw Water Delivery System").

[P] The Authority is in the process of constructing a treated water delivery system that will transmit treated water from the Plant to customers of the City and the Authority generally located between the City of San Marcos and the City of Buda (the "IH 35 Project"). The IH-35 Project may result in a need to increase the capacity of the Plant.

[Q] The City and the Authority entered into an Agreement dated July 1, 1997, as amended by that certain letter agreement between the City and the Authority dated December 9, 2003, that provides, among other things, for delivery of raw water to the Plant, for potential expansion of the Plant for the City's and/ or the Authority's use, and for delivery of treated water from the Plant to City and Authority customers (the "Regional Agreement") and it is the intent of the parties that this Service Contract does not modify or amend the rights and obligations of the parties under the Regional Agreement or any other existing agreements, other than the current operating contract between the parties dated May 11, 1999.

[R] The City desires to receive, and the Authority desires to provide water treatment system operations and asset management services under the terms of this Service Contract.

NOW, THEREFORE, in consideration of the mutual covenants herein contained, the parties hereto, intending to be legally bound, agree as follows:

ARTICLE I

DEFINITIONS AND INTERPRETATION

SECTION 1.1. DEFINITIONS. As used in this Service Contract, the following terms shall have the meanings set forth below:

"Affiliate" means any person directly or indirectly controlling or controlled by another person, corporation or other entity or under direct or indirect common control with such person, corporation or other entity.

"Appendix" means any of the Appendices attached to this Service Contract, as the same may be amended or modified from time to time in accordance with the terms hereof.

"Applicable Law" means: (1) any federal, state or local law, code, or regulation; (2) any formally adopted and generally applicable rule, requirement, determination, standard, policy, implementation schedule, or other order of any Governmental Body having appropriate jurisdiction; (3) any established interpretation of law or regulation utilized by an appropriate Governmental Body if such interpretation is documented in writing by such Governmental Body and generally applicable; (4) any Governmental Approval applicable to the Facilities or the Contract Services; and (5) any consent order or decree, settlement agreement or other similar agreement between the City and any Governmental Body, in each case having the force of law and applicable from time to time: (a) to the siting, permitting, design, acquisition, construction, equipping, financing, ownership, possession, start-up, testing, operation, maintenance, repair, replacement or management of water facilities or systems, including the Facilities; (b) to the conveyance, delivery, treatment, storage, supply of water to and from the Facilities; (c) to the air emissions from the Facilities; (d) to the transfer, handling, processing, transportation or disposal of Residuals produced from the Facilities; and (e) to any other transaction or matter contemplated by the Service Contract (including any of the foregoing which pertain to water treatment, Residuals and waste disposal, health, safety, fire, environmental protection, labor relations, building codes, the payment of prevailing or minimum wages and non-discrimination).

"Authority" means Guadalupe-Blanco River Authority, a conservation and reclamation district and political subdivision created and existing under the laws of the State of Texas, and its permitted successors and assigns.

"Authority Breach" means any breach (including the untruth or breach of any Authority representation or warranty herein set forth), failure, nonperformance or non-compliance by the Authority with respect to its obligations under this Service Contract to the extent not directly attributable to any Uncontrollable Circumstance or City Breach, and

which materially and adversely affects the City's rights, obligations or ability to perform under this Service Contract.

"Bankruptcy Code" means the United States Bankruptcy Code, 11 U.S.C. §§ 101 et seq., as amended from time to time, and any successor statute thereto. "Bankruptcy Code" shall also include any similar state law relating to bankruptcy, insolvency, the rights and remedies of creditors, the appointment of receivers or the liquidation of companies and estates that are unable to pay their debts when due.

"Base Fee" has the meaning specified in Section 10.3.

"Billing Period" means each calendar month, except that (1) the first Billing Period shall begin on the Commencement Date and shall continue to the last day of the month in which the Commencement Date occurs and (2) the last Billing Period shall end on the last day of the Term of this Service Contract. Any computation made on the basis of a Billing Period shall be adjusted on a pro rata basis to take into account any Billing Period of less than the actual number of days in the month to which such Billing Period relates.

"Capital Modification" means any material change made to the Facilities, including the installation of new structures, equipment, systems or technology.

"Change in Law" means any of the following acts, events or circumstances to the extent that compliance therewith materially increases or decreases the cost of performing or materially increases or decreases the scope of a party's obligations hereunder:

- (a) the adoption, amendment, promulgation, issuance, modification, repeal or written change in administrative or judicial interpretation of any Applicable Law on or after the Contract Date, unless such Applicable Law was on or prior to the Contract Date duly adopted, promulgated, issued or otherwise officially modified or changed in interpretation, in each case in final form, to become effective without any further action by any Governmental Body;
- (b) the order or judgment of any Governmental Body issued on or after the Contract Date (unless such order or judgment is issued to enforce compliance with Applicable Law which was effective as of the Contract Date) to the extent such order or judgment is not the result of willful or negligent action, error or omission or lack of reasonable diligence of the Authority or of the City, whichever is asserting the occurrence of a Change in Law; provided, however, that the contesting in good faith or the failure in good faith to contest any such order or judgment shall not constitute

- or be construed as such a willful or negligent action, error or omission or lack of reasonable diligence; or
- (c) except with respect to any Governmental Approval required for the Facilities as provided within (b) below pertaining to exclusions from "Changes in Law", the denial of an application for, a delay in the review, issuance or renewal of, or the suspension, termination, or interruption of any Governmental Approval, or the imposition of a term, condition or requirement which is more stringent or burdensome than the Contract Standards in effect as of the Contract Date in connection with the issuance, renewal or failure of issuance or renewal of any Governmental Approval, to the extent that such occurrence is not the result of willful or negligent action, error or omission or a lack of reasonable diligence of the Authority or of the City, whichever is asserting the occurrence of a Change in Law; provided, however, that the contesting in good faith or the failure in good faith to contest any such occurrence shall not be construed as such a willful or negligent action or lack of reasonable diligence.

It is specifically understood, however, that none of the following shall constitute a "Change in Law":

- (a) with respect to the City (but not the Authority), Changes in Law made by the City, other than Changes in Law required by federal or State Changes in Law or due to a manifest danger to public health or the environment;
- (b) acts, events and circumstances with respect to which the Authority has assumed the permitting risk under the Service Contract;
- (c) a change in the nature or severity of the actions typically taken by a Governmental Body to enforce compliance with Applicable Law which was effective as of the Contract Date; or
- (d) any event that affects generally applicable working conditions or standards that are not specific to the water industry or to the Facilities, or that does not require a Capital Modification.

"Change Order" means a written order of the City signed by the City's Contract Representative authorizing and approving a change to any Capital Modification pursuant to Section 9.1.

"Chemical Cost Adjustment Factor" has the meaning set forth in subsection 10.6(B).

"City" means the City of San Marcos, Texas, a municipal corporation organized and existing under the laws of the State of Texas.

"City Breach" means any breach (including the untruth or breach of any City representation or warranty herein set forth), failure, nonperformance or non-compliance by the City with respect to its obligations under this Service Contract to the extent not directly attributable to any Uncontrollable Circumstance or Authority Breach, and which materially and adversely affects the Authority's rights, obligations or ability or costs to perform under this Service Contract.

"City Indemnatee" means the City and its officers, agents and employees.

"City Property" means any structures, improvements, equipment, fire alarm systems, wastewater and water mains, valves, pumping systems, hydrants, hydrant connections, duct lines, streets, lamps, lampposts, monuments, sidewalks, curbs, trees or any other systems, fixtures, or real or personal property owned, leased, operated, maintained, or occupied by the City.

"City Utility Contracts" means the contracts listed as "City Utility Contracts" in the table of contents to this Service Contract.

"Commencement Date" means the first date on which all of the Commencement Date Conditions shall be satisfied or waived, as agreed to in writing by the parties pursuant to Section 4.4.

"Commencement Date Conditions" has the meaning specified in Section 4.3.

"Consumables" means those materials, supplies and similar consumables generally used in connection with the operation and management of infrastructure such as the Facilities, which may include, but are not limited to, fuel oil, diesel fuel, chlorine, quick lime, coagulants, sand, activated carbon, cartridge filters, lubricants, polymers, and other chemicals, office supplies, fuels, materials, supplies and similar consumables.

"Contract Administration Memorandum" has the meaning set forth in subsection 14.2(B).

"Contract Administrator" has the meaning specified in Section 14.3.

"Contract Date" means the date this Service Contract is executed and delivered by the parties hereto.

"Contract Representative" means, in the case of the Authority, the individual specified in writing from time to time by the Authority as the representative of the Authority for purposes of this Service Contract and, in the case of the City, the Director of Water and Wastewater Utilities or such other representative as shall be designated in writing by the City from time to time.

"Contract Services" means everything required to be furnished and done for and relating to the Facilities by the Authority pursuant to this Service Contract during the Term hereof. Contract Services include the employment and furnishing of all labor, materials, equipment, supplies, tools, storage, transportation, insurance except property damage insurance, sales, delivery and other things and kinds of services whatsoever necessary for the full performance of the Authority's operation, maintenance, repair, replacement, management and related obligations under this Service Contract, and all of the Authority's administrative, accounting, record-keeping, reporting, notification and similar responsibilities of every kind whatsoever under this Service Contract pertaining to such obligations.

"Contract Standards" means the terms, conditions, methods, techniques, practices and standards imposed or required by: (1) Applicable Law; (2) the Performance Guarantees; (3) Good Engineering and Construction Practice; (4) Good Industry Practice; (5) the Operation and Maintenance Manual; (6) generally-accepted operation and maintenance standards; (7) generally-accepted repair and replacement standards; (8) equipment manufacturers' specifications applicable to the Facilities; (9) Insurance Requirements applicable to the Service Contract; and (10) any other standard, term, condition or requirement specifically provided in this Service Contract to be observed by the Authority. Subsection 1.2 (M) shall govern issues of interpretation related to the applicability and stringency of the Contract Standards.

"Contract Year" means the City's fiscal year commencing on October 1 in any year and ending on September 30 of the following year; provided, however, that the first Contract Year shall commence on the Commencement Date and shall end on the following September 30, and the last Contract Year shall commence on October 1 prior to the date this Service Contract expires or is terminated, whichever is appropriate, and shall end on the last day of the Term of this Service Contract or the effective date of any termination, whichever is appropriate. Any computation made on the basis of a Contract Year shall be adjusted on a pro rata basis to take into account any Contract Year of less than 365 days.

"Cost Substantiation" has the meaning described in Section 14.7.

"Designated Employee" means the employee currently employed by the City to operate and maintain the Wells, as identified in Appendix 5.

"ECI" means the Employment Cost Index published by the Bureau of Labor Statistics (the "BLS"), Not Seasonally Adjusted, Private Industry, South Region, Series J.D. ECU 132021, or similar data if the BLS ceases to publish this index.

"Encumbrance" means any Lien, lease, mortgage, security interest, charge, judgment, judicial award, stop-notice, attachment or encumbrance of any kind with respect to the Facilities.

"Enhanced Standards" means those standards set forth in Section 7.2 and Appendix 6.

"EPA" means the United States Environmental Protection Agency and any predecessor or successor agency.

"Event of Default" means, with respect to the Authority, those items specified in Section 11.2, and with respect to the City, those items specified in Section 11.3.

"Extraordinary Items Component" has the meaning set forth in Section 10.5.

"Facilities" means the Plant, the Plant Site, the Pump Stations, and the Wells and related facilities and equipment as described in Sections 1.1 through 1.5 of Appendix L

"Facilities Equipment" means all of the manufactured equipment, property or assets, whether or not constituting personal property or fixtures, constituting part of the Facilities. "Facilities Equipment" is further described in Appendix 1.

"Facilities Manager" has the meaning set forth in Section 6.5.

"Fees and Costs" means reasonable fees and expenses of employees, attorneys, architects, engineers, expert witnesses, contractors, consultants and other persons, and costs of transcripts, printing of briefs and records on appeal, copying and other reimbursed expenses, and expenses reasonably incurred in connection with investigating, preparing for, defending or otherwise appropriately responding to any Legal Proceeding.

"Finished Water" means Raw Water that has been treated at the Plant in accordance with the requirements set forth herein.

"Good Engineering and Construction Practice" means those methods, techniques, standards and practices which, at the time they are to be employed and in light of the circumstances known or reasonably believed to exist at such time, are generally recognized and accepted as good design, engineering, equipping, installation, construction and commissioning practices for the design, construction and improvement of capital assets in the water utility industry as followed in the State.

"Good Industry Practice" means those methods, techniques, standards and practices which, at the time they are to be employed and in light of the circumstances known or reasonably believed to exist at such time, are generally recognized and accepted as good operation, maintenance, repair, replacement and management practices in the water treatment industry as observed in the State.

"Governmental Approvals" means all orders of approval, permits, licenses, authorizations, consents, certifications, exemptions, registrations, rulings, entitlements and approvals issued by a Governmental Body of whatever kind and however described which are required under Applicable Law to be obtained or maintained by any person with respect to the Contract Services.

"Governmental Body" means any federal, State, regional or local legislative, executive, judicial or other governmental board, agency, authority, commission, administration, court or other body, or any official thereof having jurisdiction.

"Guaranteed Maximum Chemical Utilization" has the meaning set forth in Section 10.4.

"Guaranteed Maximum Electricity Utilization" has the meaning set forth in Section 10.4.

"Hazardous Material" means any waste, substance, object or material deemed hazardous under Applicable Law.

"ICI" means the Producers Price Index-Commodities published by the BLS, Not Seasonally Adjusted, Chemical and Allied Products-Industrial Chemicals, Series I.D. WPU061, or similar data if the BLS ceases to publish this index.

"Independent Evaluator" means a qualified independent evaluator or evaluation firm with demonstrated skill and experience in the evaluation of utility property, not otherwise associated with the transactions contemplated hereby, selected with the mutual consent of the parties for the purpose of evaluating and determining the condition of the Facilities pursuant to Section 8.2. The Independent Evaluator may be an engineer or other technical professional competent to perform such services.

"Initial Term" has the meaning specified in Section 3.1.

"Insurance Requirement" means any rule, regulation, code, or requirement issued by any fire insurance rating bureau or any body having similar functions or by any insurance company which has issued a policy of Required Insurance under this Service Contract, as in effect during the Term hereof, compliance with which is a condition to the effectiveness of such policy.

"kWh" means kiloWatthours.

"Legal Proceeding" means every action, suit, litigation, arbitration, administrative proceeding, and other legal or equitable proceeding having a bearing upon this Service Contract, and all appeals therefrom.

"Letter of Credit" has the meaning specified in Section 13.1.

"Lien" means any and every stop-notice and lien against the Facilities or against any monies due or to become due from the City to the Authority under this Service Contract, for or on account of the Contract Services, including mechanics', materialmen's, laborers' and lenders' liens.

"Loss-and-Expense" means any and all actual loss, liability, forfeiture, obligation, damage, fine, penalty, judgment, deposit, charge, Tax, cost or expense, including all

Fees and Costs, except as explicitly excluded or limited under any provision of this Service Contract.

"Major Maintenance Repair and Replacement Schedule" has the meaning specified in subsection 8.1(C).

"Materially" in the context of Changes in Law and Uncontrollable Circumstances, means having a cost consequence to a party during a Contract Year of \$1,500 or more. Such costs will be subject to Cost Substantiation as described in Section 14.7.

"Operation and Maintenance Manual" means the manual and related computer programs prepared by the Authority in accordance with Good Industry Practice, and generally containing operating and maintenance procedures and other instructions, policies, directives, routines, schedules and other matters relating to the Contract Services, maintained and updated as required by Article VI and Appendix 3.

"Overdue Rate" means the maximum rate of interest permitted by the laws of the State, if applicable, or the Prime Rate, whichever is lower.

"Pass-through Cost Component" has the meaning set forth in Section 10.4.

"Performance Guarantees" means the guarantees of performance made by the Authority set forth in Article VII.

"Permits" means [1] the TCEQ authorization to operate the Plant and [2] the Edwards Aquifer Authority permits for withdrawal of Edwards Aquifer water through the City's wells.

"Plant" means the San Marcos Surface Water Treatment Plant and the real property on which it is located described in Appendix 1, consisting generally of that separate and contiguous part of the Water Treatment System comprising buildings, structures and equipment, and the roads, grounds, fences and landscaping appurtenant thereto, utilized for treatment of Raw Water, laboratory functions and administration and management of the Facilities, including any Capital Modifications made thereto from time to time. The Plant is located at 91 Old Bastrop Highway, San Marcos, Texas.

"Plant Site" means the parcel of real property described or referred to in Appendix 1 on which the improvements constituting the Plant are located.

"PPI" means the Producer Price Index-Commodities published by the BLS, Not Seasonally Adjusted, Finished Goods, Series I.D. WPUSOP3000, or similar data if the BLS ceases to publish this index.

"Pre-Existing Environmental Condition" means, and is limited to, (1) the presence anywhere in, on or under the Facilities on the Contract Date of undisclosed underground storage tanks (for the storage of chemicals or petroleum products) that are not then in use; and (2) the presence of Hazardous Materials or Regulated Substances in

environmental media anywhere in, on or under the Facilities (including the presence in surface water, groundwater, soils or subsurface strata) as of the Contract Date, unless for both (1) and (2) above, the Authority has caused such condition to occur or knew or should have known that such condition existed prior to the Contract Date.

"Prime Rate" means the prime rate as published in The Wall Street Journal (Eastern Edition), or a mutually agreeable alternative source of the prime rate if it is no longer published in The Wall Street Journal (Eastern Edition) or the method of computation thereof is substantially modified.

"Pump Stations" means those pump stations described in Appendix 1 that are a part of the Facilities and the System.

"Rating Service" means Moody's Investors Service, Inc., Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc., or Fitch, Inc. or any of their respective successors and assigns and, if such corporations shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, "Rating Service" shall be deemed to refer to any other nationally recognized securities rating agency designated by the City.

"Raw Water" means any untreated surface water made available by the City for treatment by the Plant.

"Reference Documents" means the documents identified in Appendix 2 and the City Utility Contracts.

"Regulated Substance" means (1) any oil, petroleum or petroleum product and (2) any pollutant, contaminant, toxic substance, toxic pollutant, solid waste, municipal waste, or industrial waste that is defined as such by and is subject to regulation under any Applicable Law.

"Renewal Term" has the meaning specified in Section 3.2.

"Required Insurance" has the meaning specified in Appendix 9.

"Residuals" means any solid or semi-solid material resulting from the treatment of Raw Water which requires disposal as waste material.

"RFP" means the City's Request for Proposals for Operation, Maintenance and Management of Water Facilities on January 11, 2004, as supplemented and amended by subsequent amendments and requests for clarifications.

"Safety and Security Plan" means the plan developed by the Authority which addresses (1) reasonable precautions for the safety of, and reasonable protection to prevent damage, injury or loss by reason of or related to the operation of the Facilities to (a) all employees working at the Facilities and all other persons who may be involved with the operation or maintenance of the Facilities, (b) all visitors to the Facilities, (c) all machinery,

materials and equipment under the care, custody or control of the Authority on the Site, and (d) other property on the Site; (2) reasonable safeguards for safety and protection, including posting danger signs and other warnings against hazards and promulgating safety regulations; (3) notices and compliance with all Applicable Laws relating to the safety of persons or property or their protection from damage, injury or loss; (4) designation of a qualified and responsible employee at the Facilities whose duty shall be responsible for safety, the prevention of fires and accidents and the coordination of such activities as shall be necessary with federal, State and City officials; (5) operation of all equipment in a manner consistent with the manufacturer's safety recommendations; (6) provision for safe and orderly vehicular movement; and (7) development and carrying out of a safety program for the Facilities, including employee training and periodic inspections, designed to implement the requirements of the plan.

"SCADA" means, in the context of data gathering and telemetry systems, "Supervisory Control and Data Acquisition."

"Senior Supervisor" has the meaning specified in Section 6.5(C).

"Service Contract" means this Service Contract for Water Treatment Facilities Operations and Asset Management between the Authority and the City, including the Appendices and the Transaction Forms, as the same may be amended or modified from time to time in accordance herewith.

"Service Contract Approvals" means all approvals, authorizations, consents or clearances, if any, necessary to be obtained by the City from the EPA, TCEQ, or any other Governmental Body in order for this Service Contract to become effective.

"Service Fee" has the meaning specified in Section 10.1.

"Service Fee Adjustment Factor" has the meaning specified in subsection 10.6(A).

"Service Territory" means those areas within the City of San Marcos' Water Service Certificate of Convenience and Necessity, in which customers are served by the Facilities.

"Specified Site Conditions" means, and is limited to, (1) the presence at the Facilities of site structures, materials or conditions having historical, archaeological, religious or similar significance, (2) the presence at the Facilities of functioning site structures used by Utility providers on, underneath, near or adjacent to the Facilities, if not disclosed to the Authority as of the Contract Date, (3) the presence at the Facilities of any habitat of an endangered or protected species as provided in Applicable Law, and (4) unforeseen site geological conditions that could not have been known by the Authority or reasonably been anticipated or discovered with the exercise of commercially reasonable due diligence by the Authority before the Contract Date.

"Staffing Plan" has the meaning specified in Appendix 4.

"State" means the State of Texas.

"Subcontract" means an agreement or purchase order by the Authority or a Subcontractor to the Authority, as applicable.

"Subcontractor" means a person (other than employees of the Authority) employed or engaged by the Authority or any person directly or indirectly in privity with the Authority (including all subcontractors and every sub-subcontractor of whatever tier) for any portion of the Contract Services, whether for the furnishing of labor, materials, equipment, supplies, services, or otherwise.

"System" means the Water Treatment System.

"Tax" means any tax, fee, levy, duty, impost, charge, surcharge assessment or withholding, or any payment-in-lieu thereof, and any related interest, penalty or addition to tax.

"TCEQ" means the Texas Commission on Environmental Quality or its successor agency as to regulation and/or permitting of the Water Treatment System by the State of Texas.

"Term" has the meaning set forth in Article III.

"Termination Date" means the last day of the Term of this Service Contract.

"Transaction Form" means any of the Transaction Forms appended to this Service Contract.

"Transferred Property" means all vehicles, rolling stock, spare parts, hand tools, furniture and fixtures, computers and communications equipment and Consumables in stock at the Facilities and having operational utility which are to be transferred to the Authority on the Commencement Date for its use, as described in Appendix 1.

"Transition Period" means the period from the Contract Date to, and including, the day preceding the Commencement Date, during which the parties will carry out their transition obligations under Article IV.

"Unaccounted-For Water" means that portion of the Raw Water entering the Plant that is not delivered to water customers as Finished Water.

"Uncontrollable Circumstance" means any act, event or condition that is beyond the reasonable control of the party relying thereon as justification for not performing an obligation or complying with any condition required of such party under the Service Contract, and that materially interferes with or materially increases the cost of performing its obligations hereunder, to the extent that such act, event or condition is not the result of the willful or negligent act, error or omission, failure to exercise reasonable diligence, or breach of the Service Contract on the part of such party.

Inclusions. Subject to the foregoing, Uncontrollable Circumstances may include, and shall not be limited to, the following:

- (a) a Change in Law;
- (b) the existence of a Pre-Existing Environmental Condition;
- (c) the existence of a Specified Site Condition;
- (d) contamination of the Facilities from groundwater, soil or airborne Hazardous Material migrating from sources outside the Facilities to the extent not caused by Authority Breach;
- (e) naturally occurring events (except weather conditions normal for the service territory) such as landslides, underground movement, earthquakes, lightning, hail storms, fires, tornadoes, hurricanes, floods (but only to the extent the capacity of the Facilities is exceeded), epidemics, and other acts of God;
- (f) explosion, sabotage or similar occurrence, acts of a declared public enemy, extortion, war, blockade or insurrection, riot or civil disturbance;
- (g) labor disputes, except labor disputes involving employees of the Authority, its Affiliates, or subcontractors which affect the performance of the Contract Services;
- (h) the failure of any Subcontractor (other than the Authority or any Affiliate thereof) to furnish services, materials, chemicals or equipment on the dates agreed to, but only if such failure is the result of an event which would constitute an Uncontrollable Circumstance if it affected the Authority directly, and the Authority is not able after exercising all reasonable efforts to timely obtain substitutes;
- (i) the failure of any appropriate Governmental Body or private utility having operational jurisdiction in the area in which the Facilities are located to provide and maintain Utilities (other than Raw Water) to the Facilities which are required for the performance of the Contract Services;
- (j) any failure of title to the Facilities or any placement or enforcement of any encumbrance on the Facilities not consented to in writing by, or arising out of any action or agreement entered into by, the party adversely affected thereby;
- (k) the preemption, confiscation, diversion or destruction of materials or services by a Governmental Body in connection with a public emergency or any condemnation or other taking by eminent domain of any material portion of the Facilities;
- (l) with respect to the Authority, any City Breach and City-requested Change Orders not due to Authority Breach;
- (m) with respect to the City, any Authority Breach;

(n) with respect to the Authority, the consequences of any act, error, neglect or omission by the City or any other person or entity acting on behalf of the City; or

(o) electric power outages beyond the control of the Authority.

Exclusions. It is specifically understood that none of the following acts, events or circumstances shall constitute Uncontrollable Circumstances:

(a) any act, event or circumstance that would not have occurred if the affected party had complied with its obligations hereunder;

(b) changes in interest rates, inflation rates, wage rates, insurance costs, currency values, exchange rates or other general economic conditions;

(c) changes in the financial condition of the City, the Authority, or its affiliates or subcontractors affecting the ability to perform their respective obligations;

(d) the consequences of error, neglect or omissions by the Authority, any Subcontractor, any of their Affiliates or any other person in the performance of the Contract Services;

(e) union or labor work rules, requirements or demands which have the effect of increasing the number of employees employed at the Facilities or otherwise increasing the cost to the Authority of performing the Contract Services;

(f) any impact of prevailing wage or similar laws, customs or practices on the Authority's costs;

(g) weather conditions normal for the service area;

(h) any surface or subsurface geotechnical or hydrological conditions, including the existence of compressible soil layers, masses, unstable soils, manmade deposits, and water table fluctuations (other than Pre-Existing Environmental Conditions or Specified Site Conditions);

(i) any act, event, circumstance or Change in Law occurring outside of the United States;

(j) mechanical failure of equipment to the extent not resulting from a condition that is listed in the "Inclusions" section of this definition;

(k) failure of the Authority to secure patents which it deems necessary for the performance of the Contract Services;

(l) any failure in obtaining appropriate Governmental Approvals for the Facilities;

(m) a Change in Law pertaining to Taxes (except a Change in Law which imposes a State or local tax on the private provision of water treatment services or the imposition of a new State Tax or an increase or decrease in the rate of local tax currently imposed for use of the City's water system); or

(n) any Change in Law (including the issuance of any Governmental Approval, the enactment of any statute, or the promulgation of any regulation) the terms and conditions of which do not impose more stringent or burdensome requirements on the Authority than are imposed by the Contract Standards.

"Utilities" means any and all utility services and installations whatsoever (including gas, electricity, telephone, and telecommunications), and all piping, wiring, conduits, and other fixtures of every kind whatsoever related thereto or used in connection therewith.

"Water Treatment System" means the City's potable water treatment system and the real property on which the structures constituting part of such system are located, as described in Appendix 1, consisting generally of the Plant, Wells, storage reservoirs, pipes, mains, valves, and treatment equipment, together with all improvements thereto acquired, installed, constructed or reconstructed from time to time.

"Wells" means the wells drawing groundwater from the Edwards Aquifer, as further described in Appendix 1.

"Well Supply Equipment" means the pumps, meter, column, casing, pipes, valves, motor control center, electric disconnects, and other well supply equipment.

"Well System SCADA" means the Wells' monitoring and control system.

"Well Water" means all groundwater water pumped from the Wells for distribution through the water distribution system in the Service Territory in accordance with Applicable Law.

SECTION 1.2. INTERPRETATION. In this Service Contract notwithstanding any other provision hereof:

(A) References Hereto. The terms "hereby," "hereof," "hereto," "herein," "hereunder" and any similar terms refer to this Service Contract; and the term "hereafter" means after, and the term "heretofore" means before, the Contract Date.

(B) Gender and Plurality. Words of the masculine gender mean and include correlative words of the feminine and neuter genders, and words importing the singular number mean and include the plural number and vice versa.

(C) Persons. Words importing persons include firms, companies, associations, joint ventures, general partnerships, limited partnerships, limited liability corporations, trusts, business trusts, corporations and other legal entities, including public bodies, as well as individuals.

(D) Headings. The table of contents and any headings preceding the text of the Articles, Sections and subsections of this Service Contract shall be solely for convenience of reference and shall not affect its meaning, construction or effect.

(E) Entire Service Contract. This Service Contract contains the entire agreement between the parties hereto with respect to the transactions contemplated by this Service Contract. Without limiting the generality of the foregoing, this Service Contract shall completely and fully supersede all other understandings and agreements among the parties with respect to such transactions, although the City recognizes that the Authority, in entering into this Service Contract has relied upon the City's RFP, the proposal of the Authority submitted in response thereto, and the amendments or supplements to the RFP and the proposal. The Raw Water Contract and the Regional Agreement between the parties are not altered or superceded by this service contract.

(F) Standards of Workmanship and Materials. Any reference in this Service Contract to materials, equipment, systems or supplies (whether such references are in lists, notes, specifications, schedules, or otherwise) shall be construed to require the Authority to furnish the same in accordance with the grades and standards indicated in this Service Contract. Where this Service Contract does not specify any explicit quality or standard for construction materials or workmanship, the Authority shall use only workmanship and materials of a quality consistent with that of construction workmanship and materials in accordance with Good Engineering and Construction Practices and Good Industry Practices.

(G) Technical Standards and Codes. References in this Service Contract to all professional and technical standards, codes and specifications are to the most recently published professional and technical standards, codes and specifications of the institute, organization, association, authority or society specified, all as in effect as of the Contract Date. Unless otherwise specified to the contrary, all such professional and technical standards, codes and specifications shall apply as if incorporated herein.

(H) Causing Performance. A party shall itself perform, or shall cause to be performed, the obligations affirmatively undertaken by such party under this Service Contract, subject to any limitations specifically imposed hereby with respect to Subcontractors or otherwise.

(I) Party Bearing the Cost of Performance. All obligations undertaken by each party hereto shall be performed at the cost of the party undertaking the obligation, unless the other party has explicitly agreed herein to bear all or a portion of the cost either directly or by reimbursement to the other party or through an adjustment to the Service Fee.

(J) Assistance. The obligations of a party to cooperate with, to assist or to provide assistance to the other party hereunder shall be construed as an obligation to use the party's personnel resources to the extent reasonably available in the context of performing their normal duties, and not to incur material additional overtime or third party expense unless requested and reimbursed by the assisted party.

(K) Interpolation. If any calculation hereunder is to be made by reference to a chart or table of values, and the reference calculation falls between two stated values, the calculation shall be made on the basis of linear interpolation.

(L) Good Industry Practice and Good Engineering and Construction Practice. Good Industry Practice and Good Engineering and Construction Practice shall be utilized hereunder, among other things, to implement, and in no event displace or lessen the stringency of, the Contract Standards. In the event that, over the course of the Term of this Service Contract, Good Industry Practice or Good Engineering and Construction Practice evolves in a manner which in the aggregate materially and adversely affects the cost of compliance therewith by the Authority, the Authority shall be relieved of its obligation to comply with such evolved Good Industry Practice and Good Engineering and Construction Practice (but not Good Industry Practice and Good Engineering and Construction Practice as of the Contract Date) unless the City agrees to adjust the Service Fee on a Cost Substantiation basis to account for such additional costs. Except to the extent that the Authority is relieved of its obligation to comply with such evolved Good Industry Practice or Good Engineering and Construction Practice, as provided above, in no event shall any evolution of Good Industry Practice or Good Engineering and Construction Practice, or any City election to pay or not pay any such additional costs, relieve the Authority of its obligations hereunder.

(M) Applicability and Stringency of Contract Standards. The Authority shall be obligated to comply only with those Contract Standards which are applicable in any particular case. Where more than one Contract Standard applies to any particular performance obligation of the Authority hereunder, each such applicable Contract Standard shall be complied with. In the event there are different levels of stringency among such applicable Contract Standards, the most stringent of the applicable Contract Standards shall govern.

(N) Delivery of Documents in Digital Format. In this Service Contract, the Authority may be obligated to deliver reports, records, designs, plans, drawings, specifications, proposals and other documentary submittals in connection with the performance of its duties hereunder. The Authority agrees that all such documents shall be submitted to the City both in printed form (in the number of copies indicated) and, at the City's request, in digital form. Electronic copies shall consist of computer readable data submitted in any standard interchange format which the City may reasonably request to facilitate the administration and enforcement of this Service Contract.

(O) Severability. If any clause, provision, subsection, Section or Article of this Service Contract shall be ruled invalid by any court of competent jurisdiction, then the parties shall: (1) promptly negotiate a substitute for such clause, provision, subsection,

Section or Article which shall, to the greatest extent legally permissible, effectuate the intent of the parties in the invalid clause, provision, subsection, Section or Article; (2) if necessary or desirable to accomplish item (1) above, apply to the court having declared such invalidity for a judicial construction of the invalidated portion of this Service Contract; and (3) negotiate such changes, in substitution for or addition to the remaining provisions of this Service Contract as may be necessary in addition to and in conjunction with items (1) and (2) above to effect the intent of the parties in the invalid provision. The invalidity of such clause, provision, subsection, Section or Article shall not affect any of the remaining provisions hereof, and this Service Contract shall be construed and enforced as if such invalid portion did not exist.

(P) Drafting Responsibility. Notwithstanding the City's having assumed primary drafting responsibility for the main body and certain Appendices to this Service Contract, or the Authority's having assumed primary drafting responsibility for certain Appendices to this Service Contract, neither party shall be held to a higher standard than the other party in the interpretation or enforcement of this Service Contract as a whole or any portion hereof as a result of having assumed such drafting responsibility.

(Q) No Third Party Rights. This Service Contract is exclusively for the benefit of the City and the Authority and shall not provide any third parties with any remedy, claim, liability, reimbursement, cause of action, or other rights.

(R) References to Days. All references to days herein are references to calendar days.

(S) References to Knowledge. All references to "knowledge," "knowing," "know" or "knew" shall be interpreted as references to a party having actual knowledge.

(T) Counterparts. This Service Contract may be executed in any number of original counterparts. All such counterparts shall constitute but one and the same Service Contract.

(U) Governing Law. This Service Contract shall be governed by and construed in accordance with the applicable laws of the State of Texas.

(V) Defined Terms. The definitions set forth in Section 1.1 shall control in the event of any conflict with the definitions used in the recitals hereto.

ARTICLE II
REPRESENTATIONS AND WARRANTIES

SECTION 2.1. REPRESENTATIONS AND WARRANTIES OF THE CITY. The City represents and warrants that:

(A) Existence and Powers. The City is a municipal corporation of the State, validly existing under the laws of the State, with full legal right, power and authority to enter into and to perform its obligations under this Service Contract.

(B) Due Authorization and Binding Obligation. This Service Contract has been duly authorized, executed and delivered by all necessary action of the City and constitutes a legal, valid and binding obligation of the City, enforceable against the City in accordance with its terms, except to the extent that its enforceability may be limited by bankruptcy, insolvency or other similar laws affecting creditors' rights from time to time in effect and by equitable principles of general application.

(C) No Conflict. To the best of its knowledge, neither the execution and delivery by the City of this Service Contract nor the performance by the City of its obligations in connection with the transactions contemplated hereby or the fulfillment by the City of the terms or conditions hereof: (1) conflicts with, violates or results in a breach of any constitution, law or governmental regulation applicable to the City; or (2) conflicts with, violates or results in a breach of any order, judgment or decree, or any contract, agreement or instrument to which the City is a party or by which the City or any of its properties or assets are bound, or constitutes a default under any of the foregoing.

(D) No Approvals Required. No approval, authorization, order or consent of, or declaration, registration or filing with, any Governmental Body is required for the valid execution and delivery of this Service Contract by the City or the performance of its payment or other obligations hereunder except such as have been duly obtained or made.

(E) No Litigation. Except as disclosed in writing to the Authority, to the best of its knowledge, there is no Legal Proceeding before or by any Governmental Body pending or, to the best of the City's knowledge, overtly threatened or publicly announced against the City, in which an unfavorable decision, ruling or finding could reasonably be expected to have a material and adverse effect on the execution and delivery of this Service Contract by the City, or the validity, legality or enforceability of this Service Contract against the City or any other agreement or instrument entered into by the City in connection with the transactions contemplated hereby, or on the ability of the City to perform its obligations hereunder or under any such other agreement or instrument.

(F) Applicable Law Compliance. Except as disclosed in writing to the Authority, to the best of its knowledge, the City is not in material violation of any law, order,

rule or regulation applicable to any plant or system providing water service to the general public designed, constructed, operated, maintained or managed by the City.

(G) Information Supplied by the City. The information supplied and representations and warranties made by the City in all submittals and addenda made in relation to the RFP and in all post-proposal responses with respect to the City are true, correct and complete in all material respects.

SECTION 2.2. REPRESENTATIONS AND WARRANTIES OF THE AUTHORITY. The Authority represents and warrants that:

(A) Existence and Powers. The Authority is a conservation and reclamation district and political subdivision of the State of Texas duly organized, validly existing and in good standing under the laws of the State, with the full legal right, power and authority to enter into and perform its obligations under this Service Contract.

(B) Due Authorization and Binding Obligation. This Service Contract has been duly authorized, executed and delivered by all necessary corporate action of the Authority and constitutes a legal, valid and binding obligation of the Authority, enforceable against the Authority in accordance with its terms, except to the extent that its enforceability may be limited by bankruptcy, insolvency or other similar laws affecting creditors' rights from time to time in effect and by equitable principles of general application.

(C) No Conflict. To the best of its knowledge, neither the execution and delivery by the Authority of this Service Contract nor the performance by the Authority of its obligations in connection with the transactions contemplated hereby or the fulfillment by the Authority of the terms or conditions hereof: (1) conflicts with, violates or results in a breach of any constitution, law or governmental regulation applicable to the Authority; or (2) conflicts with, violates or results in a breach of any order, judgment or decree, or any contract, agreement or instrument to which the Authority is a party or by which the Authority or any of its properties or assets are bound, or constitutes a default under any of the foregoing.

(D) No Approvals Required. No approval, authorization, order or consent of, or declaration, registration or filing with, any Governmental Body is required for the valid execution and delivery of this Service Contract by the Authority or the performance of its payment or other obligations hereunder except such as have been duly obtained or made.

(E) No Litigation. Except as disclosed in writing to the City, to the best of its knowledge, there is no Legal Proceeding before or by any Governmental Body pending or, to the best of the Authority's knowledge, overtly threatened or publicly announced against the Authority, in which an unfavorable decision, ruling or finding could reasonably be expected to have a material and adverse effect on the execution and delivery of this Service Contract by the Authority, or the validity, legality or enforceability of this Service Contract against the Authority or any other agreement or instrument entered into by the Authority in connection with the

transactions contemplated hereby, or on the ability of the Authority to perform its obligations hereunder or under any such other agreement or instrument.

(F) Governmental Approvals. The Authority has obtained or will obtain in the course of its performance hereunder, either directly or through qualified Subcontractors, the Governmental Approvals which the Authority must obtain in its own name or that of its Subcontractors to provide the Contract Services.

(G) Applicable Law Compliance. Except as disclosed in writing to the City, to the best of its knowledge, the Authority is not in material violation of any law, order, rule or regulation applicable to any water plant or system providing service to the general public designed, constructed, operated, maintained or managed by the Authority.

(H) Information Supplied by the Authority. The information supplied and representations and warranties made by the Authority in all submittals made in response to the RFP and in all post-proposal submittals with respect to the Authority (and, to the best of its knowledge, all information supplied in such submittals with respect to any Subcontractor) are true, correct and complete in all material respects.

(I) City Utility Contracts. The Authority is familiar with the City Utility Contracts, and the coordination needed on the Authority's part to ensure the City's ongoing compliance with its obligations under the City Utility Contracts.

SECTION 2.3. KNOWLEDGE-BASED REPRESENTATIONS. Whenever a representation or warranty hereunder is made to the best of the knowledge of the City or the best of the knowledge of the Authority, such representation or warranty hereunder shall be deemed made, as the case may be, to the knowledge of the City Manager of the City or to the knowledge of the chief executive officer of the Authority.

ARTICLE III

TERM

SECTION 3.1. EFFECTNE DATE AND INITIAL TERM. This Service Contract shall become effective on the Contract Date, and shall continue in effect for 10 years following the Commencement Date (the period from the Contract Date to the tenth anniversary of the Commencement Date constituting the "Initial Term") or, if renewed as provided in Section 3.2, until the last day of the renewal term (the "Renewal Term"; the Initial Term and any Renewal Term being referred to herein as the "Term"), unless earlier terminated pursuant to the termination provisions of Article XI hereof, in which event the Term shall be deemed to have ended as of the date of such termination. All rights, obligations and liabilities of the parties hereto shall commence on the Contract Date, subject to the terms and conditions hereof. The City shall have no obligation to make Service Fee payments until the Commencement Date. At the end of the Term of this Service Contract, all other obligations of the parties hereunder shall terminate, except as provided in Sections 11.6.

SECTION 3.2. RENEWAL OPTION. This Service Contract may be renewed and extended for up to two additional five-year renewal terms by the mutual agreement of the parties. The Authority shall give the City written notice of the approaching expiration of the Initial Term or any Renewal Term no later than 270 days prior to such expiration. In such notice the Authority will state whether it desires to renew the Service Contract. The City, not later than 180 days prior to the expiration of the Initial Term and any Renewal Term, shall give the Authority written notice stating whether or not the City desires to renew the Service Contract. If the parties agree to renew the Service Contract, the renewal shall be on the same terms and conditions as are in force under this Service Contract as of the date of renewal. If either party does not wish to renew this Service Contract, the Service Contract will terminate, and the City will determine whether to assume the operation and maintenance of the Water Treatment Facilities, or contract for such services using a competitive process in accordance with Applicable Law.

ARTICLE IV

TRANSITION PERIOD

SECTION 4.1. AUTHORITY TRANSITION PERIOD RESPONSIBILITIES.

(A) Obligation to Proceed. The Authority shall use good faith efforts to satisfy the following Authority responsibilities as soon as practicable after the Contract Date, each of which shall be a condition precedent to the occurrence of the Commencement Date.

(1) Transition. The Authority shall carry out and complete its transition obligations to ensure the orderly transfer of management responsibility for the Wells from the City to the Authority in accordance with Article VI as it specifically pertains to transition obligations to be performed by the Authority prior to the Commencement Date, and shall provide management, technical, administrative, engineering, labor relations and other personnel necessary in connection therewith. The Authority shall demonstrate such compliance to the satisfaction of the City.

(2) City Employee and Staffing. The Authority shall carry out and complete its obligations set forth in Section 6.7, with respect to offering employment to the City employee identified in Appendix 5, and shall demonstrate such compliance to the satisfaction of the City. In addition, the Authority shall hire any additional personnel necessary to fill all positions included in its Staffing Plan, if any.

(3) Governmental Approvals. The Authority shall submit complete applications and take all other steps which are necessary under Applicable Law to obtain all Governmental Approvals required to be obtained by the Authority before the Commencement Date for the performance of the Contract Services, or certify to the City that no such Governmental Approvals are required.

(4) Letter of Credit. The Authority shall obtain and deliver to the City the Letter of Credit, or other security agreeable to the City in accordance with Section 13.1. The Letter of Credit shall be substantially in the form set forth in the Transaction Forms.

(5) Safety and Security Plan. The Authority shall submit, subject to City review, a Safety and Security Plan.

(6) Operation and Maintenance Manual. The Authority shall review the operation and maintenance procedures contained in the City's existing Operation and Maintenance Manual for the Wells, and identify areas which need to be modified or added in light of the contract provisions to be performed hereunder, including its Major Repair and Replacement Schedule set forth in Appendix 3.

(7) Contact Information. The Authority shall submit to the City the contact information specified in subsection 14.3(A).

(8) Required Insurance. The Authority shall submit to the City proof of insurance naming the City as an "additional insured" for the Required Insurance specified in Appendix 9 for which an "additional insured" may be named.

(9) Service Contract Approval Assistance. The Authority shall actively advise the City with respect to, and shall cooperate with and assist the City in obtaining, any required Service Contract Approvals.

(10) Authority Law Compliance. The Authority shall certify to the City as of the Commencement Date that the Authority is in substantial compliance with laws, regulations, rules and orders, non-compliance with which would have a material and adverse effect upon its ability to perform its obligations under this Service Contract.

(11) Financial Condition. The Authority shall provide consolidated balance sheets and income statements for the Authority for the most recently completed fiscal year and quarterly period. Since the Contract Date, there shall not have occurred any change, financial or otherwise, in the condition of the Authority that would materially and adversely affect the ability of the Authority to perform its respective obligations under this Service Contract.

(12) Documents Evidencing Required Activities. The Authority shall have provided to the City copies of all filings and reports conducted, prepared or obtained with respect to or evidencing the Authority's activities pursuant to this Section.

(13) Representations. The representations of the Authority set forth in Section 2.2 shall be true and correct in all material respects as of the Commencement Date as if made on and as of the Commencement Date, and the Authority shall deliver to the City a certificate of an authorized officer to that effect.

(B) Access to Facilities During Transition Period. The execution of this Service Contract shall be deemed to constitute the granting to the Authority of a right of access to the Facilities for the purposes of performing further inspections, engineering, analysis and such additional studies or tests as deemed necessary by the Authority. To the extent such right of access exceeds those rights of the Authority under any other written agreement with the City, such right of access shall be subject to the City's prior approval, which shall not be unreasonably withheld, as to time and scope, and shall be exercised in a manner consistent with the performance obligations of the City. The Authority shall assume all risks associated with such activities.

(C) Notice of Default. The Authority shall provide to the City, promptly following the receipt thereof, copies of any notice of default, breach or non-compliance received under or in connection with any Governmental Approval or Subcontract pertaining to the Transition Period.

SECTION 4.2. CITY TRANSITION PERIOD RESPONSIBILITIES. The City shall use good faith efforts to satisfy the following City responsibilities as soon as practicable after the Contract Date, each of which shall be a condition precedent to the occurrence of the Commencement Date.

(1) Governmental Approvals. The City shall cooperate with the Authority in the submittal of all applications for the Governmental Approvals, if any, which the Authority is obligated to submit pursuant to subsection 4.1(A)(3).

(2) Service Contract Approvals. The City shall make all submittals and take all other action which is reasonably necessary under Applicable Law in order to apply for any required Service Contract Approval.

(3) Transfer of Management Responsibilities. The City shall transfer management responsibility for the Facilities to the Authority, as necessary, as of the Commencement Date, and shall provide for an orderly transfer of responsibility to the Authority.

(4) Representations. The representations of the City set forth in Section 2.1 shall be true and correct in all material respects as of the Commencement Date as if made on and as of the Commencement Date, and the City shall deliver to the Authority a certificate of an authorized officer to that effect.

SECTION 4.3. COMMENCEMENT DATE CONDITIONS. (A) Commencement Date Conditions Defined. The obligations of the Authority and the City to proceed with their respective obligations hereunder during the Management Period shall not commence until all of the following conditions (the "Commencement Date Conditions") are satisfied or waived by both parties:

(1) Authority Transition Period Responsibilities. The Authority shall have fulfilled all of its responsibilities with respect to the Transition Period under Section 4.1.

(2) City Transition Period Responsibilities. The City shall have fulfilled all of its responsibilities with respect to the Transition Period under Section 4.2.

(3) Governmental Approvals. All Governmental Approvals required for the commencement of the Contract Services shall have been issued or obtained and shall be in full force and effect.

(4) Service Contract Approvals. All required Service Contract Approvals, if any, shall have been issued or obtained and shall be in full force and effect.

(5) Inventory and Assessment. An inventory and condition assessment of all Transferred Property shall have been conducted as required by Section 8.2, and the parties shall have agreed on such inventory and condition assessment for purposes of such Section.

(6) Acceptability and Effectiveness of Documents. All of the documents and instruments identified in this Section shall be in form and substance reasonably satisfactory to both parties, and shall be valid, in full force and effect and enforceable against each party thereto on the Commencement Date. It is understood that any such document, instrument or agreement, the form of which is set forth in a Transaction Form, that is executed and delivered in substantially such form, is and shall be deemed to be in form and substance satisfactory to the parties. No such document, instrument or agreement shall be subject to the satisfaction of any outstanding condition precedent except those expressly to be satisfied after the Commencement Date. No party to any such document, instrument or agreement shall have repudiated or be in default or imminent default thereunder, and each party shall have received such certificates or other evidence reasonably satisfactory to it of such facts as such party shall have reasonably requested.

(7) Legal Proceedings. There shall be no Legal Proceeding pending before or by any Governmental Body which: (a) challenges, or might challenge, directly or indirectly, (i) the authorization, execution, delivery, validity or enforceability of this Service Contract, or (ii) the interest of the City in the Facilities; (b) seeks to enjoin or restrict the use of the Facilities in the manner or for the purposes contemplated by this Service Contract; or (c) seeks damages, fines, remediation or any other remedy in connection with the environmental condition or any other matter pertaining to the Facilities, in any such case which can reasonably be expected to materially and adversely affect the City's or the Authority's ability to comply with its obligations hereunder.

(8) No Change in Law Affecting Service Contract. No Change in Law shall have occurred after the Contract Date and before the Commencement Date that would make the authorization, execution, delivery, validity, enforceability or performance of this Service Contract a violation of Applicable Law.

(B) Commencement Date Conditions for which Both Parties Have Responsibility. The City and the Authority shall each use all reasonable efforts in taking such actions as may reasonably be under their control in order to satisfy the Commencement Date Conditions set forth in items (3), (4), (5), (6), (7), and (8) of subsection (A) of this Section as soon as practicable.

(C) No Payment to Either Party for Transition Period Expenses of the Other. All costs and expenses incurred by each party in performing its obligations during the Transition Period shall be for the account of such party and shall not be reimbursable by the other party except upon the occurrence of an Event of Default. However, during the Transition Period, the Authority may continue to charge the City and the City will continue to pay the

Authority's charges related to the ongoing operation of the Plant pursuant to the existing Service Contract. The Authority's charges under the existing Service Contract shall cease with the Commencement Date of this Service Contract.

SECTION 4.4. CLOSING THE TRANSITION PERIOD. (A) Establishment of Commencement Date. The parties shall give each other prompt notice when each Commencement Date Condition has been achieved. Upon the satisfaction or waiver of all of such Commencement Date Conditions, the parties shall hold a formal closing on a date and at a location determined by the parties acknowledging such satisfaction, delivering copies of all relevant documents, and certifying that the Commencement Date has occurred. The date of such closing shall be deemed to be the Commencement Date hereunder, and thereupon the Initial Term shall commence. Written documents or instruments constituting or evidencing satisfaction of the Commencement Date Conditions shall be furnished to each party for review prior to the Commencement Date to the extent practicable.

(B) Failure of Conditions. If by the date that is 90 days following the Contract Date (as such date may be extended day-for-day by any third party Legal Proceeding or Uncontrollable Circumstance, which has a material bearing upon the ability of the parties to proceed with the transactions contemplated hereby, but not later than the first anniversary of the Contract Date}, or such later date upon which the City and the Authority may agree, any of the Commencement Date Conditions are not satisfied, or have not been waived, either party may, by notice in writing to the other party, terminate this Service Contract, effective on the date stated in the notice. Neither party shall be liable to the other for the termination of this Service Contract pursuant to this Section (including any termination resulting from a Legal Proceeding which has the effect of invalidating this Service Contract or the City's authorization thereof) except to the extent that such party breaches its obligations under Sections 4.1 or 4.2, respectively, and each of the parties shall bear its respective costs and expenses incurred in seeking to satisfy the Commencement Date Conditions.

SECTION 4.5. CITY UTILITY CONTRACTS. [(A) Current Workscope. The City Utility Contracts are those contracts to which the City is a party as of the Contract Date under which the City has agreed to perform services of various kinds for other Governmental Bodies or commercial entities, such as asset operation and maintenance services, and water wheeling services. Commencing on the Commencement Date, the Authority shall coordinate with and provide information to the City to assist the City in complying with its obligations under the City Utility Contracts existing as of the Commencement Date; provided, however, that the Authority shall have no obligation to perform any construction services thereunder. The City shall make any payments that may be due under the City Utility Contracts and shall enforce performance by the counterparty to all of the City Utility Contracts. All payments for

services or otherwise made by the counterparty and all other revenue collected under the City Utility Contracts shall be the property of the City.

(B) Workscope Changes. The Service Fee shall be increased to take account of workscope changes occurring during the Term under the City Utility Contracts that increase the Authority's costs. Such changes may occur, for example, through the modification, expiration or termination of an existing City Utility Contract or the addition of new City Utility Contracts. The City shall have the right, in its sole discretion, to make any such modification, termination or addition, and in connection therewith the City and the Authority shall negotiate terms and conditions of the Contract Administration Memorandum or amendment to this Service Contract which is appropriate on account thereof.

ARTICLE V

PERMITTING RESPONSIBILITIES

SECTION 5.1. AUTHORITY PERMITTING RESPONSIBILITIES. Except as provided in Section 5.2, the Authority shall be responsible (at its own cost, including annual or periodic fees) for applying for, obtaining, providing necessary reports required under, and maintaining in force all Government Approvals required for the operation of the Facilities even though such Governmental Approvals may be in the name of the City, as more fully provided for in Section 6.12. The City shall provide the Authority reasonable assistance and cooperation in the permitting process at its own cost. The Authority shall bear the cost of (including permit fees) and risks (except to the extent a new permit condition constitutes a Change in Law) associated with obtaining, maintaining and complying with such Governmental Approvals. The Authority shall be responsible for completion of all permit efforts in progress at the time of commencement of this Service Contract.

SECTION 5.2. CITY PERMITTING RESPONSIBILITIES. The City shall be responsible for all reporting requirements under the City's Edwards Aquifer Authority permits, and the Authority will fully support the City's reporting requirements by providing any data, reports, test results and other information related to the Facilities which may be necessary for the City to comply with such reporting requirements. The Authority shall not be responsible for obtaining permits or approvals necessary for the implementation of Capital Modifications initiated by the City (unless the parties mutually agree otherwise); provided, however, that the Authority shall provide the City any data, reports, test results and other information and assistance related to the Facilities that may be necessary to obtain such permits and approvals.

SECTION 5.3. OTHER REPORTING REQUIREMENTS. The Authority will fully support the City's reporting requirements for other agencies and entities such as Texas Water Development Board by providing any data, reports, test results and other information related to the Facilities which may be necessary for the City to comply with such reporting requirements or information requests.

ARTICLE VI
MANAGEMENT AND OPERATION

SECTION 6.1. OWNERSHIP AND USE OF THE FACILITIES. (A) City Ownership. Subject to parties rights and obligations under the Regional Agreement, the System, the Facilities, all Capital Modifications, and all equipment used or installed by the Authority are and shall be owned by the City throughout and following the Term of this Service Contract, and the Authority shall have no ownership interest therein by virtue of this Service Contract. The Authority shall perform the Contract Services as an independent contractor and shall not have any legal, equitable, tax beneficial or other ownership or leasehold interest in the System, the Facilities, or any Capital Modification by virtue of this Service Contract. The Authority may however from time to time utilize some of its own vehicles or equipment in the performance of its Service Contract obligations without those vehicles or equipment becoming the property of the City.

(B) Use. During the Term hereof, the Authority may enter upon, occupy and use the Facilities to operate, maintain, repair, replace and manage the Facilities, and to design, construct, install and start-up any Capital Modifications approved by the City, all to provide the Contract Services in accordance herewith, and for no other purpose. The Authority shall keep the Facilities in good working order and condition in light of their intended use hereunder.

(C) Use of Transferred Property. The Authority shall have the right to use and consume in the performance of the Contract Services at the Facilities the spare parts and Consumables constituting part of the Transferred Property.

(D) City Access to Facilities. The City shall have the right at any time, on a 24-hour per day, 365-day per year basis, to visit and inspect the Facilities and observe and assess the Authority's performance of the Contract Services. The Authority shall allow and facilitate access to the Facilities for such purposes by authorized City personnel and by agents and contractors designated by the City. Keys or passwords, as applicable, for the facilities or structures constituting the Facilities shall be provided to the City's Contract Administrator by the Authority in accordance with the Authority's physical security plan and key control program. All City employees, agents and contractors, and all visitors shall comply with the Authority's reasonable operating and safety procedures and rules, and shall not interfere with the Authority's operations of the Facilities. When visiting any portion of the Facilities that is staffed by the Authority at the time of the visit, all City employees, agents and contractors shall announce themselves to the staff, and Authority employees may elect to accompany any City employees, agents and contractors during the visit. The parties agree that the City (but not its agents and contractors) shall have immediate access to the Facilities, and no Authority rule or

procedure shall impede, impair or delay such access. The parties agree that access by the City's agents and contractors shall normally be arranged with the Authority in advance and that such access shall normally be at times reasonably convenient for the Authority. While the Authority shall attempt to provide a safe and secure workplace at the Facilities in accordance with Section 6.10(A), City agents, contractors and visitors entering the Facilities shall enter at their own risk.

(E) Liens and Encumbrances. At all times during the Term of this Service Contract, the Authority shall keep the Facilities free from any and all Liens and Encumbrances arising out of or in connection with (1) the Contract Services, or (2) any acts, omissions or debts of the Authority, its Affiliates and its Subcontractors, other than Liens arising by operation of law, which shall be promptly bonded or discharged.

(F) Authority Prohibitions. In addition to any other provision set forth herein and the limitations set forth under Applicable Law, the Authority shall not:

- (1) change the nature of the business of the Facilities as currently conducted without the City's prior written authorization;
- (2) enter into any contract, commitment or transaction on behalf of the City without the City's prior written authorization;
- (3) utilize the Facilities for any purpose other than the continued operation of the Facilities, such as (i) managing or operating non-City facilities (other than the San Marcos Raw Water Delivery System, and the pump station and pipeline on the Plant Site for the IH 35 Project) from the Facilities, except as is expressly agreed to by the City in writing, (ii) using personnel, equipment, software, rolling stock, consumables or other materials that are utilized at the Facilities at non-City facilities except as authorized in writing by the City, or (iii) storing equipment and spare parts for other non-City facilities (other than equipment, spare parts and materials related specifically to the operation and maintenance of the San Marcos Raw Water Delivery System or the IH 35 Project);
- (4) share Facilities staff with other non-City facilities, subject to subdivision (3)(i) above; or
- (5) distribute, dispose of (except as authorized in writing by the City), transfer, convey, pledge, mortgage or encumber any of the assets of the Facilities except as permitted by the Regional Agreement.

(G) Third-Party Access. Except as provided herein, the Authority shall prohibit access to the Facilities to all unauthorized personnel and third parties.

SECTION 6.2. AUTHORITY OBLIGATIONS GENERALLY. (A) Management Responsibility. Commencing on the Commencement Date, the Authority shall operate and manage the Facilities on a 24-hour per day, 7-day per week basis, and shall treat and deliver Finished Water to the System, provide all information necessary to secure Governmental Approvals, and otherwise manage and operate the Facilities so as to comply with the Contract Standards applicable to such activities, each of the plans pertaining thereto set forth in the Appendices, and the other terms and conditions of this Service Contract.

(B) Transfer and Application of Industry Experience. The Authority shall use reasonable efforts to transfer to and apply at the Facilities the benefit of the advances and improvements in technology, management practices and operating efficiencies which are developed by the Authority through the operation of their water treatment and distribution businesses and industry research and development activities conducted over the full Term of this Service Contract, and which are useful and appropriate in the good faith judgment of the Authority for carrying out the Contract Services in a manner which improves upon the Contract Standards.

SECTION 6.3. CITY OBLIGATIONS GENERALLY. The City, in addition to the obligations it has accepted elsewhere in this Service Contract, shall:

- (1) Make available to the Authority upon request information relating to the Facilities which is in the possession of the City and material to the Authority's performance hereunder;
- (2) Grant and assure the Authority access to the Facilities for the performance of its obligations hereunder, but for no other purpose;
- (3) Make available for the Authority's use hereunder all Consumables and spare parts in inventory at the Facilities as of the Commencement Date;
- (4) Maintain and repair in good working order all System assets which are not included in the Facilities which the Authority is obligated to maintain;
- (5) Obtain and maintain all Governmental Approvals that are the responsibility of the Authority hereunder;
- (6) Pay the Service Fee and any other amounts due the Authority in accordance with the terms and conditions of this Service Contract;
- (7) Provide billing and revenue collection services with respect to the use of the System; and
- (8) On a periodic basis to be determined by the parties, direct the Authority as to the amount of raw water from each water source that is to be utilized.

SECTION 6.4. FACILITIES CONDITION CONFIRMATION. (A) Familiarity with Facilities. The Authority shall acknowledge following the Transition Period that: (1) the Authority's employees have visited, inspected, observed and are familiar with the Facilities,

their design, and their physical condition relevant to the obligations of the Authority pursuant to this Service Contract, including structural and operating conditions, roads, Utilities, topographical conditions; (2) the Authority is familiar with current local conditions which may be material to the Authority's performance of its obligations under this Service Contract; (3) the Authority has received and reviewed the Reference Documents, the background documents provided by the City in the RFP process and other records and information pertaining to the Facilities that it has deemed necessary to receive and review for the purposes of entering into and performing this Service Contract, and assumes the risk of incompleteness or inaccuracy in any information provided to it by the City or third parties in the process of entering into this Service Contract; and (4) based on the foregoing, the Facilities can be managed, operated, maintained, repaired and replaced, so as to comply with the Performance Guarantees and the other terms and conditions hereof.

(B) "As-Is" Condition of Facilities. Based on its review of the design drawings, plans and specifications pertaining to the Plant, its inspections of the Facilities, and other inquiries and investigations made by the Authority prior to the Commencement Date, which the Authority acknowledges to be sufficient for this purpose, the Authority assumes the risk of the adequacy and sufficiency of the Facilities and the existing, "as-is" condition of the Facilities as such condition may affect the ability of the Authority to comply with Applicable Law, meet the Performance Guarantees, meet its maintenance, repair and replacement obligations or perform any of its other obligations hereunder on the schedule and for the compensation provided for herein. Prior to the Commencement Date, the Authority will provide the City written notification of any defect, flaw, error, inoperability, inadequacy or other condition or aspect of the existing condition of the Facilities which exists. Any such defect, flaw, error, inoperability, inadequacy or other condition or aspect not identified by the Authority in its notice to the City as of the Commencement Date or which may be revealed during the performance hereof shall not be an Uncontrollable Circumstance. The Authority's assumption of risk under this subsection is subject to the limitations provided in subsection (C) of this Section.

(C) Limitations on the Authority's Assumption of "As-Is" Risk. It is specifically understood that the Authority's assumption of the "as-is" risk of the condition of the Facilities as provided in subsection (B) of this Section shall not extend to the following: (1) Pre-Existing Environmental Conditions, (2) Specified Site Conditions and (3) the actual condition of structures and equipment which could not have been known to the Authority prior to the Commencement Date or could not have been verified by the Authority prior to the Commencement Date without cutting through such equipment or structures, draining or removing material therefrom or unreasonably materially interfering with the operation of the Facilities, but only to the extent that such conditions could not have been reasonably

anticipated based upon the Authority's experience operating the Plant and Good Engineering Practice. The City shall retain all obligations arising out of any third party Legal Proceedings resulting from Pre-Existing Environmental Conditions or Specified Site Conditions at the Facilities, except to the extent such Legal Proceeding is based in whole or in part on the Authority's breach of its obligations pursuant to Section 7.9. No other Uncontrollable Circumstance, however, shall relieve or limit the Authority's assumption of the "as-is" risk as provided in subsection 6.4(B).

SECTION 6.5. SERVICE COORDINATION. [(A) Authority's Facilities Manager. The Authority shall appoint a Facilities Manager for the Facilities and the Contract Services (the "Facilities Manager" or "Plant Manager") who shall be licensed and certified as a Grade A Licensed Water Works Operator by the State of Texas, trained, experienced and proficient in the management and operation of water treatment systems comparable to the Facilities. The Facilities Manager shall (1) be responsible for the management and provision of the Contract Services provided to the City hereunder, (2) be responsible for the day-to-day management of the Facilities, and (3) serve as the day-to-day business representative of the Authority in the performance of this Service Contract. The initial Facilities Manager shall be Jerry L. Sharp, who shall not be replaced without the prior approval of the City for a period of one year from the Commencement Date, unless for reasons of retirement, resignation or cessation of employment with the Authority.

(B) City Approval of Replacement Facilities Manager. The Authority acknowledges that the performance of the Facilities Manager serving from time to time will have a material bearing on the quality of service provided hereunder, and that effective cooperation between the City and the Facilities Manager will be essential to effectuating the intent and purposes of this Service Contract. Accordingly, not fewer than 30 days prior to the date on which any candidate for Facilities Manager from time to time during the Term of this Service Contract is proposed by the Authority to assume managerial responsibility for the Facilities, the Authority shall: (1) provide the City with a comprehensive resume of the candidate's licenses, training, and experience, related to management operations similar to the Facilities and customer relations; and (2) afford the City an opportunity to meet with the candidate and the Authority with respect to such matters. The City shall have the right within 30 days following such meeting to provide written comments to the Authority about such candidate. The Authority shall consider the City's comments before making a decision whether to hire the candidate.

(C) Authority's Senior Supervisors. The Authority shall from time to time appoint and inform the City of the identity of one or more senior managers of the Authority with supervisory responsibility for the Facilities and the performance of this Service Contract (the "Senior Supervisors"). The Authority shall promptly notify the City in writing of the

appointment of any successor Senior Supervisors. The Senior Supervisors shall cooperate with the City in any reviews of the performance of the Authority under the Service Contract which the City may undertake from time to time, and shall give full consideration to any issues raised by the City in conducting such performance reviews.

(D) Communications and Meetings. On or before the Commencement Date, the Authority shall inform the City of any business telephone, fax and beeper numbers, e-mail address and other means by which the Facilities Manager and Senior Supervisors may be contacted. The City shall furnish to the Authority comparable communications information with respect to the Contract Administrator. The Authority shall meet with the City each month to review the contents of the operations reports required to be prepared pursuant to Section 6.15. The Facilities Manager and, if requested by the City, a Senior Supervisor shall personally attend the monthly operations meeting with the City, and public City meetings which the City may reasonably request from time to time, to review management, operational, performance and planning matters arising with respect to the Facilities and this Service Contract.

SECTION 6.6. OPERATION AND MAINTENANCE MANUAL. (A) Development. The Authority shall provide to the City five copies of a draft updated Operation and Maintenance Manual within 90 days following the Commencement Date. Prior to the City's approval of the draft Operation and Maintenance Manual in accordance with subsection (B) of this Section, the Authority shall use and follow the procedures set forth in the existing Operation and Maintenance Manual for the Facilities. The content of the Operation and Maintenance Manual shall be consistent with the Contract Standards, shall contain a description of the means and methods of properly operating the Facilities and any sampling, testing and measurement procedures, shall document predictive, preventive and corrective maintenance procedures, practices and schedules, and shall otherwise be sufficiently detailed to permit the Facilities to be operated and maintained by a qualified party reasonably experienced in water distribution. The Operation and Maintenance Manual shall be developed and maintained in a manner which is fully consistent with the computerized maintenance management system installed and utilized by the Authority pursuant to Section 8.4. The Contract Services shall be performed substantially in compliance with the Operation and Maintenance Manual and the Authority's computerized maintenance management system.

(B) City Review and Approval. The Authority shall review and discuss in good faith with the City any questions the City may have related to the draft Operation and Maintenance Manual, and shall deliver the final Operation and Maintenance Manual to the City within 60 days following completion of review and approval by the City. The Authority shall keep the Operation and Maintenance Manual current and shall periodically supply the City with appropriate updates, supplements or revisions thereto or at any time that a material

change to the Operation and Maintenance Manual is made, to be reviewed and approved in accordance with the procedures described in this Section. Such updates shall not diminish the standards set forth in the initial Operation and Maintenance Manual. Notwithstanding any such review and approval by and discussion with the City, the Operation and Maintenance Manual shall remain at all times the responsibility of the Authority. Neither the review of or approval by, nor the failure of the City to review, comment on, or approve the Operation and Maintenance Manual shall relieve the Authority of any of its responsibilities under this Service Contract.

(C) Supplements for Capital Modifications. The Authority shall prepare supplements and revisions to the Operation and Maintenance Manual which are required due to the design, construction and installation of Capital Modifications. Such supplements and revisions shall be provided, reviewed and approved in the same manner as provided in this Section with respect to the initial Operation and Maintenance Manual. The cost and expense of all such supplements and revisions shall be borne by the Authority, except with respect to supplements and revisions necessitated by Capital Modifications directed by the City or required by a Change in Law or other Uncontrollable Circumstance.

SECTION 6.7. DESIGNATED EMPLOYEE. (A) Authority Employment of Designated Employee. The Authority shall provide full-time, regular employment to the Designated Employee if he elects to accept such employment, to be effective as of the Commencement Date. The Authority's provision of employment will be effectuated subject to the Authority's standard drug and alcohol screening, and background checks. The Authority may also require the Designated Employee to participate in standard health, competency and other tests required of all new employees as long as such tests and evaluations are not used to disqualify the Designated Employee from initial employment. The Authority acknowledges that the City intends to discontinue its employment of the Designated Employee and transfer the Designated Employee to the Authority on the Commencement Date. The City acknowledges and agrees that the Authority is an "at will employer" and that the Designated Employee will be subject to the policies, procedures and programs applicable to all Authority employees.

(B) Wages and Benefits of Designated Employee. The Authority's offer of employment to the Designated Employee shall include (1) wages which in the aggregate, are equal to or better than the wages provided by the City to the Designated Employee as of the Contract Date, and (2) personnel, pension and/ or retirement savings benefits the value of which, in the aggregate, are substantially equivalent to the value of the personnel, pension or retirement savings benefits provided by the City to the Designated Employee as of the Contract Date. For purposes of this Subsection 6.7(B), the City acknowledges that the Authority's current personnel benefits, and pension and retirement savings plans as summarized on Appendix 5 are "substantially equivalent" to those provided by the City.

SECTION 6.8. STAFFING AND PERSONNEL TRAINING. (A) Staffing. The Authority shall staff the Facilities during the Term of this Service Contract with qualified personnel who meet the licensing and certification requirements of the State, under a staffing plan which is consistent with the Authority's response to the RFP. The Authority will promptly fill vacated positions and will, from time to time, notify the City of any change in staffing levels and positions. The Authority shall not reduce the staffing level from that contained in the Staffing Plan without the City's written approval, which the City shall not withhold unreasonably.

(B) Changes in Staffing Plan. Changes in the staffing plan or refusal by the appropriate Governmental Body to approve proposed changes in the staffing plan shall not constitute a Change in Law unless such changes are required in order for the Authority to provide the Contract Services as a result of a separate and identified Change in Law event. In the case of such a separate and identified Change in Law event, the staffing plan as approved and in effect as of the date of such event shall be the baseline for measuring the effect of any such Change in Law event that affects required staff levels.

(C) Training. The Authority shall be responsible for training the Facilities Manager and all other Authority personnel.

SECTION 6.9. ENERGY SUPPLY AND CONSUMPTION. The Authority shall have the right and the responsibility to arrange for the supply of electricity, telephone, and all other Utilities to the Facilities, and to negotiate and establish rates and terms of service with the respective suppliers, subject to the written approval of the City, which approval may not be unreasonably withheld. The City shall be responsible for providing water and wastewater service to the Facilities that meet the needs of the Authority in fulfilling its obligations under the Service Contract. The Authority shall pay Utility bills in a timely manner. The Authority acknowledges that the Base Fee of the Service Fee, as escalated, includes all compensation to which the Authority is entitled on account of Utility service, except with respect to electricity, which is a Pass-Through Cost up to the Guaranteed Maximum Electricity Utilization.

SECTION 6.10. SAFETY AND SECURITY. (A) Safety. The Authority shall maintain the safety of the Facilities at a level consistent with Applicable Law, Required Insurance, the Safety and Security Plan and Good Industry Practice. Without limiting the foregoing, the Authority shall: (1) maintain the security of the Facilities, take reasonable actions to prevent vandalism to and trespass or terrorism at the Facilities, and take reasonable precautions for the safety of, and provide reasonable protection to prevent damage, injury or loss by reason of or related to the operation of the Facilities to, (a) all employees working at the Facilities and all other persons who may be involved with the operation, construction, maintenance, repair and replacement of the Facilities, (b) all visitors to the Facilities, (c) all materials and equipment under the care, custody or control of the Authority on the Site, and

(d) other property constituting part of the Facilities; {2) establish and enforce reasonable safeguards for safety and protection, including posting danger signs and other warnings against hazards and promulgating safety regulations; (3) give notices and comply with all Applicable Law relating to the safety of persons or property or their protection from damage, injury or loss; {4) designate a qualified and responsible employee at the Facilities whose duty shall include the responsibility for plant safety, the prevention of fires and accidents and the coordination of such activities as shall be necessary with federal, State and City officials; (5) operate all equipment in a manner consistent with the manufacturer's safety recommendations; {6) provide for safe and orderly vehicular movement and conduct periodic inspections to ensure that each Authority or Facility vehicle possesses the required safety equipment; and (7) develop and carry out a safety program related to the Facilities, including employee training and periodic inspections, designed to implement the requirements of this Section. The Authority shall report breaches in security and threats of such breaches to the City's Contract Administrator and to the San Marcos Police Department immediately upon discovery. The Authority will conduct an annual review of the Facilities' security with the City to identify areas of risk and measures for improving security. The Authority may change the locks and security codes at the Facilities, provided a duplicate key and/ or security codes for all changed locks shall be provided to the City. The Authority will provide information, as requested, to the appropriate Governmental Body, or other designated agencies.

(B) ADA. The City shall be responsible for making any modifications to the Facilities, as they exist on the Commencement Date, needed for compliance with the Americans with Disabilities Act. Thereafter, the Authority and the City shall make all Capital Modifications to the Facilities in compliance with the provisions of the Americans with Disabilities Act in effect at the time of each such Capital Modification. In accordance with Section 9.1(C), the City shall be responsible for the costs associated with any such Capital Modification unless the Capital Modification is requested by the Authority. Upon completion of any such Capital Modifications, the Authority shall bear all risk of any non-compliance with the Americans with Disabilities Act.

(C) Security. The Authority shall be responsible for the security of the Facilities, and shall maintain the existing fences and gates, and the locks at the Facilities.

SECTION 6.11. COMPLIANCE WITH APPLICABLE LAW. {A) Compliance Obligation. The Authority shall perform the Contract Services in accordance with Applicable Law, and shall cause all Subcontractors to comply with Applicable Law. The Authority shall comply with the terms of all Governmental Approvals and other Applicable Law pertaining to the Facilities and Finished Water, notwithstanding the fact that the Authority may not be a permittee or co-permittee with respect to some or all of such Governmental Approvals.

(B) Sampling, Testing and Laboratory Work. The Authority shall perform and provide all sampling, laboratory testing and analyses, and quality assurance and quality control procedures and programs required by the Contract Standards and Applicable Law. The Authority shall use competitive laboratories for all compliance testing and analysis not performed by the Authority or TCEQ and their designated employees unless otherwise authorized in writing by the City. In any event, all testing laboratories shall be certified by the TCEQ, EPA or other appropriate entity for the applicable test, and shall be inspected and monitored by the Authority for compliance with the required standard test methods. All sampling and test data shall be available for review by the City. The Authority will provide the City with reports on the sampling and test data requested by the City. The Authority explicitly assumes the risk of incorrect sampling, testing and laboratory work and any consequences thereof or actions taken or corrections needed based thereon, whether such work is performed by itself or third parties, both as to failures to detect and as to false detections. The Authority shall permit the City, at the City's expense, to perform any testing, sampling or analytical procedure it deems appropriate, using the Facilities, so long as such testing, sampling and analysis does not hinder the Authority's ability to fulfill its obligations under the Service Contract. In the event third party analytical quality is not compliant with standard test methods, shows patterns of consistent quality control failure, or for any reason fails to meet the requirements of this Subsection, the Authority may request of the City authorization to change the analytical provider. The Authority will cooperate in the City review of such claims. The City retains the right to direct a change in provider if it is deemed to be in the interest of the City

(C) Investigations of Non-Compliance. In connection with any actual or alleged event of non-compliance with Applicable Law, the Authority shall, in addition to any other duties which Applicable Law may impose: (1) fully and promptly respond to all inquiries, investigations, inspections, and examinations undertaken by any Governmental Body; (2) attend any meetings and hearings required by any Governmental Body; (3) provide corrective action plans, reports, submittals and documentation required by any Governmental Body; (4) in conjunction with the City, communicate in a timely and effective manner with the general public as to the nature of the event, the impact on the public, and the nature and timetable for the planned remediation measures; and (5) promptly upon receipt thereof, provide the City with a copy of any written notice of violation or non-compliance with Applicable Law, and a transcript of any oral notice of non-compliance with Applicable Law, issued or given by any Governmental Body. The Authority shall furnish the City with prompt written notice describing the occurrence of any event or the existence of any circumstance which does or may result in any such notice of violation or non-compliance to the extent the Authority has

knowledge of any such event or circumstance, and of any Legal Proceeding alleging such non-compliance.

(D) Fines. Penalties and Remediation. Except to the extent excused by Uncontrollable Circumstances, City Breach or the exceptions to the Authority's assumption of the "as-is" risk set forth in subsection 6.4{C), in the event that the Authority or any Subcontractor fails at any time to comply with Applicable Law with respect to the Facilities, Finished Water, or this Service Contract, the Authority shall, without limiting any other remedy available to the City upon such an occurrence and notwithstanding any other provision of this Service Contract: (1) promptly correct such failure and resume compliance with Applicable Law; (2) bear all Loss-and-Expense of the Authority and the City resulting therefrom; (3) pay or reimburse the City for any resulting actual damages, fines, assessments, levies, impositions, penalties or other charges; (4) make any Capital Modifications and changes in operating and management practices that the City may request which are necessary to assure that the failure of compliance with Applicable Law will not recur; and (5) comply with any corrective action plan filed with or mandated by any Governmental Body in order to remedy a failure of the Authority to comply with Applicable Law.

(E) No Nuisance Covenant. The Authority shall keep the Facilities neat, clean and litter-free at all times, and ensure that the operation of the Facilities does not create any odor, litter, noise, fugitive dust, vector or other adverse environmental effects constituting, with respect to each of the foregoing, a nuisance condition under Applicable Law. Should any such nuisance condition occur which is not caused by Uncontrollable Circumstances, City Breach or other City activity, the Authority shall promptly remedy the condition, pay any regulatory fines or penalties relating thereto, make any Capital Modifications and changes in operating and management practices that the City may request which are necessary to prevent a recurrence of the nuisance condition, and, to the full extent of its liability under applicable law, pay costs related to the nuisance condition in accordance with Section 12.3.

SECTION 6.12. GOVERNMENTAL APPROVALS. (A) Applications and Submittals. Except with respect to the City's Edwards Aquifer Authority Permit, the Authority, in a timely manner, shall make all applications necessary to obtain and maintain the Permits and all other Governmental Approvals required to be made, obtained or maintained under Applicable Law in order to operate the Facilities, including those set forth in Appendix 2. With respect to Governmental Approvals, the Authority, in a timely manner, shall: (1) develop and furnish all necessary supporting material; (2) supply all data and information which may be required; (3) familiarize itself with the terms and conditions of such Governmental Approvals; (4) attend required meetings and hearings; and (5) take other action necessary in obtaining, maintaining, renewing, extending and complying with the terms of such Governmental Approvals. All permit and filing fees required in order to obtain and maintain Governmental

Approvals for the Contract Services shall be paid by the Authority, except Governmental Approvals required in connection with an Uncontrollable Circumstance or a City requested Capital Modification. The Authority shall agree to be named as a co-permittee on any Governmental Approval if so required by the issuing Governmental Body. The City shall be responsible for paying all fees and charges related to its Edwards Aquifer Authority Permit, including any charges related to Section 1.29 of Senate Bill 1477 (the "Edwards Aquifer Authority Act").

(B) Data and Information. Data, information and action required to be supplied or taken in connection with the Governmental Approvals required for the Contract Services shall be supplied and taken on a timely basis. The data and information supplied by either party to the other and to all regulatory agencies in connection therewith shall be correct and complete in all material respects. All such information shall be submitted in draft form by the submitting party sufficiently in advance to allow full and meaningful review and comment by the reviewing party. Each party shall be responsible for any schedule and cost consequences which may result from its submission or modification of materially incorrect or incomplete information. The City reserves the right to reject, modify, alter, amend, delete or supplement any information supplied by the Authority pursuant to this Section.

(C) Non-Compliance and Enforcement. The Authority shall report to the City, promptly upon obtaining knowledge thereof, all violations of the terms and conditions of any Governmental Approval or Applicable Law pertaining to the Facilities. The City shall have the right independently to enforce compliance with the requirements of any Governmental Approval regardless of whether a concurrent or different regulatory enforcement action has been undertaken by any other Governmental Body. The failure of the Authority to take action to comply with any Governmental Approval may constitute a breach of this Service Contract.

(D) Reports to Governmental Bodies. The Authority shall prepare all periodic and annual reports, make all information submittals and provide all notices to all Governmental Bodies required by all Governmental Approvals (other than the Edwards Aquifer Authority Permit) and under Applicable Law with respect to the Facilities, including sampling and testing results and monthly discharge monitoring or operating reports. Such reports shall contain the information required by the Governmental Body, and may be identical to comparable reports prepared for the City, if such are acceptable to the Governmental Body. The Authority shall provide the City with a copy of each such report, submittal and notice prior to submittal to the Governmental Body.

(E) Potential Regulatory Change. The Authority shall keep the City regularly advised as to potential changes in regulatory requirements affecting the Facilities, and provide recommended responses to such potential changes so as to mitigate any possible adverse economic impact on the City should a Change in Law actually occur. The Authority, at the

request of the City, shall participate in performance evaluation surveys conducted by TCEQ, TDWB and EPA.

SECTION 6.13. CUSTOMER SERVICE. (A) Customer Service, Generally. The Authority shall provide customer service for the Facilities and shall develop and implement customer service procedures subject to City approval.

(B) Customer Service Requirements. The Authority shall perform the customer services in accordance with the following minimum requirements:

(1) The Authority shall maintain a sufficient staff to assist the City's customers with issues related to the Facilities. The Authority's staff shall be trained to answer questions related to the Facilities.

(2) The Authority shall establish and maintain a 24-hours per day local San Marcos telephone number that will normally be answered by a person and not a voicemail or other automated recorder, for the receipt of reports of emergencies, complaints or other customer communications relating to the Facilities.

(3) The Authority shall respond to Facilities emergencies, including loss of pressure, communication outages, power interruptions, overflow conditions, water quality issues and leaks related to the Facilities within an appropriate time of the Authority's knowledge thereof.

(4) The Authority shall log all customer complaints and communications to be included in the monthly operations report.

(C) Community Outreach. The Authority shall prepare, subject to City review and approval, a comprehensive information brochure relating to the Facilities within 90 days following the Commencement Date. The Authority shall make sufficient copies available for all reasonable public information purposes. In addition, the Authority shall, upon the reasonable request of the City, conduct educational tours of the Facilities, appear or speak at community functions related to the Facilities and participate in communications with media outlets to inform the public of issues relating to the performance and status of the Facilities and related systems.

(D) Reports. The Authority shall submit as part of its monthly operations reports, delivered pursuant to Section 6.15, information with respect to its community outreach activities related to the Facilities.

SECTION 6.14. ASSET AND FINANCIAL RECORDS. (A) Facilities Records. The Authority, on and after the Commencement Date, shall establish and maintain computerized information systems with respect to the Facilities for operations and maintenance data and process control, including the information necessary to verify calculations made pursuant to this Service Contract and demonstrate compliance with the Contract Standards. The Authority shall promptly provide the City, upon reasonable request,

with copies of operations and maintenance data and other information kept by the Authority in its performance of the Contract Services.

(B) Availability of Facilities Records to City. The Authority shall make available to the City operations, maintenance, performance, complaint tracking, Finished Water, Delivered Water, process control and similar records and data related to the Facilities. The Authority and the City agree to cooperate to identify methods to provide the City with real time, continuous computer access to such records and data through their respective information systems.

(C) Record Documents and Mapping. The Authority shall maintain at the Plant and make available to the City upon request for review and copying all designs, drawings, blueprints, plans, specifications and "as-built" or record drawings and documents relating to any Capital Modifications performed by the Authority. The Authority shall: (1) keep current all such Facilities records to show any changes to the Facilities (including valves, pipes, pumps, meters and other assets) made by the Authority in the performance of the Contract Services; and (2) provide advice to the City, based on such records, in establishing and maintaining any City geographic mapping and information systems.

(D) Financial Records. The Authority shall prepare and maintain accurate, complete and current financial books, records and accounts, in accordance with generally accepted accounting principles, with respect to all aspects of the Facilities and Contract Services, including direct and indirect personnel expenses, Subcontractor costs, the costs of material, equipment and supplies, maintenance, repair and replacement items, operating expenses and overhead. These financial records shall be in form and substance sufficient to support all financial reporting, including Cost Substantiation, required hereunder. Appropriate forms of these financial records may include paper copies as well as electronic copies or images. In the event the Authority fails to prepare or maintain the books, records or accounts as required under this Section, the Authority shall not be entitled to the requested payments or adjustments for which Cost Substantiation was required hereunder to the extent such failure prevented Cost Substantiation. The Authority shall keep in a form consistent with other Authority records of a similar nature the relevant portions of the books, records and accounts maintained with respect to each Contract Year until at least the seventh anniversary of the last day of each such Contract Year (or such longer period as may be appropriate to account for any dispute then pending). For those circumstances that require Cost Substantiation under Section 14.7, the Authority shall make such books and records available to the City for inspection, audit and copying upon reasonable notice during business hours to the extent necessary to allow the City to determine to its reasonable satisfaction the accuracy, completeness, currency and propriety of any charge or request for payment hereunder. The Authority shall also be required to provide the City with monthly budget performance reports in

a format consistent with similar reports the Authority prepares for other operations and an annual income statement prepared in accordance with generally accepted accounting principles showing profit or loss under this Service Contract. The annual statement may be based upon the Authority's fiscal year.

(E) Inspection, Audit and Adjustment. The City shall have the right to perform or commission an inspection or an independent audit of the financial information required to be kept under this Section, subject to possible reimbursement as provided in this Section. The inspection or audit of any financial information shall be conducted no later than three years following the year in which financial transactions were incurred that are the subject of the financial information. If an inspection or audit reveals that the City has overpaid the Service Fee, then the Authority shall, at the election of the City, either immediately reimburse to the City or offset against future Service Fee payments, as a Service Fee adjustment, the overpaid amount. If an inspection or audit reveals that the City has underpaid the Service Fee, then the City shall immediately pay the underpaid amount. The foregoing remedies shall be in addition to any other remedies the City may have, including remedies for an Event of Default by the Authority.

SECTION 6.15. PERIODIC REPORTS. (A) Monthly Operations. The Authority shall provide the City with monthly operations reports no later than 15 days after the end of each calendar month, including the following operating data:

- (1) a summary of all notices and laboratory, test and other reports filed with or received from all Governmental Bodies pursuant to the Governmental Approvals;
- (2) a summary of the quantities and characteristics of Finished Water received and distributed, and the quantity of Unaccounted-For Water produced during such month;
- (3) a summary of quantities and types of chemicals and other agents used in the treatment of Finished Water;
- (4) a summary of operational issues, including personnel and Utility usage;
- (5) a description of any complaints received by the Authority in relation to the Contract Services and of how each complaint was addressed by the Authority;
- (6) a brief description of the maintenance, repair and replacement activities performed and Capital Modifications made by the Authority during the prior month and anticipated during the current month;
- (7) any adverse conditions which may reasonably be expected to arise during the current month that may affect the ability of the Authority to collect, receive, and treat Well Water and to distribute Finished Water in accordance herewith;

(8) a description of any regulatory or insurance inspections conducted during the prior month, the anticipated results, and activities performed to comply with such inspections;

(9) information on any Utility outages occurring during the prior month;

(10) any failure to meet permit standards;

(11) a description of any environmental, health or safety tests or monitoring procedures conducted by any Governmental Body, during the prior month, and copies of any reports or other submittals made to or received from any such Governmental Body; and

(12) any notices of violations of any Governmental Approval received during the prior month.

(B) Annual Operations and Maintenance Reports. The Authority shall furnish the City, within 60 days after the end of each Contract Year, an annual summary of the information contained in the monthly operations reports. That report will also include a list of any Facilities Equipment disposed of as surplus property during the year pursuant to Section 8.6; and the quantity of electricity used during the year. The Authority shall also perform and report to the City, as part of its annual operations report, the results of an annual review of administrative, operational and maintenance practices employed in the management of the Facilities. Such report shall include summaries of Service Fee payments and any necessary reconciliations.

(C) Default Reports. The Authority shall provide to the City, immediately after the receipt thereof, copies of any written notice of a material default, breach or non-compliance received or sent under or in connection with any material contract entered into by the Authority in connection with the Contract Services.

(D) Permit Communications and Reports. The Authority shall provide to the City copies of all communications and reports furnished to any Governmental Body pursuant to this Section simultaneously with their submittal to the Governmental Body.

SECTION 6.16. EMERGENCIES. Should the Authority fail, refuse or be unable to operate the Facilities in accordance with the Service Contract for a period of 24 hours, the City may provide the Authority with written notice of such failure, refusal or inability. If the Authority fails, refuses or is unable to resume operation of the Facilities in accordance with the Service Contract within 24 hours of receipt of notice from the City, then the City may (but shall not be obligated to) take possession of the Facilities and perform the Authority's operations obligations. If the Authority fails, refuses or is unable to operate the Facilities in accordance with the Service Contract for any period of time, and such failure, refusal or inability to operate the Facilities would, in the opinion of the City, endanger public health, safety or welfare, the City, upon written notice, may (but shall not be obligated to) take

possession of the Facilities and perform the Authority's operations obligations. The City may operate the Facilities pursuant to this Section by using City employees, or Authority employees assigned to the Facilities (with their consent), or by hiring a subcontractor. If the failure, refusal or inability of the Authority to operate the Facilities as described above is not the result of Uncontrollable Circumstances or the result of the acts, actions or omissions of the City or any person or entity acting for or on behalf of the City, payment of the Service Fee shall be suspended (except for the costs of Authority employees used by the City, if any,) during the period of the failure, refusal or inability to operate the Facilities, and the Authority shall reimburse the City for the amount of any costs and expenses incurred by the City in operating the Facilities which exceed the suspended Service Fee amount. If such failure, refusal or inability is the result of an occurrence covered by insurance, the City and the Authority shall determine the extent to which the insurance proceeds cover their respective costs and obligations related to the failure, refusal or inability, and shall distribute the insurance proceeds accordingly. The City may require the Authority to resume its operating obligations at any time.

SECTION 6.17. COST REDUCTION AND SERVICE IMPROVEMENT. In the event either party offers the other party any idea, approach or concept for lowering the Authority's cost, reducing the City's Service Fee or total costs, or improving the Authority's service, the other party shall reasonably consider and explore the development and implementation of the concept. Neither party shall be obligated to negotiate or to agree to amend this Service Contract to effectuate any such idea, approach or concept except in its sole discretion and upon terms and conditions acceptable to it.

SECTION 6.18. LANDSCAPING. The Authority shall maintain the landscaping at the Facilities, including utilization of a landscape irrigation system, to enhance the appearance of the Facilities.

ARTICLE VII
PERFORMANCE

SECTION 7.1. FACILITIES PERFORMANCE GENERALLY. (A) Reliance. The Authority acknowledges that the City, in serving water supply needs of the Service Territory, is providing an essential public service, and in complying with its obligations under Applicable Law is relying on the performance by the Authority of its obligations hereunder. Except to the extent relieved by Uncontrollable Circumstances or a specific provision of this Service Contract relieving the Authority of its obligations, the Authority shall operate the Facilities on a continuous, uninterrupted 24-hour per day, 7-day per week basis.

(B) Maximum Capacity Utilization. Within the capacity limits of the Plant and the Wells, the Authority shall utilize the Facilities to supply the amount of Finished Water and Well Water required by the City. The Authority shall not be required by the City to produce Finished Water or Well Water in quantities that exceed such capacities or which produce Finished Water or Well Water that exceeds the quality requirements of any Governmental Body. The Authority shall not intentionally reduce the level of water treatment capable of being achieved by the Facilities in an effort to reduce its operating and maintenance expenses.

(C) Curtailments and Shutdowns. If the operation of the Facilities is temporarily reduced, curtailed or shut down so that the Authority is unable to collect, receive, treat or to deliver Finished Water, in accordance herewith, the Authority shall promptly advise the City as to the nature and probable duration of such reduction, curtailment or shutdown and the expected effect on the operation of the Facilities, and take the steps necessary to remedy the reduction, curtailment or shutdown and to resume full performance hereunder as soon as possible.

(D) Limitations on Authority Rights. The Authority shall not use the Facilities for any purpose other than the purposes contemplated in this Service Contract. The only compensation payable by the City to the Authority for providing the Contract Services under this Contract shall be the Service Fee payable by the City hereunder, as that Service Fee is adjusted and may be amended from time to time pursuant to this Service Contract.

(E) Selection of Raw Water. The City shall have at all times the right to determine the quantities of raw water from each raw water source to be utilized in the System. The City will regularly communicate to the Facilities Manager the quantities and sources of Raw Water desired by the City. The Authority will manage withdrawals from the Wells to comply with regulatory and contract requirements of the Edwards Aquifer Authority applicable to the City. The Authority shall have at all times the right to determine the quantities of raw

water from each raw water source that are treated at the Plant for use by water suppliers other than the City, including the customers of the Authority.

SECTION 7.2. WATER TREATMENT GUARANTEE. (A) Applicable Law Limits. The Authority shall operate the Facilities in accordance with Applicable Law and the terms of this Service Contract.

(B) Enhanced Standards. In addition to its obligation to comply with Applicable Law as provided in subsection (A) of this Section and except to the extent relieved by Uncontrollable Circumstances or a specific provision in this Service Contract, the Authority shall operate the Facilities so that Finished Water is produced in compliance with the requirements of Applicable Law and the Enhanced Standards (whichever is more stringent) set forth in Appendix 6 (the "Enhanced Water Standards"). The obligation of the Authority to produce Finished Water in compliance with the requirements of Applicable Law and the Enhanced Standards shall constitute the "Water Treatment Guarantee".

(C) Applicability of Water Treatment Guarantee. The Water Treatment Guarantee shall apply, except to the extent excused by Uncontrollable Circumstances or City Breach.

(D) Conditions to Relief. In the event and for any period during which the Authority is unable to achieve the Water Treatment Guarantee due to an Uncontrollable Circumstance or City Breach, the Authority shall use reasonable efforts in accordance with Good Industry Practice to comply with the Water Treatment Guarantee.

(E) Change in Law Affecting Finished Water. The parties acknowledge that a Change in Law may affect Finished Water standards or impose more stringent requirements relating to equipment or processes than those established hereunder as of the Commencement Date. In the event such a Change in Law occurs, the Authority shall be entitled to performance relief or additional compensation under Section 12.2 if: (1) such Change in Law imposes a regulatory standard or operating requirement with respect to any particular Finished Water characteristic or parameter which is more stringent or burdensome to comply with than the Contract Standards applicable to such characteristic or parameter, or requires equipment or processes not then in place or practiced at the Facilities; and (2) the Authority is unable to meet the Water Treatment Guarantee, after taking the mitigation measures required under Subsection 12.2 (B) with respect to such a Change in Law. The Parties acknowledge and agree that the costs associated with sampling and additional treatment required by the proposed Long Term 2 Enhanced Surface Water Treatment Rule have not been included in the Service Fee, and therefore will be subject to the provisions of this subsection.

SECTION 7.3. WATER AVAILABILITY AND LEVELS. The Authority shall, throughout the Term, operate the Facilities to maintain water in the City's storage tanks at levels established by the City and the Authority. The storage tank level set points will be

established to assure, within the capabilities of the Facilities, the availability of Finished Water to the System even in the event of a power outage or if needed for fire-fighting purposes. The Authority shall monitor measuring devices in the City's Finished Water reservoirs, sufficient for determining the level of Finished Water in the such reservoirs on a continuous basis.

SECTION 7.4. PRODUCTION EFFICIENCY GUARANTEE. (A) Standards. Except to the extent relieved for Uncontrollable Circumstances or City Breach, the Authority shall operate the Plant to achieve Unaccounted-For Water of 5% or less on an annual average basis over the course of each Contract Year following the Commencement Date.

(B) Preventing Recurrence of Violations. In the event the Authority fails to comply with the Production Efficiency Guarantee set forth or referred to in this Section, and is not excused by Uncontrollable Circumstances or City Breach, in addition to any other remedy available to the City hereunder, the Authority shall implement changes in operating, maintenance, repair, replacement and management practices in accordance with Good Industry Practice in order to achieve the Production Efficiency Guarantee.

SECTION 7.5. WATER PRESSURE AND FLOW GUARANTEE. The Authority shall operate and maintain the Facilities in accordance with the requirements of Applicable Law and this Service Contract with respect to water pressure and emergency fire flow capacity requirements. Pressures and flows that do not fulfill the requirements of the Service Contract will not be the responsibility of the Authority if those failures are due to Uncontrollable Circumstances, City Breach or malfunctions and inadequate capacity in the System, including but not limited to leaks, closed valves or localized water hammer effects not caused by the Authority's operation of pumps at the Plant or the Wells.

SECTION 7.6. WATER QUANTITY GUARANTEE. The Authority shall furnish Finished Water to meet the City's demand and to meet emergency fire flow capacity requirements in accordance with Applicable Law. In addition, within the capacities of the Plant and Wells, the Authority shall furnish Finished Water in the quantities required under the City's agreement to provide Finished Water to the City of Kyle and other similar customers designated by the City during the Term of the Service Contract. However, the Authority is not required to furnish such Finished Water to the extent the System does not have the capacity to deliver such Finished Water to the City of Kyle or other similar customers.

SECTION 7.7. EDWARDS AQUIFER AUTHORITY REQUIREMENTS. The Authority shall cooperate with the City in fulfilling the City's strategy to meet Edwards Aquifer Authority requirements. The City shall determine the quantity of water to be produced by the Authority from the Wells and shall provide direction to the Authority about such quantities on a regular basis. Such directions from the City will not require that the Authority pump more water from Edwards Aquifer Authority than allowed under Edwards Aquifer Authority pumping restrictions or critical period reduction rules based on declining aquifer levels. The City

reserves the right to change pumping strategies at any time and will promptly notify the Authority of any such changes.

SECTION 7.8. RELEASES, LEAKS AND SPILLS. (A) Unauthorized Releases Prohibited. The Authority shall operate the Facilities in such a manner that Finished Water, Residuals or chemicals will not contaminate, or be bypassed, released, leaked or spilled on or into, the environment, other than as permitted by the more stringent of Applicable Law or the applicable Contract Standards.

(B) Notification and Reporting. The Authority, while contemporaneously notifying the City, shall be responsible for fulfilling all notification of and reporting requirements established by Applicable Law related to any unauthorized release of Finished Water, Residuals or chemicals into the environment from or in connection with its operation and management of the Facilities. The Authority shall prepare a memorandum evidencing such notification and reporting, and provide copies thereof to the City, along with any documents provided to the relevant Governmental Body regarding the release.

(C) Cleanup and Costs. The Authority shall coordinate with the City and the appropriate Governmental Bodies in effectuating the prompt remediation of any unauthorized release. The Authority shall, in the most expeditious manner possible under the circumstances, cause any unauthorized release of Finished Water, Residuals or chemicals to be remediated in accordance with Applicable Law. All costs associated with performing any such cleanup and remediation measures shall be borne by the Authority, except to the extent the unauthorized release of Finished Water, Residuals or chemicals resulted from an Uncontrollable Circumstance or City Breach.

SECTION 7.9. PRE-EXISTING ENVIRONMENTAL CONDITIONS AND SPECIFIED SITE CONDITIONS. Within sixty (60) days of the Contract Date, the City shall notify the Authority of any Pre-Existing Environmental Condition or Specified Site Condition known to the City related to the Facilities. The Authority shall operate and manage the Facilities so as not to aggravate the effect of any Pre-Existing Environmental Condition or Specified Site Condition known to the Authority. If at any time a Pre-Existing Environmental Condition or Specified Site Condition is determined to exist which (1) requires an action under Applicable Law, (2) interferes with the performance of the Contract Services, or (3) increases the cost to the Authority of performing the Contract Services, then the City shall within [60] days after written notice from any Governmental Body or the Authority of the presence or existence thereof, commence and diligently prosecute such actions as may be necessary to dispose of, remediate or otherwise correct the Pre-Existing Environmental Condition or Specified Site Condition or otherwise make the Pre-Existing Environmental Condition or Specified Site Condition comply with Applicable Law. The City shall have the right to contest any determination of a Pre-Existing Environmental Condition or Specified Site Condition and

shall not be required to take any action under this subsection so long as: (1) the City is contesting any determination of a Pre-Existing Environmental Condition or Specified Site Condition in good faith by appropriate proceedings conducted with due diligence; and (2) Applicable Law permits continued operation of the Facilities pending resolution of the contest, so that the Authority shall have no liability as a result of the failure of the City to dispose of, remediate or otherwise correct such Pre-Existing Environmental Condition or Specified Site Condition during the period of contest.

SECTION 7.10. CITY REMEDIES FOR NON-COMPLIANCE WITH PERFORMANCE GUARANTEES. (A) Remedies. If the Authority fails to comply with any Performance Guarantee, the Authority shall: (1) promptly notify the City within 8 hours of the Authority's having knowledge of any such non-compliance; (2) promptly provide the City within 24 hours with copies of any notices sent to or received from the EPA, TCEQ or any other Governmental Body having regulatory jurisdiction with respect to any violations of Applicable Law; (3) promptly prepare all public notifications required by Applicable Law, and submit such notifications for publication; (4) indemnify, defend and hold harmless the City Indemnitees in accordance with Section 12.3 in connection with the failure; and (5) assist the City with and manage all public relations matters necessary to adequately address any public concern caused by such non-compliance, including preparation of press releases, attendance at press conferences, and participation in public information sessions and meetings and handle all public inquiries. If the Authority fails to comply with any Performance Guarantee and such nonperformance is not due to City Breach, Change in Law or an Uncontrollable Circumstance, the Authority shall, without relief under any other Performance Guarantee, and in addition to any other remedy provided herein, allowed by Applicable Law or required by a Governmental Body: (1) pay the City for the any actual costs incurred by the City; (2) pay any other resulting third party damages, fines, levies, assessments, impositions, penalties or other charges, judgments or awards assessed under applicable law; and (3) at its own cost and expense take any action (including making all repairs and replacements and operating and management practices changes) necessary in order to comply with such Performance Guarantee, continue or resume performance hereunder and eliminate the cause of, and avoid or prevent the recurrence of non-compliance with such Performance Guarantee.

(B) Performance Testing. The City, at any time after giving the Authority reasonable notice, may require a performance test to be conducted by the Authority, at the City's cost and expense, to reasonably demonstrate that the Facilities are operating in compliance with Applicable Law and the Performance Guarantees. The performance tests shall be conducted in a manner as to not unduly interfere with the Authority's performance obligations hereunder. If the test is not successfully passed, the Authority shall reimburse the City for the City's actual costs incurred in association with the first performance test, and, at

its own cost and expense, make all necessary repairs and replacements, including major repairs and replacements, and the test shall be re-performed at the Authority's sole cost until the test is successfully passed by the Authority. The City will conduct or document each such test.

SECTION 7.11. TESTING, AND METERING. (A) Testing. The Authority shall conduct sampling, testing, and monitoring of Finished Water and Residuals in accordance with Applicable Law, Good Industry Practice and Subsection 6.11 (B) of this Service Contract.

(B) Metering . The Authority shall maintain in good working order, and repair and replace when necessary, devices at the Facilities capable of (1) metering the instantaneous and daily total volume of Raw Water, Well Water, and Finished Water, (2) metering or determining the amount of Residuals leaving the Plant for disposal, (3) metering the continuous and daily total amount of Finished Water flow at the Pump Stations, and (4) any other metering or measuring requirement imposed by Applicable Law. The City shall have reasonable access to such meters, instruments, controls, recorders, and other metering and measuring devices. All operating data produced by such metering and measuring devices shall be subject to audit, and shall be summarized in the monthly operations reports delivered to the City pursuant to Section 6.15. All such metering and measuring devices shall be calibrated to the accuracy required by, and shall be operated and maintained in accordance with the requirements of, the Contract Standards. To the extent any metering or measuring device is incapacitated or is being tested, the Authority shall estimate as accurately as practicable the data required by the Authority to perform the Contract Services. This estimate and methodology shall, with the City's approval, be used as the basis for determining the operating data required hereunder during the outage. The City shall have the right to monitor, inspect and test such metering and measuring devices which are part of the Facilities at any reasonable time and for any purpose and to take its own measurements regarding Raw Water, Well Water, Finished Water Residuals without unreasonably interfering with the Authority's ordinary operations. The City shall ensure that the metering and measuring devices at the Wells are in good working order and are properly calibrated as of the Commencement Date. Prior to the Commencement Date, the City shall repair or replace any metering and measuring devices at the Wells that are not operating properly or are not properly calibrated.

SECTION 7.12. ADMINISTRATIVE COMPLIANCE. (A) Compliance. The Authority shall perform the Contract Services in accordance with the Contract Standards. Except to the extent the Authority is relieved for Uncontrollable Circumstances or City Breach, the Service Fee shall be reduced by the City's actual costs and expenses, if any, for the Authority's inability to comply with the requirements indicated below:

- (1) failure to report any exceedance as required by the Contract Standards.

(2) failure to calibrate or verify calibration of flow meters to the manufacturer's accuracy tolerance.

(3) failure to respond to a written request for information related to this Service Contract made by the Contract Administrator and designated as a "priority request" within a reasonable period of time.

(4) failure to provide any plan, proposal, report or other deliverable required hereunder with respect to Uncontrollable Circumstances or any regulatory matter by the deadline agreed upon by the parties with respect thereto.

(5) failure to keep monthly maintenance records as required by Section 8.1.

(6) failure of Authority staff to attend City meetings as reasonably requested, with adequate advance notice from the City.

(7) failure to provide any reports required hereunder within [7] days of the due date.

(8) failure to maintain proper certification as required by any Governmental Body.

(9) failure to respond to alarms at the Plant as required hereunder.

(10) failure to properly sample, test or report the results thereof as required by the Contract Standards.

SECTION 7.13. ENFORCEMENT OF PERFORMANCE GUARANTEES. Non-enforcement of any Performance Guarantee or other performance obligation contained herein for whatever reason shall not constitute a waiver of the City's right to enforce or in any way restrict the City in determination of or action regarding future occurrences.

ARTICLE VIII

MAINTENANCE, REPAIR AND REPLACEMENT

SECTION 8.1. MAINTENANCE, REPAIR AND REPLACEMENT GENERALLY.

(A) Ordinary Maintenance. Except for the Well Supply Equipment, the Well System SCADA, and the City's SCADA system used to monitor and control the System which will be maintained by the City, the Authority shall perform all normal and ordinary maintenance of the machinery, equipment, structures, improvements and all other property constituting the Facilities, shall keep such Facilities in good working order, condition and repair, in a neat and orderly condition and in accordance with the Contract Standards, and shall maintain the aesthetic quality of the Facilities as of the Commencement Date. The Authority shall provide or make provisions for all labor, materials, supplies, equipment, spare parts, Consumables and services which are necessary for the normal and ordinary maintenance of the Facilities and shall conduct predictive, preventive and corrective maintenance of the Facilities as required by the Contract Standards. In accordance with Good Industry Practice, the Authority shall keep monthly and annual maintenance records describing maintenance activities performed, shall develop and comply with a predictive maintenance plan, and shall update the Operations and Maintenance Manual as required to reflect changes in parameters, newly installed equipment or replacement equipment and modified regulatory requirements and operating practices. The Parties acknowledge and agree that the Authority is not responsible for performing maintenance to the City's storage tanks and related cathodic protection equipment, specifically including activities such as coatings protection, metals preparation and painting.

(B) Repair and Maintenance of Site Grounds. The Authority, in accordance with the Contract Standards, shall keep the grounds of the Sites in a neat and orderly condition (including the cleanup of litter and debris on a regular basis). The Authority shall also maintain and repair all fencing, lighting, and signage. The cost for repairs to such fencing, lighting, and signage that result from an Uncontrollable Circumstance, or are insured by the City's property insurance (other than those resulting from the negligent or intentional acts or omissions of the Authority or its officers, agents, employees or Subcontractors) shall be reimbursed by the City to the Authority, subject to the provisions of Section 12.2(E). In addition, the Authority shall provide lawn mowing, and brush cutting services for the Sites, and provide maintenance for all parking lots, roadways, walk-ways, and building entrances and exits at the Sites in accordance with Applicable Law and Good Industry Practice.

(C) Major Maintenance, Repair and Replacements. Except for the Well Supply Equipment and Well System SCADA, the Authority shall perform all major maintenance, repairs and replacement of the machinery, equipment, structures, improvements and all other property constituting the Facilities during the Term of this Service Contract

required under the Contract Standards, including all maintenance, repair and replacement which may be characterized as "capital" in nature. The Operation and Maintenance Manual, or a similar document, shall contain the Authority's plan for the maintenance, repair and replacement of the Facilities as set forth in Section 8.5 and will include the Authority's schedule of major maintenance, repair and replacement set forth in Appendix 3 (the "Major Maintenance, Repair and Replacement Schedule"). With respect to the specific items included in the Major Maintenance, Repair and Replacement Schedule, the Authority shall be obligated to perform such work unless substitute work of equal value is approved in writing by the City. Notwithstanding the itemized Major Maintenance, Repair and Replacement Schedule, the Authority is responsible for performing all major maintenance, repair and replacement and will not be entitled to any additional compensation. However, costs for maintenance, repairs or replacements that result from an Uncontrollable Circumstance or are insured by the City's property insurance (other than those resulting from the negligent or intentional acts or omissions of the Authority or its officers, agents, employees or Subcontractors) shall be reimbursed by the City to the Authority, subject to the provisions of Section 12.2(E).

(D) Spare Parts. The Authority shall maintain a spare parts inventory in accordance with Good Industry Practice.

SECTION 8.2. PROCEDURES TO ASSURE SUFFICIENCY OF AUTHORITY MAINTENANCE, REPAIR AND REPLACEMENT WORK. The parties shall work together to ensure that an initial evaluation of the Facilities, equipment, assets, expendable supplies and spare parts shall be performed within 60 days of the Contract Date for the purpose of establishing the baseline condition of the structures and the quantity and condition (including functionality) of equipment, supplies, chemicals and spare parts. The parties shall also work together to ensure that a similar evaluation of the condition and functionality of the Facilities will be performed in the final Contract Year. The purpose of the initial evaluations shall be to establish an information baseline for determining compliance by the Authority with its maintenance, repair and replacement obligations under this Article. The evaluation of the Facilities shall determine and establish the state of repair of the Facilities as of the Commencement Date. As part of the evaluation, the Authority shall digitally photograph and prepare an itemized inventory of all property constituting the Facilities and shall review all relevant information provided by the City. In the event that the parties cannot agree on the results of the initial or final evaluations, an Independent Evaluator shall be selected by the parties. The Authority shall ensure that the Facilities are in at least as good a condition as when turned over to the Authority, reasonable wear and tear excepted. The Facilities will be maintained, repaired and replaced in a manner which will result in the Facilities being turned over to the City in good working order and which avoids the necessity for the City to undertake an overhaul of the Facilities when assuming management responsibilities at the end of the

term of the Service Contract. In addition, the Authority shall ensure that the value of all spare parts inventory and Consumables at the end of the Term shall be equal to the value of such inventory at the beginning of the Term.

SECTION 8.3. PERIODIC MAINTENANCE INSPECTIONS. (A) Annual Maintenance Inspection. The City may, upon reasonable written notice, perform an inspection of the Facilities and relevant records of the Authority each Contract Year to determine compliance with the Contract Standards generally. The Authority shall cooperate fully with such inspection, which shall not interfere unreasonably with the Authority's performance of the Contract Services.

(B) Triennial Inspections. Beginning in the third Contract Year, and the every third Contract Year thereafter, the City may conduct a more detailed inspection and review of the state of repair, working condition and performance capability of the Facilities. This inspection and review shall be performed by or on behalf of the City at the City's expense, and shall take place at such time as the City shall determine upon three months' written notice to the Authority. The principal purpose of the inspection and review shall be to permit the City to ascertain on a comprehensive and focused basis the extent to which the Facilities are being properly maintained, repaired and replaced in accordance with the Contract Standards generally. The inspection shall include a concurrent review of all relevant data, records and reports. The Authority shall cooperate fully with such inspections, which shall not interfere unreasonably with the Authority's performance of the Contract Services. The City shall provide the Authority with a report of any such inspections within 30 days of receipt of the completed report, and the City shall give the Authority an opportunity to respond to the report.

(C) Response Plan. Based on the annual operations and maintenance reports submitted by the Authority pursuant to Section 6.15 or the annual or triennial inspections and reviews conducted pursuant to this Section, the City may submit a statement to the Authority detailing any deficiencies found and requiring the Authority to submit a response plan. The response plan shall be sufficient to reasonably demonstrate that, if implemented, the Facilities will be promptly brought into compliance with the requirements of this Article. If the City accepts the response plan, the Authority shall thereupon implement the plan in accordance therewith. Failing any required corrective action, the Service Fee payments may be reduced by the amount of the actual costs of remediation, if any, until the costs are fully recovered by the City. Any disputes with respect to the cause or amounts specified in the City's statement, not resolved to the mutual satisfaction of the parties, shall be determined as provided in Section 11.9.

(D) Unscheduled Inspections. Nothing in this Section shall limit the City's right, on an unscheduled basis, to inspect the Facilities and relevant records of the Authority to determine compliance with this Article.

SECTION 8.4. COMPUTERIZED MAINTENANCE MANAGEMENT SYSTEM.

The Authority shall maintain, repair and replace, and if necessary, upgrade, as appropriate throughout the Term, a computerized maintenance management system capable of providing a record of repair and replacement of the Facilities; scheduling, carrying out, monitoring and controlling predictive, preventive and corrective maintenance programs; monitoring routine operations within the Facilities; issuing work orders; maintaining a spare parts inventory; and issuing exception, equipment status and repair priority reports. The maintenance management system shall constitute part of the Facilities, and shall be modified as and when appropriate during the Term to take account of removals from and additions to the Facilities. The Authority shall utilize the computerized maintenance management system to provide the City with documentation which allows it to monitor compliance by the Authority with its maintenance obligations hereunder. The Authority shall permit all electronic data to be replicated and provided to the City. The Authority and the City agree to cooperate to identify methods to provide the City with real time, continuous computer access to such records and data through their respective information systems.

SECTION 8.5. MAINTENANCE, REPAIR AND REPLACEMENT PLAN. The Operation and Maintenance Manual or a similar document shall incorporate a maintenance, repair and replacement plan that includes the Schedule set forth in Appendix 3. The Authority shall adhere to the plan, except where it can demonstrate to the City that changes are reasonable. The timing and extent of maintenance, repair and replacement activities performed by the Authority hereunder with respect to the Facilities, taken as a whole, shall equal or exceed those activities incorporated in the plan. The Authority shall perform any major and "non-major" maintenance, repair and replacement work which is necessary in order to comply with the Contract Standards. The City's approval for any such maintenance, repair or replacement shall not be required unless it constitutes a Capital Modification, in which event the City shall have the approval rights set forth in Article IX. The obligations of the Authority under this Article are intended to assure that the Facilities are fully, properly and regularly maintained, repaired and replaced in order to preserve their long-term reliability, durability and efficiency.

SECTION 8.6. DISPOSAL OF SURPLUS EQUIPMENT. The Authority may, with the approval of the City, remove from the Facilities and dispose of or sell, in accordance with Applicable Law, equipment constituting part of the Facilities that is unused or obsolete and no longer needed. All proceeds from any sale, net of the Authority's actual expenses related to the sale, shall be promptly paid to the City. The Authority shall not store or stockpile at the Facilities any such surplus equipment for an excessive period of time.

SECTION 8.7. WARRANTIES. During the Term of this Service Contract, the Authority shall be responsible for meeting the City's maintenance obligations under all

manufacturer's written warranties on new equipment purchased and installed in the Facilities by the City or by the Authority, and shall be the agent of the City in enforcing any written equipment warranties and guarantees. The Authority shall not be required to commence or maintain any litigation with respect to such warranties or guarantees, but may do so in its discretion. The Authority shall cooperate with and provide staff assistance to the City if the City seeks to enforce warranties and guarantees through litigation.

SECTION 8.8. LOSS, DAMAGE OR DESTRUCTION TO THE FACILITIES.

(A) Prevention and Repair. The Authority shall use care and diligence, and shall take appropriate precautions, to protect the Facilities from loss, damage or destruction. The Authority shall report to the City promptly upon obtaining knowledge thereof, any loss, damage or destruction to the Facilities and as soon as practicable thereafter shall submit a report to the City. The Authority shall also submit to the City within 24 hours of receipt copies of all accident and other reports filed with, or given to the Authority by, any person, insurance entity, adjuster or Governmental Body. The parties shall cooperate so as to promptly commence and proceed with due diligence to complete the repair, replacement and restoration of the Facilities to at least the character and condition thereof existing immediately prior to the loss, damage or destruction, in accordance with and subject to the procedures set forth in Article IX and Article XII, as applicable. The City shall have the right to monitor, review and inspect the performance of any repair, replacement and restoration work implemented by the Authority.

(B) Insurance and Other Third Party Payments. To the extent that any repair, replacement or restoration costs incurred pursuant to this Section can be recovered from any insurer or from another third party, each party shall use due diligence in attempting to recover such costs from the insurer or third party, and each party shall assist the other in exercising such rights as it may have to effect such recovery. Each party shall provide the other with copies of all relevant documentation at no cost to the other party, and shall cooperate with and assist the other party upon request by participating in conferences, negotiations and litigation hearings regarding insurance claims.

(C) Uninsured Costs. The City shall provide all funds (except as provided by subsection 12.2(E) with respect to the Authority's obligation to cost-share in the event of Uncontrollable Circumstances) necessary to pay the costs of repairing, replacing and restoring the Facilities in accordance with this Section and all insurance proceeds and recoveries from third parties resulting from damage to or the loss or destruction of the Facilities shall be for the account of the City, provided, however, that such costs not covered by insurance proceeds or third party payments shall be borne by the Authority to the extent the loss, damage or destruction was not caused by Uncontrollable Circumstances or City Breach.

(D) Repair of City and Private Property. The Authority shall promptly repair or replace any City Property and any private property damaged by the Authority or any officer, director, employee, representative, subcontractor or agent of the Authority in connection with the performance of, or the failure to perform, the Contract Services. The repair and replacements, to the maximum extent reasonably practicable, shall restore the damaged property to its character and condition existing immediately prior to the damage.

(E) City Property Damage Insurance. The City shall maintain an all risks property damage insurance policy in the amount of the replacement value for each of the Facilities' insurable assets including without limitation all buildings, building contents, pumps, motors, chemical feed equipment, wells and well equipment, SCADA and other telemetry equipment, storage and pressure tanks, fencing, signage, and Pump Stations. The all risk policy shall cover, without limitation, such risks as floods, tornadoes, hurricanes, hail storms, lightning, fire, earth movement, vandalism, malicious mischief, and boiler and machinery coverage.

ARTICLE IX

CAPITAL MODIFICATIONS

SECTION 9.1. CAPITAL MODIFICATIONS GENERALLY. (A) Purpose. The parties acknowledge that it may be necessary or desirable from time to time during the term of the Service Contract to modify, alter or improve the Facilities in their then-current condition, either at the request of the Authority or at the request of the City due to growth, expansion or otherwise, or as a result of Uncontrollable Circumstances or a Change in Law. Capital Modifications shall normally be the financial responsibility of the City, except as otherwise provided in the Regional Agreement. The Authority shall provide a reasonable level of design input regarding any modifications proposed by the City. Maintenance, repair and replacement of the Facilities in their then-current condition shall be the general responsibility of the Authority and shall not be considered Capital Modifications. Capital Modifications may be financed by the City through the issuance of bonds or such other method as may be determined by the City.

(B) City Approval and Change Orders Proposed by the Authority. The City shall have the right, in its sole discretion, to approve or reject all Capital Modifications except as otherwise provided in the Regional Agreement. The City's approval shall be given by means of a "Change Order," which shall contain all material information required by this Article. All Capital Modifications shall be made and implemented in accordance with this Article. For Capital Modifications financed by the City, the City shall have the express right to condition its approval of such Capital Modification upon the sharing of net cost savings expected, if any, to result therefrom as provided in subsection (D) of this Section. The City may retain all planning responsibility for Capital Modifications and all other capital facilities related to the System.

(C) Party Responsible for Costs. The City shall bear the cost and expense (subject to the cost-sharing provisions set forth in subsection 12.2(E) related to Uncontrollable Circumstances) of all Capital Modifications and related operation, maintenance, repair and replacement costs (other than as part of an enforcement action taken in response to an Authority breach hereof), unless the Capital Modification is requested by the Authority.

(D) Cost Savings. In the event any Capital Modification is financed by the City is reasonably expected to result in a net cost savings to the Authority, the parties shall negotiate in good faith the extent to which any such net cost savings shall be shared with the City, and the Service Fee shall be reduced accordingly.

(E) Capital Modifications Financing. Capital Modifications may be financed by the City through the issuance of bonds or such other method as may be determined by the City.

SECTION 9.2. CAPITAL MODIFICATIONS AT AUTHORITY REQUEST. The Authority may request that a Capital Modification be undertaken either at its cost or the City's cost by giving the City written notice of, and reasonable opportunity to review and comment upon, any such Capital Modification proposed to be made at the Authority's request. The notice shall contain sufficient information for the City to determine that the Capital Modification (1) does not diminish the capacity of the Facilities to be operated so as to meet the Contract Standards, (2) does not impair the quality, integrity, durability and reliability of the Facilities, (3) is reasonably necessary for the Authority to fulfill its obligations under the Service Contract or the Regional Agreement, and (4) is feasible. The implementation of any such Capital Modification shall be subject to the City's prior written approval. The Authority shall not be entitled to any adjustment in the terms of this Service Contract as a result of any such Capital Modification unless approved by the City or made a condition of approval by the City in its sole discretion.

SECTION 9.3. CAPITAL MODIFICATIONS DUE TO UNCONTROLLABLE CIRCUMSTANCES. Upon the occurrence of an Uncontrollable Circumstance, the Authority shall propose to the City any Capital Modifications reasonably necessary to address the Uncontrollable Circumstance and to permit the Authority to lawfully perform its obligations under this Service Contract. The Authority shall consult with the City concerning possible means of addressing and mitigating the effect of any Uncontrollable Circumstance, and the Authority and the City shall cooperate in order to minimize any delay, lessen any additional cost and modify the Facilities so as to permit compliance with the requirements resulting from the Uncontrollable Circumstance. The design and construction costs of any such Capital Modification, and any related operation, maintenance, repair and replacement costs, shall be borne by the City except to the extent provided in subsection 12.2(E) pertaining to cost sharing. The implementation of any such Capital Modification shall be subject to the City's prior written approval.

SECTION 9.4. CAPITAL MODIFICATIONS AT CITY DIRECTION. The City shall have the right to make Capital Modifications at any time and for any reason whatsoever, whether and however the exercise of such rights affects this Service Contract or the Facilities, so long as the Authority's rights are protected as provided in Section 9.8. The design and construction costs of any such Capital Modification made at the City's direction under this Section, and any related operation, maintenance, repair and replacement costs, shall be borne by the City. The City shall have no obligation to direct the Authority to make any Capital Modification.

SECTION 9.5. AVAILABLE PROCEDURES FOR IMPLEMENTING CAPITAL MODIFICATIONS. The City may, in its sole discretion, utilize any procedure available to it or required under the Applicable Law in order to implement a Capital Modification.

Implementation procedures may include, without limitation and to the extent permissible under Applicable Law, (1) contracting with third parties for the implementation of the Capital Modification on a traditional design/bid/build or other basis, with the City rather than the Authority responsible for the design and construction of the Capital Modification, or with the Authority acting as the City's agent in the design/bid/build process; (2) contracting with the Authority to manage a competition on behalf of the City for design/build services to implement the Capital Modification; and (3) contracting with the Authority to implement the Capital Modification on a design/bid/build or other basis. While it is the intention of the City to have the Authority operate, maintain, repair, replace and manage Capital Modifications on an integrated basis with the Facilities, the City is not obligated to do so. The City and the Authority shall endeavor to negotiate changes to this Service Contract with respect to Capital Modifications. If the negotiations are unsuccessful, the City may contract for such services with a third party, so long as any such third party contract does not impair the Authority's rights under this Service Contract or the Authority's ability to operate and maintain the Facilities in accordance with Good Industry Practice. The City may determine to proceed with an implementation procedure for Capital Modification at any time, whether before or after entering into negotiations with the Authority under the optional implementation procedure specified under Section 9.6. No alternative implementation procedure for Capital Modifications shall impair the Authority's rights under Section 9.8.

SECTION 9.6. OPTIONAL PROCEDURE FOR IMPLEMENTING CAPITAL MODIFICATIONS. (A) Preliminary Authority Plan and City Review. At the written request of the City and the cost and expense of the Authority, the Authority may prepare and deliver to the City a preliminary plan for the implementation of the Capital Modification. The preliminary plan shall include recommendations as to technology, design, construction, equipment, materials, and operating and performance impacts. A preliminary schedule, and capital and operating cost estimates shall be included, together with a brief assessment of possible alternatives. The preliminary plan shall specifically evaluate reasonable alternatives to the proposed Capital Modifications and changed operating and management practices which the Authority is recommending. The City shall review the Authority's preliminary plan and recommendations, and undertake discussions with the Authority in order to reach agreement on a method for implementing the Capital Modification.

(B) Formal Authority Implementation Proposal. Following agreement on the method for implementing the Capital Modification, at the written request of the City the Authority shall submit a formal implementation proposal to the City for its consideration. The implementation proposal shall contain (1) an Authority services element, to be implemented through a separate agreement or an amendment to this Service Contract, and (2) a third party construction services element, to be implemented through third party contracting. The

Authority services element shall contain (a) the Authority's proposal to perform design, construction management and acceptance testing services with respect to the Capital Modification for a fixed price, and shall include a guarantee of the performance of the Capital Modification through an acceptance test and either a good faith estimate of total construction costs or a guaranteed maximum construction price, if so requested by the City and agreed to by the Authority, and (b) the Authority's proposal to operate, maintain, repair, replace and manage the Capital Modification for a fixed fee, subject to adjustment under Section 10.6, to be added to the Service Fee following construction and acceptance. The third party construction services element shall be a proposal by the Authority to conduct, as allowed by Applicable Law, a bidding process or a competitive proposal process for the construction work or the design/build work involved in implementing the Capital Modification. The bidding process shall include an advertisement for bids and a construction contract award to the lowest responsible and qualified bidder, and shall be conducted in accordance with the requirements of Applicable Law which govern construction projects undertaken by the Authority. The design process for the Capital Modification may be implemented by a competitive proposal process which shall include a request for proposals and a contract award to the most advantageous proposer.

(C) Negotiation and Finalization of Authority Implementation Proposal. The parties shall proceed, promptly following the City's acceptance of the Authority's proposal, to negotiate an agreement on price and any adjustment to the terms and conditions of this Service Contract. Any final negotiated agreement for the implementation of a Capital Modification by the Authority under this Section shall address, as applicable, (1) design requirements and reviews, (2) construction management services, (3) acceptance tests and procedures, (4) a guarantee of completion and acceptance, (5) performance guarantees, (6) any changes to the Performance Guarantees or other Contract Standards to take effect as a consequence of the Capital Modification, (7) a payment schedule for the design and construction management-related services, (8) provisions for City review, (9) anticipated adjustments to the Service Fee resulting from the Capital Modification, including any related operation, maintenance, repair and replacement costs, (10) a financing plan, and (11) any other appropriate amendments to this Service Contract. The final adjustments to the Service Fee will be determined by agreement of the parties after the Capital Modification has been implemented and the performance tests have been completed. The Authority shall not be obligated to undertake any such Capital Modification except following agreement as to such negotiated adjustments, unless otherwise required on an emergency basis. The City shall have no obligation to reimburse the Authority for any costs incurred pursuant to the this Section except as part of a separate agreement or a negotiated amendment to this Service Contract.

SECTION 9.7. FINANCING CAPITAL MODIFICATIONS. (A) City Financing.

The City shall provide financing for any Capital Modification for which it is financially responsible under this Article, and, in the event the Authority is selected to implement the Capital Modification, shall make the proceeds of the financing available to the Authority to pay the negotiated price, as well as the price of any agreed change orders, on the milestone schedule and subject to any retainage or other conditions negotiated by the parties pursuant to this Section.

(B) Authority Financing. The City may elect, notwithstanding the provisions of subsection (A) of this Section, to request that the Authority finance all or any portion of the cost of any Capital Modification which the Authority is implementing pursuant to this Article. The terms and conditions of any such financing and its impact on the Service Contract and Service Fee shall be negotiated by the parties. The terms and conditions of any such financing shall include, but are not limited to, any City right to refinance any such Authority financing and any reimbursement due the Authority with respect to the unpaid principal amount of such financing if this Service Contract is terminated prior to the end of its scheduled Term. If the parties are unable to negotiate the terms and conditions and the impact on the Service Contract and Service Fee, then the City shall implement the Capital Modification pursuant to other Sections of this Article.

SECTION 9.8. AUTHORITY NON-IMPAIRMENT RIGHTS. (A) Authority Non-

Impairment. No Capital Modification, other than a Authority-requested Capital Modification, shall be made that impairs any right, impairs the ability to perform, imposes any additional obligation or liability, or increases the costs of the Authority hereunder, including operating, maintenance, repair and replacement costs related to such Capital Modification. The Authority shall have no right to object to any such Capital Modification, however, and such Capital Modification shall become part of the Facilities upon passing the tests for Acceptance, so long as the City affords the Authority appropriate price, schedule, performance and other relief necessary to avoid any such effect.

(B) City Operating Rights. While it is the intention of the City to have the Authority operate, maintain, repair, replace and manage Capital Modifications on an integrated basis with the Facilities, the City shall have the right, notwithstanding any other provision hereof, at its own cost and expense to operate, maintain, repair, replace and manage any Capital Modification made to the Facilities at the direction of the City. Any such operation, maintenance, repair, replacement and management work performed by the City shall not impair any right, impair the ability to perform, impose any additional obligation or liability, or increase the costs of the Authority hereunder. The City's rights hereunder do not apply to Capital Modifications made to the Facilities at the direction of the Authority.

ARTICLE X

SERVICE FEE AND OTHER PAYMENTS

SECTION 10.1. SERVICE FEE GENERALLY. From and after the Commencement Date, the City shall pay the Service Fee to the Authority as compensation for the Authority's performing the Contract Services under this Service Contract. At such time or times during the Contract Term that the production of Finished Water on a peak day basis exceeds the then-rated capacity of the Plant for three consecutive days, the parties will determine appropriate changes to the Service Fee in accordance with other provisions of this Service Contract.

SECTION 10.2. SERVICE FEE FORMULA. The annual Service Fee shall be calculated in accordance with the following formula:

$$\text{ASF} = \text{BF} + \text{PC} + \text{EIC}$$

where,

ASF	Annual Service Fee
BF	Base Fee
PC	Pass-through Cost Component
EIC	Extraordinary Items Component

Each component of the Service Fee shall be determined in accordance with this Article. In the event that the City determines to discontinue use of the Oakridge filtration equipment during the Term, the annual Service Fee shall be reduced by \$67,500 (as escalated by the Service Fee Adjustment Factor).

SECTION 10.3. BASE FEE. (A) Base Fee. The Base Fee in the first Contract Year shall be \$795,607 and shall be adjusted pursuant to the Service Fee Adjustment Factor for each subsequent Contract Year. The Base Fee shall be compensation for all Contract Services to be provided by the Authority under the Service Contract except where otherwise noted herein. Except as provided in Section 10.1 above, or further agreement among the Parties, such compensation shall not be adjusted to account for increases or decreases in instantaneous flow or loadings of raw water treated by the Facilities or by variations in the amount of Raw Water treated from each Raw Water source. The Base Fee includes compensation for, but is not limited to, labor, repairs, replacements, maintenance, tools, materials, equipment, laboratory services, and spare parts relating to the operation and maintenance and repair and replacement of the Facilities **(but not including electricity, chemicals, insurance, letter of credit fee or maintenance of the Well Supply Equipment, the Well Supply SCADA, or the SCADA system the City uses to monitor and control the System)** and costs related to the imposition of any sales tax or business tax levied against the Authority in connection with the Authority's performance of the Contract Services. The Base Fee shall also include any increase or decrease in net cost resulting from operation,

maintenance, repair and replacement costs related to a Capital Modification as more fully described in Article IX.

(B) Annual Adjustment of Base Fee. The Base Fee for the first Contract Year shall be \$795,607. The Base Fee for each subsequent Contract Year shall be determined by multiplying (1) the Base Fee for the previous Contract Year, times (2) the Service Fee Adjustment Factor, as specified in Section 10.6 (A).

SECTION 10.4. PASS-THROUGH COST COMPONENT. The Authority shall pay all electric bills incurred in the operation of the Facilities. The City shall reimburse the Authority each month for all such bills, subject to the "Guaranteed Maximum Electricity Utilization" through the Pass-through Component of the Service Fee. The Guaranteed Maximum Electricity Utilization will be 1625 kWh for each million gallons of Raw Water treated at the Plant and 2300 kWh for each million gallons of water supplied by the Wells. The Guaranteed Maximum Electricity Utilization shall not include electricity used at the Booster Stations. The Authority will not receive reimbursement for its electricity costs associated with the operation of the Facilities above the Guaranteed Maximum Electricity Utilization. The Authority shall pay all chemical bills incurred in the operation of the Facilities. The City shall reimburse the Authority each month for all such costs, subject to the "Guaranteed Maximum Chemical Utilization" through the Pass-through Component of the Service Fee. The Guaranteed Maximum Chemical Utilization will be \$16,399/mgd for Raw Water treated at the Plant, and \$8,415/mgd for water supplied by the Wells for the first Contract Year, and both of these amounts shall escalate in accordance with the Chemical Cost Adjustment Factor for each subsequent Contract Year. The Authority will not receive reimbursement for its chemical costs associated with the operation of the Facilities above the Guaranteed Maximum Chemical Utilization. The Authority shall initially pay all insurance premiums for the Required Insurance. The City shall reimburse the Authority for payment of all such Required Insurance premiums in the month following the payment of such premiums (subject in the first year to the maximum insurance cost of \$94,500 for the Required Insurance set forth in Appendix 9. The Authority shall initially pay all annual fees associated with providing a Letter of Credit as described in Article XIII. The City shall reimburse the Authority for payment of all annual Letter of Credit fees in the month following the payment of such fees.

SECTION 10.5. EXTRAORDINARY ITEMS CHARGE OR CREDIT. The Extraordinary Items component of the Service Fee, which may be a charge or a credit, shall be equal to the sum of (1) the amounts payable by the City for increased operation, maintenance or other costs incurred on account of the occurrence of an Uncontrollable Circumstance which is chargeable to the City hereunder, net of any operation and maintenance cost savings achieved by the Authority in mitigating the effects of the occurrence of such an Uncontrollable Circumstance, minus (2) any City credits due to Authority non-performance specifically

provided for under Article VII or any other provision hereof (3) any indemnification payments owed by the Authority to the City pursuant to Section 12.3, plus or minus (4) any other increase or reduction in the Service Fee provided for under any other Article of this Service Contract.

SECTION 10.6. ADJUSTMENT FACTORS. (A) Service Fee Adjustment Factor. The "Service Fee Adjustment Factor" (AFn) for any particular Contract Year shall be set once per year on the anniversary of the Commencement Date and determined as follows:

AFn	$1 + (0.6 (ECin-1 - ECin-2) \div ECin-2) + (0.4 (PPin-1 - PPin-2) \div PPin-2)$
	where,
ECin-1	The average of the most recent four (4) quarterly ECI values that are published as final values and available on the latest anniversary date of the Commencement Date.
ECin-2	The average of the four (4) quarterly ECI values which immediately proceed the four (4) ECI values utilized in the then-current ECin-1 amount.
PPin-1	The average of the most recent twelve (12) monthly PPI values that are published as final values and which are available on the latest anniversary date of the Commencement Date.
PPin-2	The average of the twelve (12) monthly PPI values that immediately precede the twelve values utilized in the then-current PPin-1 amount.

(B) Chemical Cost Adjustment Factor. The "Chemical Cost Adjustment Factor" (CAN) for any particular Contract Year shall be set once per year on the anniversary of the Commencement Date and determined as follows:

CAN	$1 + ((ICin-1 - ICin-2) \div ICin-2)$
	where,
ICin-1	The average of the most recent twelve (12) monthly ICI values that are published as final values and which are available on the latest anniversary date of the Commencement Date.
ICin-2	The average of the twelve (12) monthly ICI values that immediately precede the twelve values utilized in the then-current ICin-1 amount.

SECTION 10.7. BILLING AND PAYMENT. (A) Billing. The City shall pay the Service Fee in monthly installments in an amount equal to the sum of (1) one-twelfth of the annual Base Fee; (2) any monthly Pass-Through Costs; (3) any Extraordinary Items determined on a monthly basis; (4) one-twelfth of any Extraordinary Items determined on an annual basis; and (5) any adjustments, plus or minus, to reconcile any prior monthly Extraordinary Items or Pass-Through Cost payments. Any overpayment from prior months shall be credited against the monthly Service Fee payment.

(B) Payment. The Service Fee for each month shall be on account of the Contract Services rendered during the prior month. The Authority shall provide the City with an invoice by the fifteenth day of each month which sets forth the monthly portion of the Service Fee due for the prior month and documentation or information as the City may

reasonably require to determine the accuracy and appropriateness of the invoice. The City shall pay the invoice within 20 days of receipt.

SECTION 10.8. ESTIMATES AND ADJUSTMENTS. (A) Pro Rata Adjustments.

Any computation made on the basis of a stated period shall be adjusted on a pro rata basis to take into account any initial or final period which is a partial period. For purposes of this subsection, a month shall be taken as a month containing 30 days and a year shall be taken as a year containing 360 days.

(B) Budgeting. For City budgeting purposes, no later than July 1st preceding each Contract Year, the Authority shall provide to the City a written statement setting forth for such Contract Year its reasonable estimate of the aggregate Service Fee, each component thereof, and the estimated Service Fee Adjustment Factors. The monthly billing of the Base Fee portion of the annual Service Fee shall automatically increase by the Adjustment Factors in the month following each Commencement Date anniversary. Other components of the annual Service Fee including Pass-through Costs and Extraordinary Item Costs shall be billed in the month following their incurrence.

(C) Adjustment to Service Fee. If any adjustment to the Service Fee is required pursuant to any express provision of this Service Contract, the party requesting the adjustment shall submit to the other party a written statement setting forth the cause of the adjustment, the anticipated duration of the adjustment, and the amount of the adjustment, as appropriate. Except to the extent that a longer period is otherwise specifically provided for in this Service Contract, any request for adjustment of the Service Fee hereunder shall be accepted or rejected by the party receiving the request within 45 days of receipt. If the receiving party does not notify the requesting party of its rejection and the reasons for the rejection within such 45-day period, the request shall be deemed rejected. A rejected request may be resubmitted, with or without change, and this paragraph shall apply to such resubmitted request as it applies to an original request. Any Service Fee adjustment request which is not rejected or deemed rejected shall take effect as of the next monthly billing period thereafter, or as otherwise agreed to by the parties.

SECTION 10.9. BILLING STATEMENT DISPUTES. If the City disputes any amount billed by the Authority, the City may either (1) pay the disputed amount when otherwise due, and provide the Authority with a written objection indicating the amount that is being disputed and providing all reasons then known to the City for its objection to or disagreement with such amount, or (2) withhold payment of the disputed amount and provide the Authority with written objection as aforesaid within the time when such amount would otherwise have been payable. When any billing dispute is finally resolved, if payment by the City to the Authority of amounts withheld or reimbursement to the City by the Authority of

amounts paid under protest is required, such payment or reimbursement shall be made within 20 days of the date of resolution, with interest at the Overdue Rate.

ARTICLE XI

BREACH, DEFAULT, REMEDIES AND TERMINATION

SECTION 11.1. REMEDIES FOR BREACH. The parties agree that, except as otherwise provided in Sections 11.2, 11.3, 11.4, 11.5 and 11.6 with respect to termination rights, in the event that either party breaches this Service Contract, the other party may exercise any legal rights it has under this Service Contract, under the Letter of Credit and under Applicable Law to recover actual damages or to secure specific performance, and that such rights to recover damages and to secure specific performance shall ordinarily constitute adequate remedies for any such breach. Neither party shall have the right to terminate this Service Contract for cause except upon the occurrence of an Event of Default.

SECTION 11.2. EVENTS OF DEFAULT BY THE AUTHORITY. (A) Events of Default Not Requiring Previous Notice. Each of the following shall constitute an Event of Default by the Authority upon which the City, by notice to the Authority, may terminate this Service Contract without any requirement of having given notice previously or of providing any further cure opportunity:

(1) Failure of Performance. The failure of the Authority to meet the Performance Guarantees on a 12-month rolling average basis and such failure is not due to an Uncontrollable Circumstance or City Breach;

(2) Security for Performance. The failure of the Authority to obtain or maintain in full force and effect the Letter of Credit required by Article XIII as security for the performance of this Service Contract {unless the City has released the Authority from its obligation to provide a Letter of Credit pursuant to Section 13.2(B)};

(3) Failure to Perform a Material Obligation. The failure or refusal of the Authority to perform a material obligation hereunder, such that the failure or refusal constitutes a gross misfeasance of duty and such failure is not due to an Uncontrollable Circumstance or City Breach;

(4) Abandonment. The abandonment or failure to operate all or a substantial portion of Facilities for a period of 48 hours;

(5) Insolvency. The insolvency of the Authority as determined under the Bankruptcy Code;

(6) Voluntary Bankruptcy. The filing by the Authority of a petition of voluntary bankruptcy under the Bankruptcy Code; the consenting of the Authority to the filing of any bankruptcy or reorganization petition against the Authority under the Bankruptcy Code; or the filing by the Authority of a petition to reorganize the Authority pursuant to the Bankruptcy Code; and

(7) Involuntary Bankruptcy. The issuance of an order of a court of competent jurisdiction appointing a receiver, liquidator, custodian or trustee of the Authority or of a major part of the Authority's property, respectively, or the filing against the Authority of a petition to reorganize the Authority or pursuant to the Bankruptcy Code, which order shall not have been discharged or which filing shall not have been dismissed within 90 days after such issuance or filing, respectively.

(B) Events of Default Requiring Previous Notice. It shall be an Event of Default by the Authority upon which the City may terminate this Service Contract, by notice to the Authority, if: (1) any representation or warranty of the Authority hereunder was false or inaccurate in any material respect when made, and the representation or warranty affects the legality of this Service Contract or the ability of the Authority to carry out its obligations hereunder; or (2) the Authority fails, refuses or otherwise defaults in its duty (a) to pay any amount required to be paid to the City under this Service Contract within 60 days following the due date for such payment, or (b) to perform any material obligation under this Service Contract (except as set forth in subsection (A) above, or unless such default is excused by an Uncontrollable Circumstance or City Breach, except that no such default (other than those set forth in subsection (A) of this Section) shall constitute an Event of Default giving the City the right to terminate this Service Contract for cause under this subsection unless:

(1) The City has given prior written notice to the Authority stating that in its opinion a specified default exists which gives the City a right to terminate this Service Contract for cause under this Section unless such default is corrected within a reasonable period of time, and describing the default in reasonable detail; and

(2) The Authority has not initiated within a reasonable time and continued with due diligence to carry out to completion all actions reasonably necessary to correct the default and prevent its recurrence; except that if the Authority shall have initiated within such reasonable time and continued with due diligence to carry out to completion all such actions, the default shall not constitute an Event of Default during such period of time (in any event not more than 120 days from the initial default notice) as the Authority shall continue with due diligence to carry out to completion all such actions.

(C) Other Remedies Upon Authority Event of Default. The right of termination provided under this Section upon an Event of Default by the Authority is not exclusive. If this Service Contract is terminated by the City for an Event of Default by the Authority, the City shall have the right to pursue a cause of action for actual damages and to exercise all other remedies which are available to it under this Service Contract, under the Letter of Credit and under Applicable Law. Without limiting the foregoing, upon any termination of the Service Contract for an Event of Default the damages payable by the

Authority to the City shall include the costs of (1) making necessary repairs and replacements to the Facilities, if any, (2) completing any applicable Capital Modifications which the Authority requested if any, then under construction, (3) remediating any public health and safety problems, and (4) paying all unpaid fines and penalties payable to any Governmental Body, in each case to the extent such actions are necessitated or costs incurred as a result of the breach of this Service Contract by the Authority. Such termination damages shall also include all reasonable costs incurred by the City in the process of procuring, negotiating and implementing a new service contract with a replacement operator, if any, less any cost savings the City receives due to terminating the Service Contract with the Authority.

(D) Limitation on Termination Damages. The maximum amount of damages payable by the Authority to the City for termination of the Service Contract upon an Event of Default by the Authority under this Section shall be the lesser of: (1) the City's actual damages, if any; or (2) the Base Service Fee applicable for the year in which the termination occurs.

SECTION 11.3. EVENTS OF DEFAULT BY THE CITY. (A) Events of Default Permitting Termination. Each of the following shall constitute an Event of Default by the City upon which the Authority, by notice to the City, may terminate this Service Contract:

(1) Representations and Warranties. Any representation or warranty of the City hereunder was false or inaccurate in any material respect when made, and the legality of this Service Contract or the ability of the City to carry out its obligations hereunder is thereby adversely affected; or

(2) Failure to Pay or Perform. The failure, refusal or other default by the City in its duty: (1) to pay the amount required to be paid to the Authority under this Service Contract within 60 days following the due date for such payment; or (2) to perform any other material obligation under this Service Contract (unless such default is excused by an Uncontrollable Circumstance or Authority Breach).

(B) Notice and Cure Opportunity. No such default described in subsections (A)(1) or (A)(2) of this Section shall constitute an Event of Default giving the Authority the right to terminate this Service Contract for cause under this subsection unless:

(1) The Authority has given prior written notice to the City stating that a specified default exists which gives the Authority a right to terminate this Service Contract for cause under this Section, and describing the default in reasonable detail; and

(2) The City has not initiated within a reasonable amount of time and continued with due diligence to carry out to completion all actions reasonably necessary to correct the default and prevent its recurrence; except that if the City shall have initiated within such reasonable time and continued with due diligence to carry out to completion all such actions, the default shall not constitute an Event of Default during

such period of time (in any event not more than 30 days in the case of an overdue payment and for all other matters 120 days from the initial default notice) as the City shall continue with due diligence to carry out to completion all such actions.

(C) Termination Liquidated Damages During the Initial Term. (1) If this Service Contract is terminated by the Authority for cause as a result of an Event of Default by the City, the City shall pay the Authority, as liquidated damages upon any such termination, the same amount which would be payable under subsection 11.4(A) if this Service Contract were terminated during the Initial Term, according to the month of termination, at the election of the City for convenience and without cause.

SECTION 11.4. CITY CONVENIENCE TERMINATION DURING THE TERM OF THE SERVICE CONTRACT. (A) Termination Right and Fee. The City shall have the right at any time during the Term of the Service Contract, exercisable in its sole discretion, for its convenience and without cause, to terminate this Service Contract upon 180 days' written notice to the Authority. If the City exercises its right to terminate the Service Contract pursuant to this Section following the Commencement Date, the City shall pay the Authority a convenience termination fee equal to the sum of: (1) \$200,000 reduced by 1/120 of such amount for each month which has elapsed following the Commencement Date and including the month in which the termination date occurs, plus (2) the Authority's reasonable substantiated demobilization costs, provided, however, that such costs shall not exceed \$50,000 escalated by the Service Fee Adjustment Factor, and (3) if the Authority has provided financing for any Capital Modifications approved by the City pursuant to Section 9.7, the debt payoff or defeasance amount based on the financing methodology approved by the City at the time the financing was effectuated. If this Service Contract is renewed pursuant to Section 3.2, then the convenience termination fee payable during the Renewal Term shall be one-half of items (1) and (2) above and identical to item (3) above.

(B) Uncontrollable Circumstances. In the event an Uncontrollable Circumstance causes a total constructive loss of the Plant, or in the event an Uncontrollable Circumstance causes an extraordinary increase in City costs, and thereupon the City elects to exercise its right of convenience termination under this Section, the amount specified in item (1) of subsection (A) of this Section shall be excluded from the termination fee payable by the City. A "total constructive loss" for this purpose shall be deemed to have occurred: (1) if so determined by the casualty insurance carrier; or (2) if the Plant is substantially inoperable for a period of at least six months following the occurrence of the Uncontrollable Circumstance. "An extraordinary increase" in City costs shall be deemed to have occurred for this purpose if costs proposed to be paid to the Authority resulting from the Uncontrollable Circumstance would cause an increase of more than 10% from the prior Contract Year or an increase of more than 40% in the aggregate of the total Service Fee payable under this Service Contract (excluding the

amortization of debt incurred by the Authority for Capital Modifications resulting from Uncontrollable Circumstances) when compared to such amounts that would have been payable during the comparable periods had no Uncontrollable Circumstances occurred.

(C) Felony Conviction. In the event of a felony conviction of the Authority, as an entity, for an act directly related to the Authority's provision of the Contract Services hereunder, the amounts specified in items (1) and (2) of subsection (A) of this Section shall be excluded from the termination fee payable by the City.

(D) Payment of Amounts Owning Through the Termination Date. Upon any termination pursuant to this Section, the City shall pay the Authority all amounts due for the Contract Services up to the applicable portion of the Service Fee but not yet paid as of the date of termination.

(E) Termination Fee Payment Contingent Upon Surrender of Possession. The City shall have no obligation to pay the applicable termination fee provided for under this Section except concurrently with the surrender of possession and control by the Authority of the Facilities to the City.

(F) Acceptance of Termination Payment. The Authority agrees to accept the applicable termination fee provided in this Article as full compensation for the termination of the Authority's right to perform this Service Contract.

(G) Completion or Continuance by City. Meter the date of any termination under this Section, the City may at any time (but without any obligation to do so) take any and all actions necessary or desirable to continue and complete the Contract Services so terminated, including entering into contracts with other operators and contractors.

(H) Employment. Upon the exercise by the City of its right of convenience termination under this Section, the City shall have the right to offer, or cause any successor operator of the Facilities to offer, employment to employees of the Authority then employed at the Facilities as set forth in subsection 11.5(B)

SECTION 11.5. OBLIGATIONS OF THE AUTHORITY UPON TERMINATION OR EXPIRATION. (A) Authority Obligations. Upon a termination of this Service Contract under Section 11.2, 11.3, or 11.4 or upon the expiration of this Service Contract under Section 3.1, the Authority shall, as applicable:

- (1) stop the Contract Services on the date and to the extent specified by the City;
- (2) promptly take action as necessary to protect and preserve all materials, equipment, tools, facilities and other property;
- (3) promptly remove from the Facilities all equipment, implements, machinery, tools, temporary facilities of any kind and other property owned or leased by

the Authority (including sheds, trailers, workshops and toilets), and repair any damage caused by such removal;

- (4) leave the Facilities in a neat and orderly condition;
- (5) subject to subsection (B) of this Section, promptly remove all employees of the Authority and any Subcontractors and vacate the Facilities;
- (6) with respect to Capital Modifications, promptly deliver to the City a list of all supplies, materials, machinery, equipment, property and special order items previously delivered or fabricated by the Authority or any Subcontractor but not yet incorporated in the Facilities;
- (7) deliver to the City the Operation and Maintenance Manual and all computer programs and database files used at the Facilities (subject to the provisions of applicable licensing agreements) in the performance of Contract Services, including all revisions and updates thereto;
- (8) deliver to the City a copy of applicable books and records in its possession relating to the performance of the Contract Services;
- (9) deliver to the City fully updated plans of the Facilities;
- (10) provide the City with a list of all files, and access and security codes with instructions and demonstrations which show how to open and change such codes;
- (11) advise the City promptly of any special circumstances which might limit or prohibit cancellation of any Subcontract;
- (12) promptly deliver to the City copies of all Subcontracts, together with a statement of:
 - (a) the items ordered and not yet delivered pursuant to each agreement;
 - (b) the expected delivery date of all such items;
 - (c) the total cost of each agreement and the terms of payment; and
 - (d) the estimated cost of canceling each agreement;
- (13) assign to the City any Subcontract that the City elects in writing, at its sole election and without obligation, to have assigned to it. The City shall assume, and the Authority shall be relieved of its obligations under, any Subcontract so assigned;
- (14) terminate all Subcontracts which the City has not directed the Authority to assign, and make no additional agreements with Subcontractors;
- (15) as directed by the City, transfer to the City by appropriate instruments of title, and deliver to the Plant (or such other place as the City may specify), all special order items pursuant to this Service Contract for which the City has made or is obligated to make payment;
- (16) promptly transfer to the City all warranties given by any manufacturer or Subcontractor with respect to particular components of the Contract Services;

(17) notify the City promptly in writing of any Legal Proceedings against the Authority by any Subcontractor or other third parties relating to the termination of the Contract Services (or any Subcontracts);

(18) arrange its employee benefits in such a way that no accrued benefit liability will bind the City in the event that an Authority employee accepts employment with the City following the Termination Date; and

(19) take such other actions, and execute such other documents as may be necessary to effectuate and confirm the foregoing matters, or as may be otherwise necessary or desirable to minimize the City's costs, and take no action which shall increase any amount payable to the City under this Service Contract.

(B) **Hiring of Authority Personnel.** Upon the termination or expiration of this Service Contract under any provision hereof, the City or any successor operator of the Facilities designated by the City may offer employment on any terms it may choose to any Authority employee employed full time at the Facilities. No Authority employment agreement, letter or similar document may contravene this right. The City or its designated successor operator shall extend any such job offer within 10 days of the expiration or termination of this Service Contract. The Authority shall assist and cooperate with any such employee transition.

(C) **Continuity of Service and Technical Support.** Upon the termination of the Authority's right to perform this Service Contract under Section 11.2, 11.3, or 11.4 or upon the expiration of this Service Contract under Section 3.1, the Authority shall provide for an effective continuity of service and the smooth and orderly transition of management back to the City or any replacement operator designated by the City. Such service shall be for a period of up to 60 days and shall include providing technical advice and support and delivering any plans, drawings, renderings, blueprints, operating manuals, computer programs, or other information useful or necessary for the City or any replacement operator designated by the City to perform the Contract Services. The Authority shall provide technical advice and support only after providing the City with an estimate of the cost involved, and receiving written direction to proceed from the City. The City, after providing direction to proceed to the Authority, shall pay the Authority's actual reasonable costs associated with providing technical advice and support.

(D) **Authority Payment of Costs.** Upon the termination or expiration of this Service Contract, the Authority shall be obligated to pay the costs and expenses of undertaking its obligations under subsection 11.5(A). If the Authority fails to comply with any obligation under this Section, the City may perform such obligation and the Authority shall pay on demand the City's reasonable costs thereof subject to Cost Substantiation.

SECTION 11.6. **SURVIVAL OF CERTAIN PROVISIONS UPON TERMINATION.**
All representations and warranties of the parties hereto contained in Article II hereof and the

rights and obligations of the parties hereto pursuant to Sections [1.2(H), 4.4(8), 7.2(E), 9.1(E), 11.1, 11.2, 11.3, 11.4, 11.5, 11.6, 11.7, 11.8, 11.9, 12.2, 12.3, 13.2, 14.4 and 14.8(D)] hereof shall survive the termination of this Service Contract. No termination of this Service Contract shall (1) limit or otherwise affect the respective rights and obligations of the parties hereto accrued prior to the date of such termination, or (2) preclude either party from impleading the other party in any Legal Proceeding originated by a third party as to any matter occurring during the Term of this Service Contract.

SECTION 11.7. NO WAIVERS. No action of the City or the Authority pursuant to this Service Contract (including any investigation or payment), and no failure to act, shall constitute a waiver by either party of the other party's compliance with any term or provision of this Service Contract. No course of dealing or delay by the City or the Authority in exercising any right, power or remedy under this Service Contract shall operate as a waiver thereof or otherwise prejudice such party's rights, powers and remedies. No single or partial exercise of (or failure to exercise) any right, power or remedy of the City or the Authority under this Service Contract shall preclude any other or further exercise thereof or the exercise of any other right, power or remedy.

SECTION 11.8. NO CONSEQUENTIAL OR PUNITIVE DAMAGES. In no event shall either party be liable to the other or obligated in any manner to pay to the other any special, incidental, consequential, punitive or similar damages based upon claims arising out of or in connection with the performance or non-performance of its obligations under this Service Contract, or the material falseness or inaccuracy of any representation made in this Service Contract, whether such claims are based upon contract, tort, negligence, warranty or other legal theory. The waiver of the foregoing damages under this Section is intended to apply only to disputes and claims as between the City and the Authority.

SECTION 11.9. FORUM FOR DISPUTE RESOLUTION. It is the express intention of the parties that all Legal Proceedings related to this Service Contract or to the Facilities or to any rights or any relationship between the parties arising therefrom shall be solely and exclusively initiated and maintained in the courts of the State located in Hays County or the U.S. District Court for the Southern District of Texas, Austin Division. The Authority and the City each irrevocably consents to the jurisdiction of such courts in any such actions or proceedings, waives any objection it may have to the laying of the jurisdiction of any such action or proceeding. In addition, the parties hereby expressly waive the right to trial by jury.

ARTICLE XII

INSURANCE, UNCONTROLLABLE CIRCUMSTANCES

SECTION 12.1. INSURANCE. (A) Authority Insurance. At all times during the Term of this Service Contract, the Authority shall obtain and maintain or cause to be obtained and maintained the Required Insurance in accordance with the requirements of Appendix 9 and shall pay all premiums with respect thereto as the same become due and payable. The City shall remain responsible for obtaining and maintaining all property insurance relating to the Facilities and shall pay all premiums with respect thereto as the same become due and payable.

(B) Insurers, Deductibles and City Rights. All insurance required by this Section shall be obtained and maintained from financially sound and generally recognized responsible insurance companies meeting the qualifications set forth in Appendix 9 or from the Texas Municipal League or from the Texas Water Conservation Association Risk Management Fund. The insurers or risk management funds shall be selected by the Authority and shall be authorized to write such insurance in the State. The insurance coverage may be written with deductible amounts approved by the City, and the City shall be responsible for paying all deductible amounts unless such loss is due to the Authority or its Subcontractor' gross negligence or willful misconduct or Authority Breach. The Authority shall also be responsible for all self-insured retentions contained in its insurance coverages, as well as any excluded losses if such losses are within the liability of the Authority hereunder. All policies evidencing such insurance shall provide for: (1) payment of the losses to the City and to the Authority as their respective interests may appear; and (2) at least 30 days' prior written notice of the cancellation thereof to the Authority and the City (except with respect to cancellation for non-payment of premiums to which at least a 10-day written notice shall be required). All policies of insurance required by this Section shall be primary insurance without any right of contribution from other insurance carried by the City. The City shall have the right to participate in all insurance claim settlement negotiations with respect to claims to which the City is a party; however, the City will not have approval authority over insurance settlements of claims.

(C) Certificates, Policies and Notice. The Authority will provide to the City verification of coverage and copies of coverage amendments naming the City, its officers, officials and employees as "additional insureds" (except with respect to Workers' Compensation Insurance) for the Required Insurance. The provision of such coverage verification and coverage amendments is required by this Service Contract as a condition prior to the occurrence of the Commencement Date. Not later than 30 days prior to the beginning of each Contract Year throughout the Term, the Authority shall furnish the City with verification of

coverage and coverage amendments naming the City, its officers, officials and employees as "additional insureds" (except with respect to Workers' Compensation Insurance) and evidencing the Required Insurance. Whenever a Subcontractor is utilized, the Authority shall either obtain and maintain or require the Subcontractor to obtain and maintain appropriate insurance. The City shall have the right, upon request made to the Authority by the City and at any time during the Term, to review the full, original policies of insurance for all Required Insurance.

(D) Maintenance of Insurance Coverage. If the Authority fails to pay any premium or self-insured retention for Required Insurance, or if any insurer cancels any Required Insurance policy and the Authority fails to obtain replacement coverage so that the Required Insurance is maintained on a continuous basis, then, at the City's election (but without any obligation to do so), the City, following notice to the Authority, may pay such premium or self-insured retention or procure similar insurance coverage from another carrier, companies or risk management fund. The Authority shall comply with all applicable Required Insurance and take steps necessary to assure the Facilities remain continuously insured in accordance with the requirements of this Service Contract during the Term hereof. The failure of the Authority to obtain and maintain any Required Insurance shall not relieve the Authority of its liability for any losses intended to be insured thereby. Should any failure to provide continuous insurance coverage occur, the Authority shall, to the full extent of its liability under applicable law, defend, indemnify and hold harmless the City against any actual Loss-and-Expense arising out of such failure.

SECTION 12.2. UNCONTROLLABLE CIRCUMSTANCES. (A) Relief from Obligations. Except as expressly provided under the terms of this Service Contract, neither party to this Service Contract shall be liable to the other for any loss, damage, delay, default or failure to perform any obligation to the extent it results from an Uncontrollable Circumstance. The parties agree that the relief for an Uncontrollable Circumstance described in this Section shall apply to all obligations in this Service Contract, except to the extent specifically provided otherwise, notwithstanding that such relief is specifically mentioned with respect to certain obligations in this Service Contract but not other obligations. The occurrence of an Uncontrollable Circumstance shall not excuse or delay the performance of a party's obligation to pay monies previously accrued and owing under this Service Contract, or to perform any obligation hereunder not affected by the occurrence of the Uncontrollable Circumstance. The City shall pay the Service Fee during the continuance of any Uncontrollable Circumstance, adjusted to account for any cost reductions achieved through Authority mitigation measures required by subsection (B) of this Section, as well as for any cost increases to which the Authority is entitled under subsection (C) of this Section.

(B) Notice and Mitigation. The party that asserts the occurrence of an Uncontrollable Circumstance shall notify the other party by telephone or facsimile, on or promptly after the date the party experiencing such Uncontrollable Circumstance first knew of the occurrence thereof, followed within 15 days by a written description of: (1) the Uncontrollable Circumstance and the causes thereof (to the extent known); and (2) the date the Uncontrollable Circumstance began, its estimated duration, and the estimated time during which the performance of such party's obligations hereunder shall be delayed, or otherwise affected. As soon as practicable after the occurrence of an Uncontrollable Circumstance, the affected party shall also provide the other party with a description of: (1) the amount, if any, by which the Service Fee is proposed to be adjusted as a result of such Uncontrollable Circumstance; (2) any areas where costs might be reduced and the approximate amount of such cost reductions; and (3) its estimated impact on the other obligations of such party under this Service Contract. The affected party shall also provide prompt written notice of the cessation of such Uncontrollable Circumstance. Whenever an Uncontrollable Circumstance occurs, the party claiming to be adversely affected thereby shall, as promptly as practicable, use all reasonable efforts to eliminate the cause thereof, reduce costs resulting therefrom, mitigate and limit damage to the other party, and resume full performance under this Service Contract. While the Uncontrollable Circumstance continues, the affected party shall give notice to the other party, before the first day of each succeeding month, updating the information previously submitted. The party claiming to be adversely affected by an Uncontrollable Circumstance shall bear the burden of proof, and shall furnish promptly any additional documents or other information relating to the Uncontrollable Circumstance reasonably requested by the other party.

(C) Conditions to Performance, Service Fee and Schedule Relief. If and to the extent that Uncontrollable Circumstances interfere with, delay or increase the cost of the Authority's performing the Contract Services in accordance herewith, the Authority shall be entitled to relief from its performance obligations, an increase in the Service Fee, or an extension of schedule which properly reflects the interference with performance, the amount of the increased cost, or the time lost as a result thereof, in each case only to the minimum extent reasonably forced on the Authority by the event, and the Authority shall perform all other Contract Services. The proceeds of any Required Insurance available to meet any such increased cost shall be applied to such purpose prior to any determination of cost increase payable by the City under this Section. Any cost reduction achieved through the mitigating measures undertaken by the Authority pursuant to subsection (B) of this Section upon the occurrence of an Uncontrollable Circumstance shall be reflected in a reduction of the amount by which the Service Fee would have otherwise been increased or shall serve to reduce the Service Fee to reflect such mitigation measures, as applicable. In the event that the Authority

believes it is entitled to any performance, price or schedule relief on account of any Uncontrollable Circumstance, it shall furnish the City written notice of the specific relief requested and detailing the event giving rise to the claim within 30 days after the giving of notice delivered pursuant to subsection (B) of this Section, or if the specific relief cannot reasonably be ascertained and such event detailed within such 30-day period, then within such longer period within which it is reasonably possible to detail the event and ascertain such relief. Within 30 days after receipt of such a timely submission from the Authority the City shall issue a written determination as to the extent, if any, it concurs with the Authority claim for performance, price or schedule relief, and the reasons for the determination. The Authority acknowledges that its failure to give timely notice pertaining to an Uncontrollable Circumstance as required under this Section may adversely affect the City. To the extent the City asserts that any such adverse effect has occurred and that the relief to the Authority or the additional cost to be borne by the City under this subsection should be reduced to account for such adverse effect, the Authority, after reasonable notice by the City, shall have the affirmative burden of refuting the City's assertion. Absent such refutation, the reduction in relief to the Authority and the reduction in additional cost to the City asserted by the City in its notice shall be effective.

(D) **Capital Modifications.** Before proposing any adjustment to the Service Fee in its notice of requested relief under this Section, the Authority shall determine whether any increased costs of operation and maintenance of the Facilities resulting from an Uncontrollable Circumstance can reasonably and prudently be reduced by the undertaking of a Capital Modification. In the event that the Authority makes such a determination, the Authority shall so advise the City in accordance with Article IX. The City shall thereupon determine, in its sole discretion, whether such a Capital Modification shall be undertaken and shall so advise the Authority within 60 days of receipt of such notice by the Authority. In no event shall the Authority undertake such a Capital Modification except at the express written direction of the City.

(E) **Share of Costs of Uncontrollable Circumstances.** Except with respect to the parties' respective payment obligations, neither the City nor the Authority shall be liable to the other for any failure or delay in performance of any obligation under the Service Contract due to the occurrence of an Uncontrollable Circumstance. The costs related to the occurrence of an Uncontrollable Circumstance shall be borne first by any available insurance to cover the Uncontrollable Circumstance and secondly by the City except that the Authority shall pay the first \$25,000 each Contract Year (such amount to escalate each Contract Year by the Service Fee Adjustment Factor) of the costs necessitated by each Uncontrollable Circumstance. The Authority shall use its best efforts to mitigate the effect of any Uncontrollable Circumstance. Any costs occurring over future Contract Years as the result of an Uncontrollable

Circumstance occurring in a prior Contract Year shall be treated as Uncontrollable Circumstance costs occurring in such future Contract Year. The Authority's share of such net costs shall be paid as a lump sum within 60 days of the end of each Contract Year, unless otherwise agreed by the parties. In the event that such [\$25,000] amount (as escalated), or portion thereof, is not used in any Contract Year, such unused portion shall be added to the [\$25,000] amount (as escalated) for the following Contract Year. Within 30 days following the end of the Term or other termination of this Service Contract, any unused portions which have accumulated over the Term (without taking into consideration any interest earned thereon) shall be returned to the City.

SECTION 12.3. INDEMNIFICATION BY THE AUTHORITY. To the extent of the Authority's liability under applicable law (if any), the Authority shall indemnify, defend and hold harmless the City Indemnitees from and against (and pay the full amount of) any and all Loss-and-Expense incurred by a City Indemnatee to third parties arising from or in connection with: (1) any failure by the Authority to perform its obligations under this Service Contract; (2) the negligence or willful misconduct of the Authority or any of its officers, directors, employees, representatives, agents or Subcontractors in connection with this Service Contract; or (3) an Authority Breach. The Authority shall also to the full extent of its liability under applicable law (if any) indemnify the City Indemnitees as and to the extent provided elsewhere in this Service Contract. The Authority's indemnity obligations hereunder shall not be limited by any coverage exclusions or other provisions in any insurance policy maintained by the Authority which is intended to respond to such events. The Authority shall not, however, be required to reimburse or, to the full extent of its liability under applicable law, indemnify any City Indemnatee for any Loss-and-Expense to the extent caused by the gross negligence or willful misconduct of any City Indemnatee or to the extent attributable to any Uncontrollable Circumstance. A City Indemnatee shall promptly notify the Authority of the assertion of any claim against it for which it is entitled to be indemnified hereunder, and the Authority shall have the right to assume the defense of the claim in any Legal Proceeding and to approve any settlement of the claim. These indemnification provisions are for the protection of the City Indemnitees only and shall not establish, of themselves, any liability to third parties. This indemnification obligation shall include, but is not limited to, all claims against the City related to the Authority's performance of services under this Service Contract by a current or former officer, director, employee, representative or agent of the Authority, or any Subcontractor. The provisions of this Section shall survive termination of this Service Contract.

ARTICLE XIII

SECURITY FOR PERFORMANCE

SECTION 13.1. LETTER OF CREDIT. (A) Terms and Purpose. On or before the Commencement Date, the Authority shall provide security for the performance of its obligations hereunder through an irrevocable direct pay letter of credit (the "Letter of Credit") issued by a commercial bank, whose long term debt is rated "A" or better by either Rating Service, that is organized and existing under the laws of the United States which has a branch in Texas and which is subject to federal or Texas banking regulatory jurisdiction. The commercial bank selected by the Authority to issue the Letter of Credit shall be subject to the approval of the City, which shall not unreasonably be withheld or delayed. The Letter of Credit shall be in the stated amount of the annual Service Fee (adjusted each Contract Year by the Service Fee Adjustment Factor, rounded upward to the nearest \$100), except as provided in the following sentence, shall be for a term of one year, shall be continuously renewed, extended or replaced so that it remains in effect until 180 days after the Termination Date, and shall be issued substantially in the form set forth in the Transaction Forms. The Letter of Credit in the amount of the annual Service Fee (as adjusted each Contract Year by the Service Fee Adjustment Factor) shall, upon each renewal, extension or replacement thereof, be reduced from the required stated amount applicable for that Contract Year by the aggregate amount of all amounts drawn on all previous Letters of Credit provided under this subsection. The Letter of Credit shall serve as security for the performance of the Authority's obligations hereunder, and the stated amount thereof shall in no way limit the amount of damages to which the City may be entitled for any Authority Event of Default hereunder.

(B) Drawings for Non-Renewal or Bankruptcy. The Letter of Credit shall authorize the City to draw the full stated amount thereof (1) in the event that any required renewal, extension or replacement thereof is not made earlier than the date which is 30 days prior to its expiration date, or (2) upon certain events of bankruptcy or insolvency of the Authority described in the drawing certificate attached thereto. The proceeds of any such drawings shall be held by the City as cash collateral to secure the performance of the Contract Services and, in the event of a material breach of this Service Contract following any such drawing, may be retained by the City in payment of actual damages resulting therefrom.

(C) Drawings for Material Breach. The Letter of Credit also shall authorize the City to draw an amount representing the estimated damages suffered by the City in the event of a material breach of this Service Contract by the Authority. It shall be a condition to the right of the City to draw on the Letter of Credit for a material breach that: (1) the City Manager has given the Authority written notice of a material breach of this Service Contract, whether or not such breach constitutes an Event of Default, and attached a copy of his or her

good faith assessment of the damages the City has suffered as a result of such breach, and (2) the Authority has had an opportunity at a meeting scheduled by the City Manager to be held not earlier than 15 days nor later than 30 days following delivery of such notice, to present to the City Manager evidence disputing the City's assertion of material breach or assessment of damages. Notice to the Authority of a material breach hereof shall be given, except that following any event of voluntary bankruptcy or involuntary bankruptcy by the Authority as described in Section 11.2, no such notice shall be required to be given to the Authority, nor shall the giving of such notice be a condition to the City's drawing rights under the Letter of Credit pursuant to this subsection.

(D) Effect of Final Determination of Damages. In the event that subsequent to any drawing on the Letter of Credit it is determined by any court of competent jurisdiction in a final non-appealable decision that such drawing to any extent was not permitted hereunder, the City shall pay the amount wrongfully drawn to the Authority together with interest thereon at the Overdue Rate calculated from the date of the drawing to the date of payment to the Authority.

SECTION 13.2. COST OF PROVIDING SECURITY FOR PERFORMANCE.

(A) Inclusion in Service Fee. The cost and expense of obtaining and maintaining the Letter of Credit required under this Article as security for the performance of the Authority's obligations hereunder shall be initially borne by the Authority with subsequent reimbursement from the City as described in Section 10.4.

(B) Release of Security. The City shall have the right at any time to release the Authority from its obligation to provide the Letter of Credit required under this Article. Upon any such release, the Pass-Through Cost Component for the Letter of Credit shall cease.

ARTICLEXN

MISCELLANEOUS PROVISIONS

SECTION 14.1. RELATIONSHIP OF THE PARTIES. The Authority is an independent contractor of the City and the relationship between the parties shall be limited to performance of this Service Contract in accordance with its terms. Neither party shall have any responsibility with respect to the services to be provided or contractual benefits assumed by the other party. Nothing in this Service Contract shall be deemed to constitute either party a partner, agent or legal representative of the other party, except as explicitly provided hereunder. No liability or benefits, such as workers' compensation, pension rights or liabilities, or other provisions or liabilities arising out of or related to a contract for hire or employer-employee relationship shall arise or accrue to any party's agent or employee as a result of this Service Contract or the performance thereof.

SECTION 14.2. CONTRACT ADMINISTRATION. (A) Administrative Communications. The parties recognize that a variety of contract administrative matters will routinely arise throughout the Term of this Service Contract. These matters will by their nature involve requests, notices, questions, assertions, responses, objections, reports, claims, and other communications made personally, in meetings, by phone, by mail and by electronic and computer communications. The purpose of this Section is to set forth a process by which the resolution of the matters at issue in such communications (except to the extent that the resolution of any such matter requires City Council or Authority Board of Directors approval and an amendment to this Service Contract pursuant to subsection (D) of this Section), once resolution is reached, can be formally reflected in the common records of the parties so as to permit the orderly and effective administration of this Service Contract.

(B) Contract Administration Memoranda. The principal tool for the administration of matters arising under this Service Contract between the parties shall be a "Contract Administration Memorandum." A Contract Administration Memorandum shall be prepared, once all preliminary communications have been concluded, to evidence the resolution reached by the City and the Authority as to matters of interpretation and application arising during the course of the performance of their obligations hereunder. Such matters may include, for example: (1) the determination of the specific relief to be given the Authority under Section 12.2 on account of an Uncontrollable Circumstance; (2) the determination of the specific amount of any increase or decrease of the Service Fee to which the Authority is entitled under any provision of this Service Contract (including the parties' agreement as to the treatment and designation of the payment of any Extraordinary Item under Section 10.5); (3) issues as to the meaning, interpretation, application or calculation to be made under any

provision hereof; (4) notices, waivers, releases, satisfactions, confirmations, further assurances, consents and approvals given hereunder; and (5) other similar contract administration matters.

(C) Procedures. Either party may request the execution of a Contract Administration Memorandum. When resolution of the matter is reached, a Contract Administration Memorandum shall be prepared by the Authority or the City reflecting the resolution. The Contract Administration Memorandum shall be numbered, dated, signed by the Contract Representative for the Authority and by the Contract Administrator for the City. The City and the Authority each shall maintain a parallel, identical file of all Contract Administration Memoranda, separate and distinct from all other documents relating to the administration and performance of this Service Contract.

(D) Effect. Executed Contract Administration Memoranda shall serve to guide the ongoing interpretation, application and performance of this Service Contract. Any material change, alteration, revision or modification of this Service Contract, however, shall be effectuated only through a formal Service Contract amendment authorized, approved or ratified by the City Council in accordance with Applicable Law and properly authorized by the Authority.

SECTION 14.3. CONTRACT REPRESENTATIVES. (A) Authority's Contract Representative. The Authority shall identify an individual (the "Contract Representative") who may normally be contacted by the City immediately at any time on a 24-hour per day, 7-day per week, 365-day per year basis, for emergency response, information, or any other purpose related to the Service Contract. The Authority shall provide the City at all times with current communication information (business telephone, mobile telephone, fax, beeper, e-mail) for the individual serving as the Contract Representative. The Authority's Contract Representative's designee for certain matters may also be the Authority's Facilities Manager. The City understands and agrees that the Contract Representative has only limited authority with respect to the implementation of this Service Contract, and cannot bind the Authority with respect to any Service Contract amendment or to incurring costs in excess of the amounts committed herein. Within such limitations, the City shall be entitled to rely on the written directions of the Contract Representative.

(B) City's Contract Administrator. The City shall designate an individual to administer this Service Contract and act as the City's liaison with the Authority in connection with the Contract Services (the "Contract Administrator"). The Authority understands and agrees that the Contract Administrator has only limited authority with respect to the implementation of this Service Contract, and cannot bind the City with respect to any Service Contract amendment or to incurring costs in excess of the amounts appropriated. Within such limitations, the Authority shall be entitled to rely on the written directions of the Contract Administrator.

(C) City Approvals and Consents. When this Service Contract shall require any approval or consent by the City to a Authority submission, request or report, the approval or consent shall be given by the Contract Administrator in writing and such writing shall be conclusive evidence of such approval or consent, subject only to compliance by the City with the Applicable Law that generally governs its affairs. Unless expressly stated otherwise in this Service Contract, and except for requests, reports and submittals made by the Authority that do not, by their terms or the terms of this Service Contract, require a response or action, if the City does not find a request, report or submittal acceptable, the City may provide written response to the Authority describing the City's objections and the reasons therefor within 30 days' of the City's receipt thereof. If no response is received, the request, report or submittal shall be deemed rejected and the Authority may resubmit the same, with or without modification. Requests, reports and submittals that do not require a response or other action by the City pursuant to some specific term of this Service Contract shall be deemed acceptable to the City if the City shall not have objected thereto within 30 days of the receipt thereof.

SECTION 14.4. INTELLECTUAL PROPERTY RIGHTS. (A) Protection from Infringement. The Authority shall pay any royalties and license fees payable in connection with the performance of the Contract Services. The Authority shall indemnify, defend and hold harmless the City in accordance with Section 12.3 in connection with any claims related to infringement by the Authority of any patent, copyright, trademark or similar rights.

(B) Intellectual Property Developed by the Authority. All intellectual property developed by the Authority at or through the use of the Facilities or otherwise in connection with the performance of the Contract Services shall be owned by the Authority subject to the terms and conditions of this Section, and is hereby licensed to the City on a nonexclusive cost free, perpetual basis for use by the City and any successor operator of the Facilities (but, with respect to any successor operator, only in connection with the operation of the Facilities). Such intellectual property shall include technology, inventions, innovations, processes, know-how, formulas and software, whether protected as proprietary information, trade secrets, or patents. The Authority shall have an irrevocable, perpetual and unrestricted right to use such intellectual property at any installation where the Authority is performing services similar to the Contract Services. Neither the City nor the Authority shall license, transfer or otherwise make available such intellectual property to any third party for remuneration except with the consent of the other, which consent may be conditioned upon mutual agreement as to the sharing of any such remuneration.

SECTION 14.5. INTEREST ON OVERDUE OBLIGATIONS. Except as otherwise provided herein, all amounts due hereunder, whether as damages, credits, revenue, charges or reimbursements, that are not paid when due shall bear interest at the rate of interest which is the Overdue Rate, on the amount outstanding from time to time, on the basis

of a 365-day year, counting the actual number of days elapsed, and such interest accrued at any time shall, to the extent permitted by Applicable Law, be deemed added to the amount due as accrued.

SECTION 14.6. NEGOTIATED FIXED PRICE WORK. (A) Base Fee Component of the Service Fee. The Base Fee Component of the Service Fee has been initially fixed and agreed to by the parties based on the Authority's proposal submitted in response to the RFP as further changed during the negotiation of this Service Contract, and is not subject to Cost Substantiation.

(B) Negotiated Pricing of Work for Which the City is Financially Responsible. This Service Contract obligates the City to pay for certain costs resulting from Uncontrollable Circumstances, Change in Law, City Breach and otherwise as more specifically provided herein. It is the expectation of the parties, in general, that the City will pay for such costs on a negotiated lump sum basis, or by an addition to the Base Fee, and that the price will be negotiated in advance of the Authority's performance of the work in all instances where it is practical to do so. For example, if a Change in Law occurs, as required under Section 12.2 the parties will assess the impact of the Change in Law, take all appropriate mitigation steps, determine any necessary Capital Modifications and operating changes, and agree upon pricing. To facilitate such negotiations, the Authority shall furnish the City with all information reasonably required by the City regarding the Authority's expected costs of performing the work and its mark-up. Once the parties agree upon the price, the Authority's actual costs of performance shall not be subject to Cost Substantiation unless after-the-fact Cost Substantiation with respect to all or a portion of the Authority's actual costs was agreed to by the parties in establishing the price.

SECTION 14.7. COST SUBSTANTIATION. (A) Cost Substantiation Generally. The Authority shall provide Cost Substantiation for the costs for which the City is financially responsible hereunder, other than the Base Fee and the Pass-Through Cost Components of the Service Fee, and costs for which the parties have negotiated a lump sum price, all as provided in Section 14.6. In incurring costs which are or may be subject to Cost Substantiation, the Authority shall utilize competitive practices as required by Applicable Law.

(B) Costs Requiring Cost Substantiation. Cost Substantiation shall be provided as soon as reasonably practicable after the costs which require substantiation have been incurred by the Authority. Examples of costs which require substantiation could include, but are not limited to: (1) work done on an emergency basis to respond to an Uncontrollable Circumstance, where it is not reasonably practicable for the parties in advance to negotiate a price for the work; and (2) work done as a Change Order authorized by the City. Cost Substantiation shall also be required where the parties agree that the Authority shall perform work on a cost-plus basis.

(C) Cost Substantiation Memorandum. Any memorandum delivered hereunder to substantiate cost shall state the amount of such cost and the provisions of this Service Contract under which such cost is properly chargeable to the City, shall describe the competitive or other process utilized by the Authority to obtain the price, and shall state that such services and materials are reasonably required pursuant to this Service Contract. The Cost Substantiation memorandum shall be accompanied by copies of such documentation as shall be necessary to reasonably demonstrate that the cost as to which Cost Substantiation is required has been paid or incurred. Such documentation shall be in a format reasonably acceptable under Good Industry Practice and shall include reasonably detailed information concerning all Subcontracts and, with respect to self-performed work, (1) the amount and character of materials, equipment and services furnished or utilized, the persons from whom purchased, the amounts payable therefor and related delivery and transportation costs and any sales or personal property Taxes; (2) a statement of the equipment used and any rental payable therefor; (3) Authority employee hours, duties, wages, salaries, benefits and assessments; and (4) Authority profit, administration costs, bonds, insurance, taxes, premiums overhead, and other expenses. The Authority's entitlement to reimbursement of Cost Substantiated costs of the Authority shall be subject to the limitations set forth in this Section.

(D) Technical Services. Authority personnel and personnel of Subcontractors providing technical services shall be billed at their then currently applicable rates for similar services on projects of similar size and scope to the Contract Services. The Authority shall use commercially reasonable efforts to use available Authority personnel for additional work hereunder before using Subcontractors.

(E) Administrative Charges. On all costs incurred by the Authority for work performed directly by the Authority which are subject to Cost Substantiation, the Authority may charge an appropriate administrative charge, using the Authority-wide administrative and general charge established from time to time by the Authority board of directors.

(F) Evidence of Costs Incurred. To the extent reasonably necessary to confirm direct costs required to be Cost Substantiated, copies of timesheets, invoices, canceled checks or bank statements of imaged checks, expense reports, receipts and other documents, as appropriate, shall be delivered to the City with the request for reimbursement of such costs.

SECTION 14.8. SUBCONTRACTORS. (A) Use Restricted. The Authority shall operate the Facilities with its own employees and fully in accordance with the requirements of Article VI. Subcontractors may be used to perform other Contract Services, subject to the City's right of approval set forth in subsection (B) of this Section.

(B) Limited City Review and Approval of Permitted Subcontractors. The City shall have the right, based on the criteria provided below in this Section, to approve all Subcontractors which the Authority is permitted to engage under subsection (A) of this Section

for Contract Services valued in excess of \$25,000 (as adjusted annually by the Service Fee Adjustment Factor) annually, except: (1) Affiliates of the Authority; (2) equipment suppliers; (3) Governmental Bodies; and (4) suppliers of Consumables and chemicals. The Authority shall furnish the City written notice of its intention to engage Subcontractors requiring City approval, and shall furnish all information reasonably requested by the City pertaining to the demonstrated responsibility of the proposed Subcontractors. The City's approval will not be unreasonably withheld or delayed. In the event the City fails to respond to any such notice of intention within 15 days of receipt thereof, the City shall be deemed to have approved the proposed Subcontractor. The approval or withholding thereof by the City of any proposed Subcontractor shall not create any liability of the City to third parties or otherwise unless the City's withholding is unreasonable. In no event shall any Subcontract be awarded to any person debarred, suspended or disqualified from State or City contracting for any services similar in scope to the Contract Services.

(C) Subcontract Terms and Subcontractor Actions. The Authority shall retain full responsibility to the City under this Service Contract for all matters related to the Contract Services notwithstanding the execution or terms and conditions of any Subcontract. No failure of any Subcontractor used by the Authority in connection with the provision of the Contract Services shall relieve the Authority from its obligations hereunder to perform the Contract Services. The Authority shall be responsible for settling and resolving with all Subcontractors all claims arising out of delay, disruption, interference, hindrance, or schedule extension caused by the Authority or inflicted on the Authority or a Subcontractor by the actions of another Subcontractor.

(D) Payment of Subcontractors. The Authority shall pay or cause to be paid all Subcontractors it may retain in the execution of its responsibility under this agreement all amounts due in accordance with their respective Subcontracts. No Subcontractor shall have any right against the City for labor, services, materials or equipment furnished for the Contract Services. The City shall be responsible for any third-party contractor it may retain or cause to be retained.

(E) Nondiscrimination. The Authority shall include a nondiscrimination provision similar to that contained in Section 14.16 in any of the Authority's contracts with Subcontractors that perform services related to the Facilities.

SECTION 14.9. ACTIONS OF THE CITY IN ITS GOVERNMENTAL CAPACITY.

(A) Rights as Government Not Limited. Nothing in this Service Contract shall be interpreted as limiting the rights and obligations of the City under Applicable Law in its governmental or regulatory capacity (including police power actions to protect health, safety and welfare or to protect the environment), or as limiting the right of the Authority to bring any action against

the City, not based on this Service Contract, arising out of any act or omission of the City in its governmental or regulatory capacity.

(B) No City Obligation to Issue Governmental Approvals. The City retains all issuance and approval rights it has under Applicable Law with respect to any Governmental Approval required with respect to the Facilities, or the Contract Services, and none of such rights shall be deemed to be waived, modified or amended as a consequence of the execution of this Service Contract. The City shall not be deemed to be in breach or default hereunder as a result of any delay or failure in the issuance or approval of any such Governmental Approval.

SECTION 14.10. ASSIGNMENT. (A) By the Authority. The Authority shall not assign, transfer, convey, lease, encumber or otherwise dispose of this Service Contract, its right to execute the same, or its right, title or interest in all or any part of this Service Contract, whether legally or equitably, by power of attorney or otherwise, without the prior written consent of the City, except to an agency assuming the duties and obligations of the Authority. Any City approval given in one instance shall not relieve the Authority of its obligation to obtain the prior written approval of the City to any further assignment. Any assignment of this Service Contract which is approved by the City shall require the assignee of the Authority to assume the performance of and observe all obligations, representations and warranties of the Authority under this Service Contract, which shall remain in full force and effect during the Term hereof. The approval of any assignment, transfer or conveyance shall not operate to release the Authority in any way from any of its obligations under Service Contract unless such approval specifically provides otherwise.

(B) By the City. The City may not assign its rights or obligations under this Service Contract without the prior written consent of the Authority. The City may, however, assign its rights and obligations under this Service Contract, without the consent of the Authority, to another Governmental Body if such assignee assumes, and is legally capable of discharging, the duties and obligations of the City hereunder.

SECTION 14.11. LIMITED RECOURSE TO CITY. No recourse shall be had to the general fund or general credit of the City for any obligation of the City which may arise hereunder, or for any Loss-and-Expense of any nature arising from the performance or non-performance of the City's obligations hereunder. The sole recourse of the Authority for all such amounts shall be to the funds held in the City's water enterprise fund. All amounts held in the water enterprise fund shall be held for the uses permitted and required thereby, and no such amounts shall constitute property of the Authority.

SECTION 14.12. FURTHER AGREEMENTS. The parties may agree that the Authority shall perform services in addition to those constituting the Contract Services as of the Contract Date. The scope of such additional services, and the Authority's additional compensation therefor, shall be negotiated by the parties and their agreement with respect

thereto shall be reflected in a Contract Administration Memorandum or amendment to this Service Contract, as appropriate, and shall thereupon become part of the Contract Services. Any such agreement shall be authorized by appropriate action of the Authority and the City as required by Applicable Law.

SECTION 14.13. COMPLIANCE WITH MATERIAL AGREEMENTS. The Authority shall comply with its obligations under agreements of the Authority which are material to the performance of its obligations under this Service Contract. The City shall comply with its obligations under agreements of the City which are material to the performance of its obligations hereunder.

SECTION 14.14. BINDING EFFECT. This Service Contract shall bind and inure to the benefit of and shall be binding upon the City and the Authority and any assignee acquiring an interest hereunder consistent with Section 14.10.

SECTION 14.15. AMENDMENT AND WAIVER. This Service Contract may not be amended except by a written amendment signed by the parties. Any of the terms, covenants, and conditions of this Service Contract may be waived at any time by the party entitled to the benefit of such term, covenant, or condition if such waiver is in writing and executed by the party against whom such waiver is asserted.

SECTION 14.16. NO DISCRIMINATION. The Authority agrees that it shall not discriminate nor permit discrimination by any of its officers, employees, agents and representatives against any person because of age, race, color, religion, national origin, sex or, with respect to otherwise qualified individuals, handicap with respect to the Contract Services provided under this Service Contract.

SECTION 14.17. NOTICES. (A) Procedure. All notices, consents, approvals or written communications given pursuant to the terms of this Service Contract shall be: (1) in writing and delivered in person; (2) transmitted by certified mail, return, receipt requested, postage prepaid or by overnight courier utilizing the services of a nationally recognized overnight courier service with signed verification of delivery; or (3) given by facsimile transmission, if a signed original is deposited in the United States Mail within two days after transmission. Notices shall be deemed given only when actually received at the address first given below with respect to each party. Either party may, by like notice, designate further or different addresses to which subsequent notices shall be sent.

(B) Authority Notice Address. Notices required to be given to the Authority shall be addressed as follows:

Guadalupe-Blanco River Authority
933 East Court Street
Seguin, Texas 78155

Attn: General Manager

(C) City Notice Address. Notices required to be given to the City shall be addressed as follows:

City Manager
The City of San Marcos
630 East Hopkins
San Marcos, Texas 78666

SECTION 14.18. NOTICE OF LITIGATION. In the event the Authority or City receives notice of or undertakes the defense or the prosecution of any Legal Proceedings, claims, or investigations in connection with the Facilities, the party receiving such notice or undertaking such prosecution shall give the other party timely notice of such proceedings and shall inform the other party in advance of all hearings regarding such proceedings.

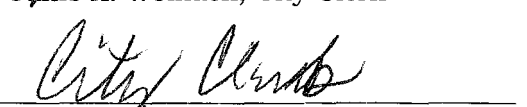
SECTION 14.19. FURTHER ASSURANCES. The City and Authority each agree to execute and deliver such further instruments and to perform any acts that may be necessary or reasonably requested in order to give full effect to this Service Contract. The City and the Authority, in order to carry out this Service Contract, each shall use all commercially reasonable efforts to provide such information, execute such further instruments and documents and take such actions as may be reasonably requested by the other and not inconsistent with the provisions of this Service Contract and not involving the assumption of obligations or liabilities different from or in excess of or in addition to those expressly provided for herein.

[SIGNATURE PAGE FOLLOWS]

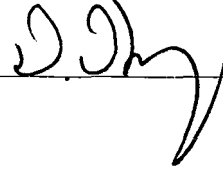
IN WITNESS WHEREOF, the parties have caused this Service Contract to be executed by their duly authorized representatives as of the day and year first above written.

CITY OF SAN MARCOS, TEXAS

ATTEST:


Janis K. Womack, City Clerk


Signature: _____



Printed Name: Dan O'Leary

Title: City Manager

Signature



ATTEST:



GUADALUPE C ; zRITY

Printed Name: William E. West

Title: General Manager

TRANSACTION FORMS
RELATING TO THE
SERVICE CONTRACT
FOR
WATER TREATMENT FACILITIES OPERATIONS
AND ASSET MANAGEMENT

between

THE CITY OF SAN MARCOS, TEXAS

and

GUADALUPE-BLANCO RIVER AUTHORITY

Dated

September 20, 2005

TRANSACTION FORM A
FORM OF LETTER OF CREDIT

TRANSACTION FORM A

FORM OF LETTER OF CREDIT

[Date]

City of San Marcos
[Address]
[Address]
San Marcos, Texas 78666

Ladies and Gentlemen:

1. At the request and for the account of Guadalupe-Blanco River Authority, a conservation and reclamation district and political subdivision of the State of Texas (the "Authority"), [Name of Bank] (the "Bank") hereby establishes in your favor our direct--pay irrevocable Letter of Credit No. _ (the "Letter of Credit"), in the amount of \$ (the "Stated Amount"), effective immediately. Capitalized terms used but not defined herein are used as defined in the Service Contract referred to below.

2. We hereby irrevocably authorize you to draw drafts on us at sight in accordance with the terms and conditions hereinafter set forth. The aggregate amount drawn hereunder shall not exceed the Stated Amount.

3. This Letter of Credit is effective immediately and will expire on _____ (the "Stated Termination Date").

4. Subject to the foregoing and the further provisions of this Letter of Credit, a demand for payment may be made by you by presentation to us of your sight draft, accompanied by your written and completed certificate, signed by you, in substantially the form of Annex A hereto (such certificate being your "Drawing Certificate"), in an amount not exceeding the Stated Amount, representing amounts payable to you by the Authority under and pursuant to the Service Contract for Water Treatment Facilities Operations and Asset Management, dated __, 2005, between the Authority and the City of San Marcos, Texas (the "Service Contract").

5. Each sight draft drawn under this Letter of Credit must bear on its face the clause "Drawn under Irrevocable Letter of Credit No. _ "

6. Demand for payment may be made by you under this Letter of Credit prior to 3:00 PM on the date of expiration at its address at (Bank's Address] Attention: , on a Business Day (as hereinafter defined). As used herein the term "Business Day" means a day on which the Bank at our aforesaid office is opened for the purpose of conducting commercial banking business. We hereby agree that all sight drafts drawn under and in strict conformity with the terms of this Letter of Credit will be duly honored by us upon delivery of the sight drafts and certificates. If we receive any of your sight drafts and certificates, all in strict conformity to the terms of this Letter of Credit, at our aforesaid office not later than 11:00 A.M. (local time) on a Business Day on or before the Stated Termination Date hereof, we will honor the same by 3:00 P.M. (local time) on the same day in accordance with your payment instructions. If we receive any of your sight drafts and certificates, all in strict conformity to the terms of this Letter of Credit at such office after 11:00 A.M. (local time) on a Business Day, on or before the Stated Termination Date hereof, we will honor the same not later than 1:00 P.M. (local time) on the next succeeding Business Day in accordance with your payment instructions. If requested by you, payment under this Letter of Credit may be made by Federal

Reserve Wire Transfer of funds to your account in a bank on the Federal Reserve Wire Facility or by deposit of same day funds into a designated account that you maintain with us.

7. The Stated Amount shall be reduced automatically by the amount of each drawing hereunder.

8. This Letter of Credit is transferable in its entirety (but not in part) to your successor which you certify to us has succeeded you as beneficiary and may be successively so transferred. Transfer of this Letter of Credit to such transferee shall be effected upon the presentation to us of this Letter of Credit accompanied by a certificate in the form of Annex B attached hereto.

9. Only you (or a transferee as provided in paragraph 8 hereof) may make a drawing under this Letter of Credit. Upon the payment to you or your account of the amount specified in a sight draft drawn hereunder, we shall be fully discharged of our obligation under this Letter of Credit with regard to that payment, and we shall not thereafter be obligated to make further payments under this Letter of Credit with regard to that payment to you.

10. This Letter of Credit, except as otherwise stated herein, is subject to International Standby Practices 1998, International Chamber of Commerce Publication 590 1998 (the "ISP98") and shall be governed and construed in accordance with the laws of the State of Texas and applicable U.S. federal law.

11. Communications with respect to this Letter of Credit shall be in writing and shall be addressed to us at our address at (Bank Address] Attention: , specifically referring to the number of this Letter of Credit.

12. This Letter of Credit sets forth in full our undertaking and such undertaking shall not in any way be modified, amended, amplified or limited by reference to any document, instrument or agreement referred to herein (including, without limitation, the Service Contract), except only the certificates, sight drafts, and Letter of Credit referred to herein and ISP98; and any such reference shall not be deemed to incorporate herein by reference any document, instrument or agreement, except for ISP98, such certificate, sight drafts and Letter of Credit.

Very truly yours,

[Name of Bank]

By:_____

Authorized Officer

ANNEX A TO LETTER OF CREDIT

CERTIFICATE FOR DRAWING
IN CONNECTION WITH
PAYMENT OF AMOUNTS
UNDER THE SERVICE CONTRACT

Irrevocable Letter of Credit No.

The undersigned, a duly authorized representative of the City of San Marcos, Texas {the "Beneficiary"), hereby certifies to [Name of Bank] (the "Bank"), with reference to Irrevocable Letter of Credit No. _ (the "Letter of Credit"; terms defined therein and not otherwise defined herein being used herein as therein defined) issued by the Bank in favor of the Beneficiary, as follows:

1. The Beneficiary is a party to the Service Contract for Water Treatment Facilities Operations and Asset Management, dated _____, 2005 (the "Service Contract") by and between the Beneficiary and Guadalupe-Blanco River Authority (the "Authority") regarding the long-term operation, maintenance, repair, replacement and management of the Beneficiary's water system, in the City of San Marcos, Texas.

2. The Commencement Date has occurred.

3. The Beneficiary is making a demand for payment under the Letter of Credit in the amount of \$_____ and such amount does not exceed the Stated Amount.

4. The Beneficiary hereby certifies as follows (insert those which are applicable):

(a) The Authority has materially breached the Service Contract and, in accordance with the procedures and requirements of Section 13.1 thereof, the Beneficiary has determined that the amount set forth above represents the estimated damages suffered by the Beneficiary, not to exceed the Stated Amount.

(b) The Beneficiary has terminated the Service Contract pursuant to Section 11.2 of the Service Contract, and the Beneficiary has determined that the amount set forth above represents the estimated damages suffered by the Beneficiary, not to exceed the Stated Amount.

(c) The Letter of Credit will expire within 30 days', and the Letter of Credit has not been extended, renewed or replaced in accordance with Section 13.1 of the Service Contract. The amount set forth above represents the full Stated Amount.

(d) The Authority has filed a petition of voluntary bankruptcy under the Bankruptcy Code, the Authority has consented to the filing of any bankruptcy or reorganization petition against the Authority pursuant to the Bankruptcy Code. The amount set forth above represents the full Stated Amount.

(e) A court of competent jurisdiction has issued an order appointing a receiver, liquidator, custodian or trustee of the Authority or of a major part of the Authority's property, respectively, or a petition to reorganize the Authority pursuant to the Bankruptcy Code has been filed against the Authority, and such order has not been discharged or such filing has not been dismissed within 90

days after such issuance or filing. The amount set forth above represents the full Stated Amount.

5. Payment of the amount described hereby shall be made by wire transfer to the following account: [wire transfer instructions].

IN WITNESS WHEREOF, the Beneficiary has caused this certificate to be executed and delivered by its duly authorized representative as of this _day of_____, 20_.

THE CITY OF SAN MARCOS, TEXAS

By: _____

Title: _____

ANNEX B TO LETTER OF CREDIT

TRANSFER CERTIFICATE

[Date]

(Bank's Address]

Attention:

RE: Irrevocable Letter of Credit No.

Ladies and Gentlemen:

For value received, the undersigned Beneficiary hereby irrevocably transfers to:

[Name of Transferee]

[Address of Transferee]

all rights of the undersigned Beneficiary to draw under the above Letter of Credit in its entirety.

By this transfer, all rights of the undersigned Beneficiary in such Letter of Credit are transferred to the transferee and the transferee shall have the sole right as the Beneficiary thereof, including sole rights to any amendments whether increases or extensions or other amendments and whether now existing or hereafter made. All amendments are to be advised directly to the transferee without necessity of any consent of or notice to the undersigned beneficiary.

Such transferee is a permitted transferee under such Letter of Credit.

The Letter of Credit is returned herewith, and we ask you to endorse the transfer on the reverse thereof, and forward it directly to the transferee with your customary notice of transfer.

SIGNATURE AUTHENTICATED

THE CITY OF SAN MARCOS, TEXAS

(Bank)

By:_____

(Authorized Officer)

Title:_____

APPENDICES

to the

SERVICE CONTRACT

FOR

WATER TREATMENT FACILITIES OPERATIONS
AND ASSET MANAGEMENT

between

THE CITY OF SA^tMARCOS, TEXAS

and

GUADALUPE-BLANCO RIVER AUTHORITY

Dated

September 20, 2005

APPENDICES

1. Water Treatment Facilities Description and List of Transferred Property
2. Operating Governmental Approvals and Applicable Permits
3. Operation and Maintenance Standards
4. Staffing **Plan**
5. Designated Employee and Employee Benefits
6. Performance Guarantees
7. Approved Subcontractors
8. Approved City Access
9. Insurance Requirements

APPENDIX 1

WATER TREATMENT FACILITIES DESCRIPTION AND LIST OF TRANSFERRED PROPERTY

1.1 Water Treatment Facilities

The purpose of this Appendix is to provide a summary description of the Water Treatment Facilities. It is not intended to describe all elements that comprise the Water Treatment Facilities. The Water Treatment Facilities include the following items as defined in the Service Contract and further described below:

- Plant
- Plant Site
- Wells
- Pump Stations/Storage

The Authority shall provide the Contract Services for all of the Water Treatment Facilities, whether or not a particular element of the Water Treatment Facilities is identified herein.

1.2 Plant

The City owns the San Marcos Surface Water Treatment Plant (the "Plant") located at 91 Old Bastrop Highway, San Marcos, Texas. The Plant, which was commissioned in calendar year 2000, is a 9 mgd regional water supply treatment facility which currently provides treatment of surface water for the City and the City of Kyle, with the potential to supply treated surface water to additional users. The Plant currently has a peak rated capacity of 9 mgd. The Plant is designed for an expansion up to 24 mgd. Currently, the Plant is a conventional surface water treatment plant designed with coagulation, sedimentation by a single upflow contact basin clarifier with tube settlers, filtration with four dual media high rate filters, chemical feed systems to support enhanced coagulation, clearwell storage, pumping forebay, three high service pumps, and dual disinfection capacity with chlorine and chlorine dioxide.

1.3 Plant Site

Please see Attachment A for a map of the portion of the 300 acre Plant Site for which the Authority is responsible.

1.4 Wells

The City is permitted to pump each year approximately 5,400 acre-feet from the Edwards Aquifer under permits issued by the Edwards Aquifer Authority (EEA). The production facilities at each well pump groundwater into the City's water storage system. After treatment, the water is distributed into designated water system pressure zones. The well production facilities (collectively the "Wells") are:

- 2 Spring Lake wells located at 103 Ed JL Green Drive
- 1 Comanche well located at Vista Drive/Comanche Street
- 1 McCarty well located at 2900 Great Oaks Drive
- 1 Soyars well located at 3424 Hunter Road
- 2 Oakridge wells located at 705 Harmons Way

1.5 Pump Stations/Storage

After treatment, the water may be distributed through booster stations or into designated storage containers. The well booster/storage facilities are:

Spring Lake Pump Station located at 103 Ed JL Green Drive (capacity of 1.5 mg storage)
Ranch Road 12 storage tank located at 2826 Ranch Road 12 (capacity of 1 mg storage)
Comanche Pump Station located at 402 Sessom Drive (capacity of 1 mg storage)
Butler Pump Station located at 201 River Ridge (capacity of 0.2 mg storage)
McCarty Pump Station located at 2900 Great Oaks Drive (capacity of 0.5 mg storage)
Soyars Pump Station located at 3424 Hunter Road (capacity of 0.27 mg storage)
Oakridge Pump Station located at 705 Harmons Way (capacity of 0.065 mg storage)

1.6 Transferred Property

Subject to an on-site inventory by representatives of the City and the Authority prior to the Commencement Date, the City is proposing to transfer to the Authority, the following property:

Pump Station Equipment
Motors, pumps, couplings, shafts, control valves and other similar equipment

Equipment, spare parts and consumables to be transferred:

Hach fluoride test kit Pocket colorimeter. (Catalog number 58700-05)
Hach chlorine test kit Pocket colorimeter. (Catalog number 58700-00)
Scott air pack 30 minute

Oakridge Water Station

Pall Septra CB filter element cartridge filters- 3 sets (20 per set)
Pall Nexus NXT1-30uo prefilter cartridges- 3 sets (72 per set)
Hach sension 3 bench top PH meter
Turbidity meter 1720D Low range –3 units
Integrity test kit for the filters
LMI chemical feed pump model# P121-450F1
Hach sension ph electrode 51935-88
Hach junction box network connections (2)
Hach PS1201 Power supply 12vDC Network connection module
Chemical Safety Equipment -
(12) Chemical rubber gloves
(4) Replacement cartridges 2 per set
(2) North 7700 series half mask face piece respirators
(2) Large chemical protective jackets (green)
(2) Medium chemical protective jackets (green)
(2) Full face protective shields
(1) Rubbermaid storage unit

Soyars Water Station

Chemical Safety Equipment -

- (4) Large chemical protective jackets (green)
- (2) Protective eye goggles
- (1) LMI chemical feed pump model#P031-490FI
- (1) Rubbermaid storage unit small

McCarty Water Station

Chemical Safety Equipment -

- (6) Large chemical protective jackets (green)
- (2) Pair chemical rubber gloves
- (2) Full face protective shields
- (2) North 7700 series half mask face piece respirators
- (1) Pair replacement cartridges for respirators
- (2) Pair chemical rubber boots
- (1) Rubbermaid storage shed
- (1) Fluoride drum hand dolly

Spring Lake Water Station

Chemical Safety Equipment -

- (1) Fluoride drum hand dolly
- (2) North 7700 series half mask face piece respirators
- (2) Pair replacement cartridges for respirators
- (1) LMI chemical feed pump model# A141-450FI
- (2) Pair chemical rubber gloves
- (2) Full face protective shields
- (2) Protective eye goggles
- (2) Pair chemical rubber boots
- (4) Large chemical protective jackets (green)
- (1) Rubbermaid storage shed

Comanche Water Station

Chemical Safety Equipment -

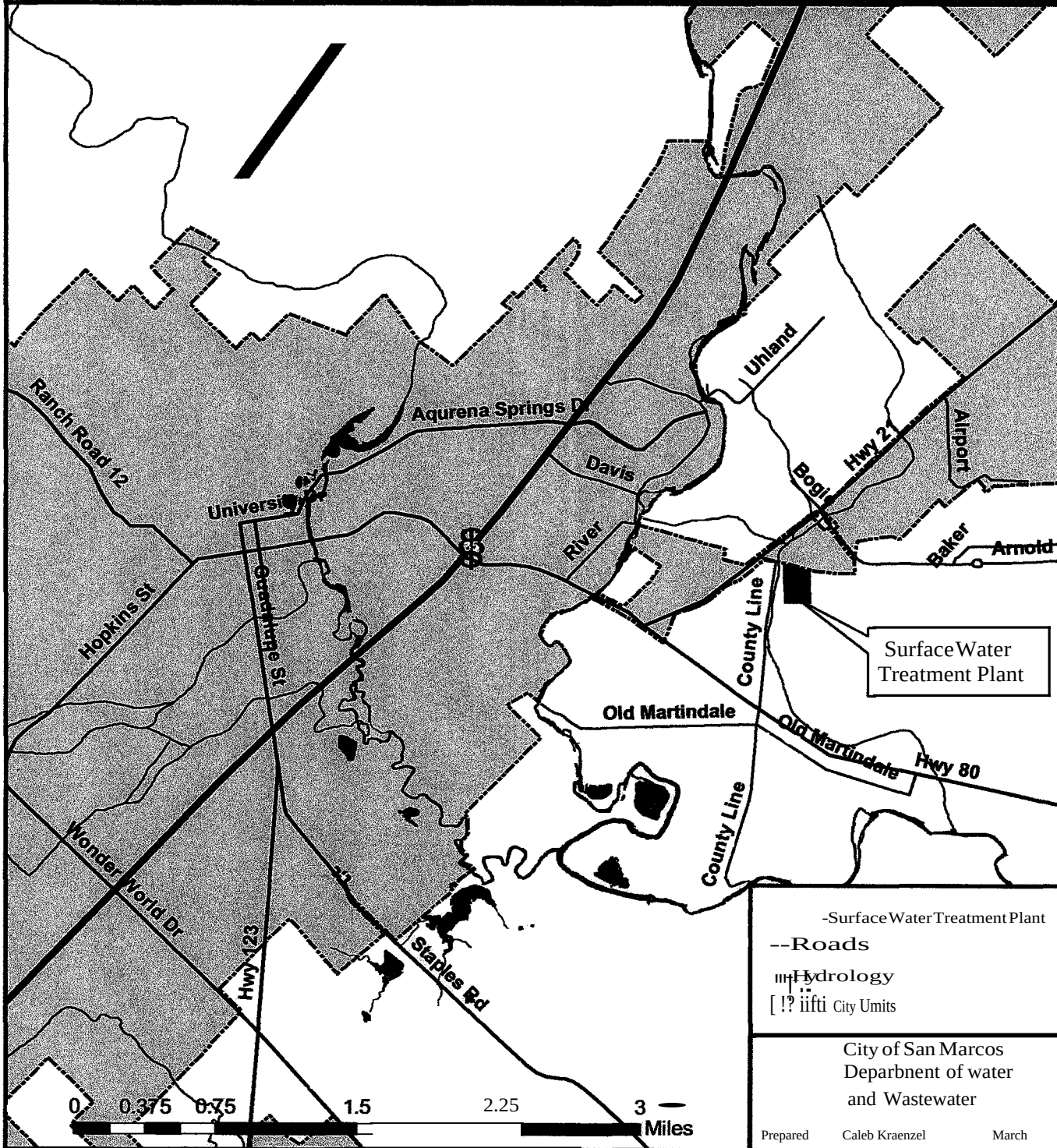
- (2) North 7700 series half mask face piece respirators
- (2) Pair replacement cartridges for respirators
- (1) LMI chemical feed pump model# A181-490FI
- (2) Pair chemical rubber gloves
- (2) Full face protective shields
- (2) Pair chemical rubber boots
- (3) Large chemical protective jackets (green)
- (3) Medium chemical protective jackets (green)
- (1) Protective eye goggle

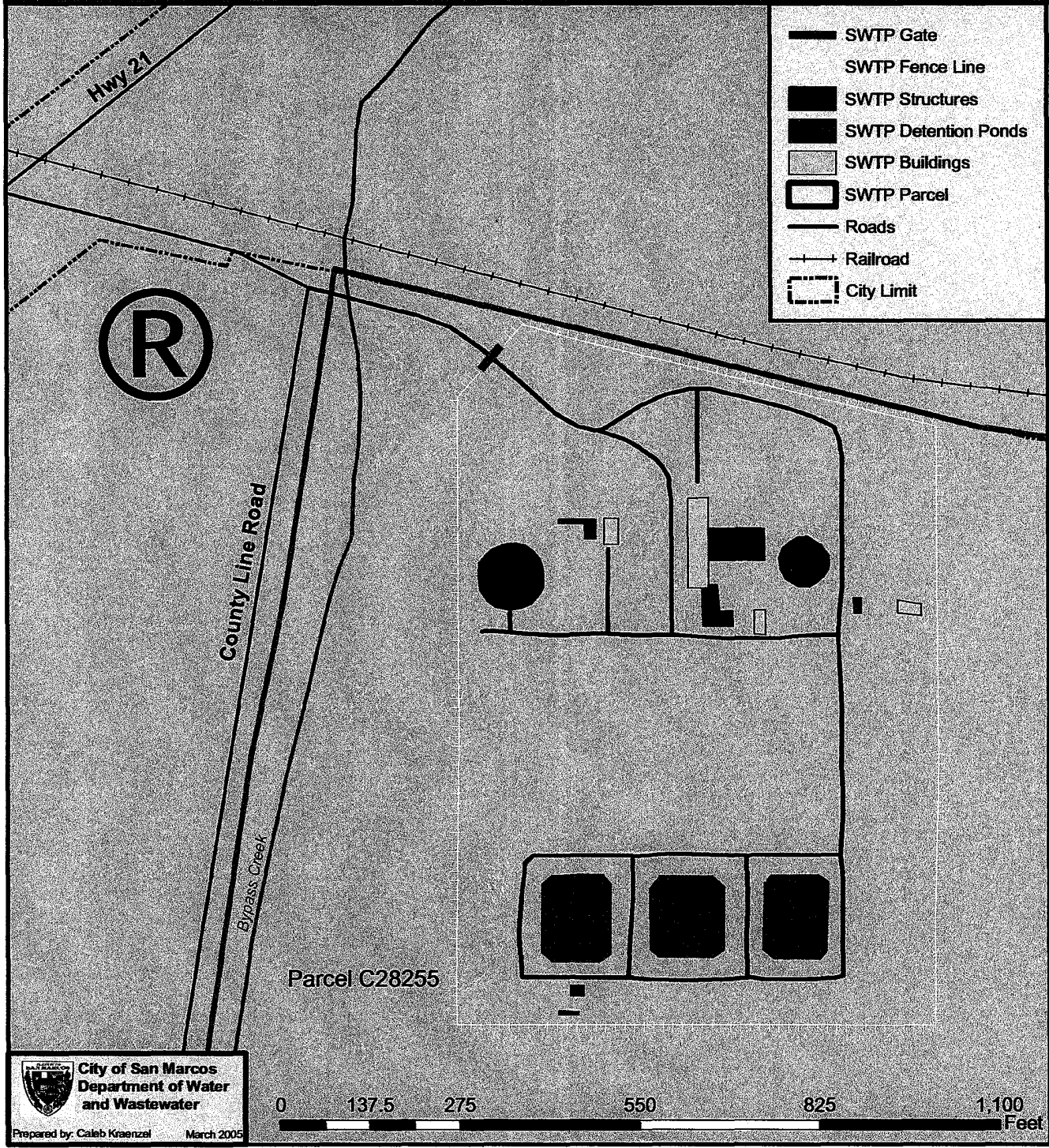
1.7 Maps of System

This information can be accessed at the City's Department of Water/Wastewater Utilities.

ATTACHMENT A TO APPENDIX 1

[To be inserted manually]





APPENDIX2

GOVERNMENTAL APPROVALS AND APPLICABLE PERMITS

The Operating Governmental Approvals and Applicable Permits shall include, but shall not be limited to, the City's two Edwards Aquifer Authority Regular Permits.

APPENDIX3

OPERATION AND MAINTENANCE STANDARDS

3.1 General

The Authority shall operate, maintain and manage the Facilities in accordance with the terms and provisions set forth in this Service Contract. Operational decision-making shall be based on the following overall objectives:

- Protection of health and welfare of the public and Water Treatment Facilities operating staff;
- Protection of the environment;
- Preservation of the long-term capability of the Facilities;
- Protection and preservation of the Water Treatment Facilities equipment;
- Maximization of the operation efficiency of the Water Treatment Facilities; and
- Minimization of operational costs to the City.

3.2 Operations And Maintenance

The Authority shall maintain the Water Treatment Facilities in good working order and repair and in a neat and orderly condition in accordance with the specific provisions of Articles VI and VIII of the Service Contract and the Contract Standards. The Authority shall maintain the aesthetic quality of the Water Treatment Facilities. The Authority shall maintain on behalf of the City all manufacturers' warranties on new equipment purchased, and shall fully cooperate and assist the City in enforcing existing equipment warranties and guaranties relative to the Water Treatment Facilities.

The Authority is responsible for the operation and maintenance of the Water Treatment Facilities components as set forth in the Service Contract, the Operation and Maintenance Manual and the provisions described below. Such information below, however, is not intended to include all specific activities necessary for meeting the requirements set forth in the Service Contract. In addition, the Authority shall understand and implement additional operation and maintenance requirements as required in the Operation and Maintenance Manual, manufacturer's recommendations, and to meet Good Industry Practices.

3.3 Maintenance

- All Maintenance, Repair and Replacement, including maintenance, repair and replacement described in the Maintenance, Repair and Replacement Plan (which shall be provided by the Authority prior to the Commencement Date). The well pumps, well motor controls, and SCADA will be maintained by the City.
- All Major Maintenance Repair and Replacement, including major maintenance, repair and replacement described in the Major Maintenance Repair and Replacement Schedule attached hereto as Attachment A to this Appendix.
- All Predictive and Preventive Maintenance, including the following predictive and preventive maintenance:
 - CMMS
 - Vibration Analysis
 - Infrared Thermography

Motor Circuit Evaluation
Basic Oil Analysis
Follow-Up

- All Corrective Maintenance
Corrective maintenance shall be performed by the Authority in accordance with the Contract Standards, manufacturer recommendations and specifications, and Good Industry Practice.
- Laboratory Work
Sampling, Testing and Lab Work as required in Section 6.11(B).

3.4 Safety and Security Plan

The Authority shall provide the Safety and Security Plan not more than 60 days after the Commencement Date.

ATTACHMENT A TO APPENDIX 3

MAJOR MAINTENANCE REPAIR AND REPLACEMENT SCHEDULE

Contract Year	Description of Major Repair and Replacement	Value
1	Oakridge filters (\$67,200); Vehicle-groundwater system (\$20,000)	\$87,200
2	Oakridge filters (\$67,200); Remote monitoring system (\$30,000)	\$97,200
3	Oakridge filters (\$67,200); Remote monitoring system (\$30,000)	\$97,200
4	Oakridge filters (\$67,200); Plant Filter media & 2_aint (\$28,000)	\$95,200
5	Oakridge filters (\$67,200); Plant Filter media & paint (\$28,000)	\$95,200
6	Oakridge filters (\$67,200); Paint clarifier (\$25,000)	\$92,200
7	Oakridge filters (\$67,200); Vehicles- Plant (\$20,000)	\$87,200
8	Oakridge filters (\$67,200)	\$67,200
9	Oakridge filters (\$67,200)	\$67,200
10	Oakridge filters (\$67,200)	\$67,200

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APPENDIX4

STAFFING PLAN

4.1 Staffing Plan

The Authority shall provide a staff of qualified and experienced employees in accordance with this Service Contract, Applicable Law and this Staffing Plan, and shall provide such additional third-party support as may be needed to perform its duties and obligations hereunder. Such third-parties shall be equally qualified for the particular services to be performed and shall not have any direct claim against the City whatsoever. The Authority shall maintain the necessary number of employees, staff and third-party contractors to operate, maintain and manage the Water Treatment Facilities in accordance with the Service Contract; to adequately maintain the Water Treatment Facilities in good repair; to adequately operate the Water Treatment Facilities to enable the City to provide good service to its customers; and to protect the health, safety and welfare of the citizens of the City. The Authority shall provide full-time (24 hour per day, 7 day per week) staffing at the Plant.

The Authority shall submit a Staffing Plan to the City for approval no later than 15 days prior to the Commencement Date. The Staffing Plan shall include, at a minimum, the following information:

- Requirement that the Water Treatment Facilities staff consist of:
 - five full-time operators,
 - Jerry Sharp as full-time Facilities Manager, and
 - availability of Darel Ball and/or other Senior Supervisors for general oversight, supervision and guidance;
- Requirement that all operators working at the Water Treatment Facilities are qualified licensed operators in compliance with TCEQ requirements;
- Requirement that the Authority shall make available to the Water Treatment Facilities as needed technical support from other Authority operations or third-party contractors;
- Requirement that the Authority shall comply with Applicable Law, including all additional licenses and qualifications necessary to satisfy regulatory requirements;
- Requirement that the Authority's coverage at the Water Treatment Facilities and the staff proposed for laboratory, operations and maintenance is in conformance with the Authority's March 2005 proposal, its clarifications and this Service Contract; and
- Requirement that the positions, titles and responsibilities of each Authority employee, are in conformance with the attached organization chart.

The Authority shall have the ability to revise the Staffing Plan provided that the Authority receives written approval of the revised Staffing Plan from the City.

4.2 Training

The Authority shall be responsible for training to all of its employees of the Water Treatment Facilities. Prior to the Commencement Date, the Authority shall work to assess the Designated

Employee's training needs against the qualifications and experience requirements of the job classification. In addition to training required by Applicable Law and the training required to obtain and retain the licenses required of employees under Section 6.8, the Authority shall provide other training and professional development in accordance with the Authority's policies and procedures, including areas such as:

- Laboratory analysis, including quality control procedures, related to the Water Treatment Facilities;
- Process control, including use of computer and monitoring equipment, response to plant upsets, record keeping and reporting;
- Water Treatment Facilities operations and maintenance, including the computerized maintenance management system;
- Training for the operation and maintenance, and repair of any applicable Capital Modifications;
- Supervisory training as appropriate and required;
- Safety, including first aid, identification of hazards, proper use of safety equipment, and safety/accident reporting;
- Confined space entry;
- Emergency preparedness and response; and
- Public and community relations.

The Authority shall cross-train employees, as deemed appropriate by the Authority, between areas such as laboratory, operations and maintenance for all services provided by the Authority to the City under the Service Contract.

The Authority shall make a reasonable effort to notify the City in advance of any Authority-sponsored training programs held within the City that may be of benefit to City personnel. The purpose of this notice is to allow City participation in such programs if space is available. The City will pay any expenses related to its participation in such training programs. The Authority shall maintain records of training provided to its employees.

APPENDIX5

DESIGNATED EMPLOYEE AND EMPLOYEE BENEFITS

5.1 Designated Employee Transition

In accordance with Article VI of the Service Contract, the Authority shall provide for the transition of the Designated Employee listed in the Attachment to this Appendix. The Designated Employee transition process shall consist of the following:

1. Employee Orientation
Within 15 days following the Contract Date, the Authority shall conduct an orientation meeting for the Designated Employee. The meeting shall include, but is not limited to, a presentation about the Authority, the Authority's policies and procedures, the Service Contract and the Authority's goals for the operation of the Water Treatment System.
2. Interview and Career Planning
Although the Designated Employee will be offered employment, an individual interview shall be conducted by the Authority. The interview shall afford the Authority and the employee an opportunity to meet and discuss career opportunities available within the Authority and to provide an opportunity for the Designated Employee to ask specific questions that may be pertinent to his situation.
3. Physical and Drug Screening
As further provided in the Service Contract, the Designated Employee will be required to successfully complete a pre-employment physical examination and drug screen consistent with the Authority's current hiring protocol.
4. Performance Review and Career Planning Session
Approximately 180 days after the Commencement Date, the Authority shall conduct a private performance feedback session with the Designated Employee to discuss his job performance and future career development.

5.2 Employee Benefits for the Designated Employee

The Authority shall provide to the Designated Employee at the Commencement Date employee benefits in accordance with those benefits set forth below. Thereafter, the Authority shall provide the Designated Employee the same benefits provided to other employees of the Authority, and nothing in the Service Agreement or this Appendix shall preclude the Authority from changing its employee benefits at any time and from time to time.

Benefits	Description	Eligibility
Medical \$500 deductible, individual \$1,000 deductible, family Prescription Drugs (\$10, \$25, \$40)	Self-Insured through Benesight, Inc. \$20 co-pay, 90% in network; 70% out-of-network Medco Health Solutions (Employee Only- \$9.23 bi-weekly)	First of the month following 2 months of employment -
Dental \$50 deductible, individual \$150 deductible, family	Self-Insured through Benesight, Inc. (Employee Only- \$0.46 bi-weekly)	First of the month following 2 months of employment
Vision \$50 eye exam Frames/lenses/contacts up to \$150 per calendar year	Self-Insured through Benesight, Inc. (Cost combined with dental)	First of the month following 2 months of employment
Flexible Benefits Plan	Medical/Dependent care Pre-taxed dollars	Completion of one month of employment
Life Insurance	Jefferson Pilot Financial 2 ½ x annual salary, AD&D No cost to employee	First of the month following 2 months of employment
Long Term Disability	Jefferson Pilot Financial No cost to employee	First of the month following 2 months of employment
Defined Benefit Retirement Plan	Wells Fargo, Trustee Rule of 85 (Age & Accrual Service equal to 85 or more years and age 60 or more years) 100% Vested after 5 years	January 1 or July 1 enrollment after completion of 1,000 hours of service
457 Retirement Savings Plan	ICMA -- GBRA matches \$0.50 per dollar up to 3% Employee vesting: 100% GBRA Vesting: 5 years Loan Provisions	Upon hire Employer matching contributions-after the completion of 12 consecutive months
Annual Leave	Accrue 7 hours per month up to 2 years; changes with years of service	Available upon completion of 1 month
Sick leave	Accrue 7 hours per month (or pro-rated proportionate to number of hours worked)	Available upon completion of 1 month
Sick Leave Pool	Unavailability of paid sick or annual leave of employee	Eligibility requirements
Holidays	9 days	Upon hire
Employee Assistance Program	Seguin Family Institute 4 free visits	Upon Hire
Employee Volunteer Program	Employee Recognition Program Annual "Our Day to Shine" Awards Banquet	Upon Hire
Safety Program	Group Incentives if 1 year accident free	Upon Hire
Group Voluntary Products (Colonial Supplemental Insurance & Jefferson Pilot Financial)	Cancer, Short Term Disability & Supplemental Life-employee's cost	First of the month following 2 months of employment

ATTACHMENT A TO APPENDIX 5

DESIGNATED EMPLOYEE

Name (Last, First)	Position	Date of Hire	Years with City	Vested	Hourly Rate (as of Contract Date)
Garza, Leroy	Water Production Operator	05/01/89	16	yes	\$16.43

APPENDIX6

PERFORMANCE GUARANTEES

The Authority shall at all times operate the Facilities to meet the following Performance Guarantees:

1. Water Treatment Guarantee -

The Authority shall operate the Facilities to produce Finished Water from the Plant in compliance with the requirements of Applicable Law and the Enhanced Standards (whichever is more stringent) set forth below. The City will provide the Authority with advance notice of its intention to undertake a Capital Modification of the Facilities. The Authority must inform the City within a time frame to be agreed upon by the parties as to whether such proposed Capital Modification will adversely affect the ability of the Authority to meet a Performance Guarantee.

Chlorine residuals less than 2.5 mg/1 but high enough to ensure 0.2 mg/1 minimum at all points in the City's distribution system;

TTHMIHAA levels below 75% of regulatory compliance levels (as measured at the Plant);

Fluoride levels at 0.7- 1.0mg/1;

TOC removal in compliance with regulatory requirements or alternate compliance criteria;

Chlorite ion levels below levels that cause taste/odor in the distribution system;

Turbidity below 75% of regulatory limit on average monthly basis with no spikes to or above regulatory level; and

- Stable, non-corrosive water with verified no pipe material etching/damage or color.

2. Water Availability Guarantee-

The Authority shall, at all times, operate the Facilities to maintain storage tank levels in accordance with the Water Availability Requirement set forth in Section 7.3.

The Authority shall maintain and/or monitor measuring devices in such Finished Water reservoirs sufficient for determining the level of Finished Water in such reservoirs on a continuous basis. Such requirement will assure the availability of Finished Water to the System in the event an extended power outage disables the Facilities or if needed for fire fighting purposes.

3. Production Efficiency Guarantee-

The Authority shall operate the Plant to achieve a treatment process loss (Raw Water to Finished Water production) of no more than 5% on an annual average basis over the course of each Contract Year following the Commencement Date.

4. Water Pressure and Flow Guarantee-

The Authority shall, at all times, operate the Facilities such that the normal System water pressure range is 35 to 115 PSI at the highest to lowest pressure zone elevations, respectively. The preferred pressure range is 50-80 PSI where and when conditions allow. Pressures outside the stated range will not be the responsibility of the Authority if due to malfunctions in the distribution system, such as leaks, closed valves or localized water hammer effects not caused by pump operation effects.

5. Water Quantity Guarantee-

The Authority shall furnish Finished Water on demand to the City's service recipients, and meet emergency fire flow capacity requirements in accordance with Applicable Law. In addition, the Authority shall furnish Finished Water in the quantities required under the City's agreement to provide Finished Water to the City of Kyle and other customers designated by the City during the Term of the Service Contract.

APPENDIX 7

APPROVED SUBCONTRACTORS

This Appendix sets forth the list of Subcontractors that the City has acknowledged that the Authority intends to use to assist in performing the Contract Services:

1. Magna Flow (residuals disposal services);
2. Altivia (chemical feed system); and
3. B&J Lawncare

Additional subcontractors may also be subsequently identified and used to perform the Contract Services subject to the provisions of Section 14.8 of the Service Contract.

APPENDIX8

APPROVED CITY ACCESS

In accordance with subsection 6.1(D) of the Service Contract, the following persons have been designated by the City for pre-approved access to the Facilities. The City will notify the Authority at least 48 hours in advance of changes to this list.

Texas State University-San Marcos Research and Laboratory personnel

APPENDIX 9

INSURANCE REQUIREMENTS

9.1. Authority Insurance Coverage. The Authority shall obtain, pay for and maintain the insurance coverages listed below with respect to the management, operation and maintenance of the Water Treatment Facilities:

(a) workers' compensation insurance required by Applicable Law covering all of the employees of the Authority;

(b) employer's liability insurance with limits of \$1,000,000 per accident or employee disease;

(c) comprehensive automobile liability insurance, including owned, non-owned and leased or hired vehicles, with limits of \$3,000,000 combined single limit per occurrence;

(d) comprehensive general liability insurance with a combined single limit of \$5,000,000 per occurrence;

(e) excess liability insurance above the required comprehensive general, and automobile liability insurance in the amount of \$10,000,000; and

(f) pollution legal liability insurance (which policy is project specific) with limits of \$5,000,000 per loss and an annual aggregate limit of \$5,000,000.

9.2. Additional Insureds. The Authority and Subcontractors shall include the City, its mayor, the City manager, the City Council and each of its members, officers, officials and employees as additional insureds (the "Additional Insureds") on all insurance policies required pursuant to this Appendix. The City and the Authority shall waive the subrogation rights of their various insurance carriers in favor of the other party.

9.3. Insurance Policies. Insurance, and any renewals thereof, shall be evidenced by verification of coverage and copies of coverage amendments issued or countersigned by a duly authorized representative of the issuer and delivered to the City for its review 30 days prior to the Commencement Date or, in the case of a renewal or amendment, as reasonably provided by the insurer. The full original policies of insurance shall require 30 days' written notice to the City of cancellation (except with respect to cancellation for non-payment of premiums to which a 10-day written notice shall be required), intent not to renew, or, to the extent that it would affect the City or its rights or obligations under such policy or the Service Contract, any reduction or change in its coverage by the insurance company.

9.4. Non-Recourse Provision. All insurance policies shall provide that the insurers shall have no recourse against the Additional Insureds for payment of any premium or assessment and shall contain a severability of interest provision in regard to mutual coverage liability policies. The coverages provided by mutual coverage liability insurance policies required pursuant to the Service Contract shall be the primary source of any restitution or other recovery for any injuries

to or death of persons or loss or damage to property incurred as a result of an action or inaction of the Authority or its Subcontractors, or their respective suppliers, employees, agents, representatives, or invitees, that fall within these coverages and also within the coverages of any liability insurance or self-insurance program maintained by the City.

9.5. Subcontractors. The Authority shall be responsible for ensuring that all Subcontractors working on the Sites secure and maintain all insurance coverage and other financial sureties required by Applicable Law in connection with their presence and the performance of their duties at or concerning the Water Treatment Facilities.

9.6. Specific Provisions for Commercial General Liability Insurance. Commercial general liability insurance, as required under this Appendix, shall include premises-operations, blanket contractual, products and completed operations, personal and advertising injury, host liquor liability, explosion, collapse, underground hazards, broad form property damage including completed operations, and independent company coverages.

9.7. Specific Provisions for Workers' Compensation Coverage. Workers' compensation insurance shall be in accordance with the requirements of Applicable Law, as amended from time to time. The required workers' compensation insurance shall include other states' coverage.

9.8. Specific Provisions for Pollution Legal Liability Insurance. Pollution legal liability insurance, as required under paragraph (f) above, shall include coverage for off-site third party bodily injury and property damage resulting from pollution conditions emanating from covered locations, off-site clean-up costs, on-site bodily injury, property damage and pollution clean-up costs, and owner's spill liability for third party claims.

9.9. Qualifications of Insurers. The Authority is required to obtain the insurance set forth herein with insurance companies that carry an A.M. Best Company's "A" or equivalent rating, or from the Texas Municipal League, the Texas Water Conservation Association Risk Management Fund, or a similar entity. In addition, insurance must be obtained and maintained with insurers authorized to do business in the State.

9.10. Cost of Insurance. If the City chooses to arrange for any of the insurance coverage outlined in this Appendix, the City may elect to obtain such insurance, provided that:

(a) written notice is received by the Authority at least 90 days prior to the Contract Year during which the City will assume this responsibility or 90 days prior to the expiration date of the insurance placed by the Authority;

(b) the City names the Authority as an Additional Insured and waives its subrogation rights upon assumption of such responsibility; and

(c) the City pays any cancellation penalty (or short-rate) arising out of canceling the Authority provided coverage required by this Appendix, prior to its expiration date.

GJ LAL OFFICE
93 st Court Street
Se , Texas 78155
Phone: 830-379-5822
800-413-5822
Fax: 830-379-9718

BUDA WASTEWATER
RECLAMATION
PLANT
575 County Road 236
Buda, Texas 78610
Phone: 512-312-0526
Fax: 512-312-0526

COLETO CREEK PARK
AND RESERVOIR
P.O. Box 68
Fannin, Texas 77960
Phone: 361-575-6366
Fax: 361-575-2267

LAKEWOOD
RECREATION AREA
167 FM 2091 South
Gonzales, Texas 78629
Phone: 830-672-2779
Fax: 830-672-2779

LOCKHART WATER
TREATMENT PLANT
547 Old McMahan Road
Lockhart, Texas 78644
Phone: 512-398-3528

LC - IART
WASTEWATER
RECLAMATION
SYSTEM
4435 "FM 20 East
Lockhart, Texas 78644
Phone: 512-398-6391
Fax: 512-398-2036

LULING WATER
TREATMENT PLANT
350 Memorial Drive
Luling, Texas 78648
Phone: 830-875-2132
Fax: 830-875-2132

PORT LAVACA
OPERATIONS
P.O. Box 146
Port Lavaca, Texas 77979
Phone: 361-552-9751
Fax: 361-552-6529

SAN MARCOS WATER
TREATMENT PLANT
91 Old Bastrop Road
San Marcos, Texas 78666
Phone: 512-353-3888
Fax: 512-353-3127

VICTORIA REGIONAL
WASTEWATER
RECLAMATION
SYSTEM
P.O. Box 2085
Victoria, Texas 77902-2085
Phone: 361-578-2878
Fax: 361-578-9039

GBRA WEBSITE
www.gbra.org



GUADALUPE-BLANCO RIVER AUTHORITY

November 23, 2005

Mr. Dan O'Leary
City Manager
The City of San Marcos
630 East Hopkins
San Marcos, Texas 78666

Ref: Service Contract for Water Treatment Facilities Operations and Asset Management

Dear Mr. O'Leary:

Pursuant to Sections 2.2 and 4.1 of the Service Contract for Water Treatment Facilities Operations and Asset Management dated September 20, 2005 (the "Service Contract"), the Guadalupe-Blanco River Authority (the "Authority") represents and warrants that:

Existence and Powers. The Authority is a conservation and reclamation district and political subdivision of the State of Texas duly organized, validly existing and in good standing under the laws of the State, with the full legal right, power and authority to enter into and perform its obligations under the Service Contract.

Due Authorization and Binding Obligation. This Service Contract has been duly authorized, executed and delivered by all necessary corporate action of the Authority and constitutes a legal, valid and binding obligation of the Authority, enforceable against the Authority in accordance with its terms, except to the extent that its enforceability may be limited by law, including bankruptcy, insolvency or other similar laws affecting creditors' rights from time to time in effect and by equitable principles of general application.

Attached is a Certificate of Board Action confirming that the Authority's Board of Directors authorized me to execute the Service Contract on September 21, 2005.

No Conflict. To the best of my knowledge, neither the execution and delivery by the Authority of this Service Contract nor the performance by the Authority of its obligations in connection with the transactions contemplated hereby nor the fulfillment by the Authority of the terms or conditions hereof: (1) conflicts with, violates or results in a breach of any constitution, law or governmental regulation applicable to the Authority; or (2) conflicts with, violates or results in a breach of any order, judgment or decree, or any contract, agreement or instrument to which the Authority is a party or by which the Authority or any of its properties or assets are bound, or constitutes a default under any of the foregoing.

No Approvals Required. No approval, authorization, order or consent of, or declaration, registration or filing with, any Governmental Body is required for the valid execution and delivery of this Service Contract by the Authority or the performance of its payment or other obligations hereunder except such as have been duly obtained or made.

No Litigation. To the best of my knowledge, there is no Legal Proceeding before or by any Governmental Body pending or, to the best of the Authority's knowledge, overtly threatened or publicly announced against the Authority, in which an unfavorable decision, ruling or finding could reasonably be expected to have a material and adverse effect on the execution and delivery of this Service Contract by the Authority, or the validity, legality or enforceability of this Service Contract against the Authority or any other agreement or instrument entered into by the Authority in connection with the transactions contemplated hereby, or on the ability of the Authority to perform its obligations hereunder or under any such other agreement or instrument.

Governmental Approvals. The Authority has obtained or will obtain in the course of its performance hereunder, either directly or through qualified

Subcontractors, the Governmental Approvals that the Authority must obtain in its own name or that of its Subcontractors to provide the Contract Services.

Applicable Law Compliance. To the best of my knowledge, the Authority is not in material violation of any law, order, rule or regulation applicable to any water plant or system providing service to the general public designed, constructed, operated, maintained or managed by the Authority.

Information Supplied by the Authority. The information supplied and representations and warranties made by the Authority in all submittals made in response to the City's RFP and in all post-proposal submittals with respect to the Authority (and, to the best of its knowledge, all information supplied in such submittals with respect to any Subcontractor) are true, correct and complete in all material respects.

City Utility Contracts. The Authority is familiar with the City Utility Contracts, and the coordination needed on the Authority's part to ensure the City's ongoing compliance with its obligations under the City Utility Contracts.

By this letter, I certify that the representations of the Authority set forth are true and correct in all material respects as of the Commencement Date as if made on and as of the Commencement Date.

Sincerely yours,

-4?

General Manager

Enclosure

Cc Mr. Tom Taggart, City of San Marcos
Cc Mr. Mark Taylor, City of San Marcos
Cc Mr. Darel Ball, GBRA
Cc Mr. Jerry Sharp, GBRA

CERTIFICATE OF BOARD ACTION

THE STATE OF TEXAS §

COUNTY OF GUADALUPE §

At a regular meeting of the Board of Directors of Guadalupe-Blanco River Authority had on September 21, 2005, at the GBRA River Annex Board Room, 905 Nolan, Seguin, Guadalupe County, Texas, a quorum being present, the Board of Directors authorized W. E. West, Jr., General Manager, to complete negotiations and execute a Service Contract with the City of San Marcos for the operation of the City's water treatment systems.

TO CERTIFY WHICH WITNESS MY HAND AND THE SEAL OF THE GUADALUPE-BLANCO RIVER AUTHORITY, on this the 30th day of September 2005.


W. E. West, Jr.
General Manager

SEAL