

MAURICE CHALMERS
DIRECTOR
OFFICE OF LEGISLATIVE
BUDGET REVIEW



NASSAU COUNTY LEGISLATURE
1550 FRANKLIN AVENUE, ROOM 126
MINEOLA, NEW YORK 11501
(516) 571-6292

Inter-Departmental Memo

To: Hon. Norma Gonsalves, Presiding Officer
Hon. Kevan Abrahams, Minority Leader
All Members of the Nassau County Legislature

From: Maurice Chalmers, Director
Office of Legislative Budget Review

A handwritten signature in blue ink, appearing to be "MC", written over a circular scribble.

Date: July 14, 2014

Re: Agreement for the Operation and Maintenance of the Nassau County Sewer System
between United Water Long Island Inc. and Nassau County

The proposed Agreement for the Operation and Maintenance of the Nassau County Sewer System is between United Water Long Island Inc. and the County of Nassau. United Water responded to a Request for Proposal (RFP) issued by the County on December 22, 2011 and was selected as the preferred proposer on May 3, 2012. The initial term of the Agreement is for 20 years and is structured as a Qualified Management Contract (QMC) with United Water responsible for the Operation and Maintenance of the sewer system. The County will maintain ownership of the system, its assets, and the power to set rates. Importantly, the QMC structure is intended to allow the system to continue to access tax-exempt financing for capital improvements which lowers the overall cost of capital for the County. Per the Administration, the intent of the Agreement is to generate annual cost savings to the County along with a more efficient and environmentally clean sewer treatment delivery system.

The Office of Legislative Budget Review (OLBR) has prepared this memo to provide a background on the Nassau County Sewer System, the selection process, a financial overview of the agreement and a discussion of its potential risks and intangible benefits. OLBR has focused on the financial impact the Agreement is projected to have on the Sewer System along with the County's General Fund.

Selection Process for United Water

The following timeline was provided by the Administration. On August 31, 2011 the County issued a Request for Operator Qualifications (RFQ) to identify qualified parties interested in



operating the System. Qualification statements were received by the deadline of September 28, 2011 from the following firms: Severn Trent Services, United Water Long Island Inc., American Water, and Veolia Water North America. Qualified operators would be invited to respond to the RFP to operate and maintain the System according to terms outlined in an operating contract. Based on the review of the qualification statements, the Committee recommended that Severn Trent, United Water and Veolia be invited to respond to the RFP.

Following the RFQ process, on December 22, 2011, the County commenced a competitive procurement process by issuing a RFP for the operation of the Nassau County Sewer System. As demonstrated in the RFP, the Administration envisioned the private operation and maintenance of the System. Proposals were due on January 31, 2012. United Water and the two other firms responded to the RFP issued by the County.

The evaluation process consisted of thorough reviews of the proposals received and interviews with each of the proposers. The County selected United Water on May 3, 2012 as the preferred proposer pursuant to the terms and criteria set forth in the RFP. The procurement process was subsequently delayed as a result of Superstorm Sandy while the County engaged in recovery efforts and sought funding to repair and upgrade the System against future hazardous weather conditions.

Based on discussions with the Administration, it is our understanding that the agreement will not impact the County's award of \$830 million from the Federal Emergency Management Agency (FEMA) to repair the damage that occurred as a result of Superstorm Sandy.

The savings to be generated by execution of the agreement are mainly based on labor savings, utility costs, and efficiencies created by capital improvements. The Administration has promised that the change in operations will not result in layoffs. However, some employees will be moved to other departments within the County. The Civil Service Employees Association has agreed to a Memorandum of Understanding (MOU) that guarantees no layoffs.

Nassau County Sewage Treatment Plant Operations

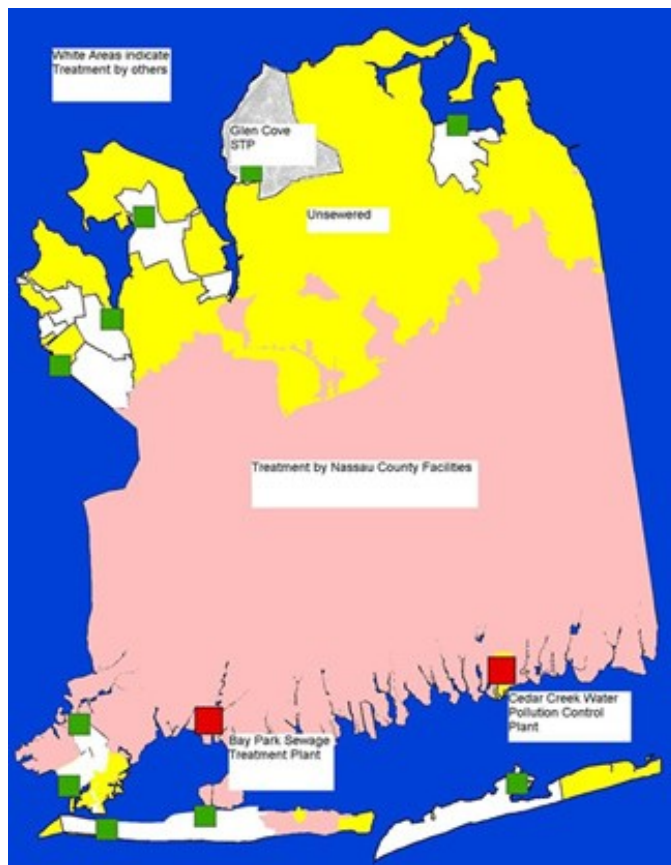
The County Department of Public Works (DPW) maintains and operates the County's sewage collection and wastewater treatment facilities. Nassau County's two sewage treatment plants (The Bay Park Sewage Treatment Plant and the Cedar Creek Pollution Control Plant) process 85% of the sewage collected within the County. These two plants treat approximately 50 million gallons per day (MGD) at Bay Park and 52 MGD at Cedar Creek, operating below their respective permitted capacities of 70 and 72 MGD. Nassau County has also assumed responsibility for the operation of the City of Glen Cove's Water Pollution Control Plant. This plant currently treats approximately 3.0 MGD leaving a surplus capacity of over 2.5 MGD which could be used to treat some of the communities in the North Shore that are currently served by cesspools.

Nassau County Sewer Financing Authority and the Sewer & Storm Water Resource District (Sewer Funds) Background

In 2003, New York State enacted Chapter 685 of the Laws of 2003, which added Title 10-D to the New York State Public Authorities Law to create the Nassau County Sewer and Storm Water Finance Authority. The primary purpose of the Authority is to refinance outstanding sewer and

storm water resources debt issued by the County and to finance future County sewer and storm water resources projects.

The County Legislature pursuant to the legislation abolished, dissolved and merged the County's prior 27 sewage collection and three sewage disposal districts into the Nassau County Sewer and Storm Water Resources District Fund. All the rights, privileges, duties, responsibilities and obligations of the prior districts became those of the District.



Rate Stabilization Program

The 2003 law required the County to transition to three remaining zones of assessment within the District by 2014: one zone of assessment (which is County-wide) for storm water resources services, one zone of assessment for areas of the County receiving sewage collection and sewage disposal services, and one zone of assessment for areas of the County receiving sewage disposal services only. According to the Assessment Department, FY 2014 is the first year that such zones of assessment are in place. The table on the next page reflects the Sewer Financing Authority tax levy from 2004 to 2014. As reflected in the chart below the levy has been as high as \$138.9 million in 2004, 2005 and 2006 and as low as \$103.9 million in 2008. The decrease was due to a shift from the sewer levy to the Major Operating Funds. In totality the levies for the Major Funds including the Sewer Funds did not change, but shifted. The current FY 2014 budget \$117.3 million. Had the levy remained at the high level, there could have been approximately \$191.7 million in additional revenue to support the Sewer System.

Budgeted Sewer Tax Levy										
2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
\$ 138.9	\$ 138.9	\$ 138.9	\$ 118.9	\$ 103.9	\$ 110.0	\$ 116.0	\$ 119.0	\$ 117.3	\$ 117.3	\$ 117.3

Historical Fund Balance

The following chart details the historical fund balance for the Sewer and Storm Water Resource District Fund. The 2013 amount is a *projection* as the Comptroller’s 2013 Comprehensive Annual Financial Report (CAFR) is not currently available. As reflected in the chart below, the County continues to deplete the fund balance reserve. The fund balance has decreased from a high of \$162.0 million in 2007 to \$45.9 million projected in 2013. The fund balance has been used to cover the annual shortfalls between the Sewer Funds’ operating expenses and revenues. The declining fund balance is a cause for concern.

Sewer and Storm Water District		
Fund Balance (in millions)	Usage	
2004 Year-End	21.4	
2005 Year-End	53.1	31.7
2006 Year-End	121.7	68.6
2007 Year-End	162.0	40.3
2008 Year-End	129.4	(32.6)
2009 Year-End	107.7	(21.7)
2010 Year-End	91.8	(15.9)
2011 Year-End	81.3	(10.5)
2012 Year-End	71.5	(9.8)
2013 Projection	45.9	(25.6)

*Source: County Comptroller's Comprehensive Annual Financial Report (CAFR)
2013 Projection provided by OMB*

In an attempt to halt fund balance usage and support the sewer operations, the County previously introduced a high water usage fee. The County planned to impose service charges upon exempt users and high water users for the use of services of sewage facilities maintained by the District at a rate not to exceed \$0.01 per gallon of water entering the County’s sewage system. The FY 14 budget includes \$12.6 million for the collection of the exempt user fee. However, due to the ongoing litigation and the Temporary Restraining Order (TRO), the County has not collected any revenue related to this fee.

Financial Impact of the United Water Agreement

By entering into this Agreement with United Water, the Administration projects Contracted and Synergy savings. The Administration provided a report from the Public Financial Management Group (PFM) illustrating projected savings that can be achieved from having a private operator run the sewer system. OLBR has reviewed the proposed contract and determined that the majority of the contracted savings will be garnered from the “commitment of United Water to reduce County staffing costs by a minimum of \$10.0 million annually.”

Based on OLBR’s analysis, the contracted savings are projected to be approximately \$283.0 million over the life of the contract with a present value of \$158.4 million. This aspect of the proposal includes labor savings referred to by the Administration as the “Guaranteed” savings. Although the Administration anticipates higher Synergy savings, OLBR estimates that it would be reasonable to expect \$122.0 million in additional savings if managed to expectation. Both categories of savings will be discussed below:

	First Year		Present Value
	Gross Savings	20 Year Gross Savings	of 20 Year Gross Savings
Contracted Savings	\$ 2,360,181	\$ 283,776,435	\$ 158,360,208
Synergy Savings	4,539,558	121,979,610	76,096,705
Contracted & Synergy Savings	6,899,739	405,756,045	234,456,914

The Contracted savings include items such as salary, fringe benefits, utilities, general and contractual expenses. Savings are realized by comparing what it would have cost the County to run the system to the projected costs from the Agreement. The majority of the contracted savings is from United Water’s \$10.0 million annual guaranteed salary savings from the reduction of County sewer personnel. United Water will either hire or utilize County employees assigned to the system for which United Water will pay the contracted service fee. If United Water is unable to meet the \$10.0 million cost savings through direct employment or the utilization of assigned County employees, the County would receive a direct payment for the difference. The Administration has explained that the direct \$10.0 million annual commitment would continue throughout the life of the Agreement. For assigned employees, the credit would increase annually based on the employee base salary, and other costs, escalation set forth in the Collective Bargaining Agreement (CBA).

It will be incumbent upon the Administration to ensure the \$10.0 million in personnel savings is realized annually through employees leaving directly to work for or assigned to United Water.

Savings are also captured from lower utility costs in the contract compared to what the County currently pays. United Water will be responsible for supplying or purchasing, and for paying all costs associated with all utilities, with the exception of natural gas and diesel fuel, required for operating and maintaining the System. These include, but are not limited to, heating oil, water, telephone, internet and electricity. While OLBR concurs there will be utility savings garnered from the Agreement, OLBR projects a lower, more conservative annual savings than the Administration. It should also be noted that United Water has every incentive to further reduce the natural gas and diesel fuel consumption as it will share in any reduction below the guaranteed maximums. Should the Administration realize the lower projected costs, it believes that there are additional annual opportunities between \$3.0 million to \$5.0 million which will increase the benefits of this contract.

The possibility of additional compensation for flows and loadings that occur above the maximum threshold needs to also be mentioned. The variable component includes additional compensation

for United Water in the event of additional flows and loadings in excess of the predetermined threshold. The maximum threshold in this Agreement is currently 114.5 million gallons per day. If the flows go over this maximum threshold, the County will be responsible for additional compensation to United Water. Based on monthly reports filed with New York State regulatory agencies, the current flow is 107.0 million gallons per day and that a buffer has been built into the maximum threshold.

The additional Synergy savings is a projection based upon redeploying Sewer Fund personnel, not assigned to work for united Water, into other areas of the County. The Administration has identified certain areas of the County budget where increased staffing can reduce overtime, the need for seasonal workers, and / or generate additional revenue. The Administration plans to reassign employees who do not accept positions with United Water to other departments such as Public Works, Parks and Recreations, and Consumer Affairs.

It is currently unclear what mechanism will be used to account for the redeployment of Sewer Fund employees since they will be performing work in the Major Operating Funds. That decision will be made by the Administration probably with the input of the Comptroller. There is a concern whether the reassignment of Sewer Fund personnel employees into other areas of the County's General Fund departments may violate the County's Civil Service codes or regulations.

The outcome of these Synergy savings is highly dependent upon the Administration's ability to manage and execute the redeployment of County Sewer Fund personnel in a manner that mitigates costs in other departments. Some of the savings appear to be achievable such as \$2.0 million in savings in the Parks Department from eliminating seasonal positions. Revenue enhancement items include using available staffing to perform additional inspections.

Capital Investment and Maintenance Costs

As part of this Agreement, the County is responsible for investing \$40.0 million to fund a series of Efficiency Capital Improvements to enhance the System. United Water will manage delivery, design, construction and implementation of the Efficiency Capital Improvements. The County will also be responsible for financing all capital improvements and United Water will assist in developing a five year Capital Improvement Plan establishing proposed capital improvements. These projects will be financed and constructed on an annual basis beginning in the 6th contract year. The plan will be updated yearly and will identify major expenditures necessary to restore, maintain, replace or upgrade the sewer system for efficiency, safety, function and compliance purposes. In addition to the \$40.0 million of initial Efficiency Capital Improvements, this Agreement anticipates the need for \$20.0 million in annual capital improvements during the final 15 years of the contract term.

The Maintenance Threshold that United Water agreed to is \$50,000 for each maintenance incident. In the event a given maintenance incident surpasses the threshold, the County would be responsible for any amount in excess of \$50,000. The Agreement sets the initial Annual Budget Maintenance Amount (ABMA) at \$3.0 million. The ABMA is included in the County's service fee and provides for the necessary maintenance requirements. The ABMA covers the parts, materials, and non-company labor required to maintain the wastewater treatment system. Every

fifth year, the County and United Water can renegotiate the ABMA based on the average actual maintenance costs for the preceding five years.

Execution Risk Assessment

Like most public-private project relationships, one of the biggest challenges is the allocation of risk between parties. Most of the risks discussed below are manageable but rely on the County's ability to effectively implement the entirety of the Agreement. OLBR has identified the following potential challenges; however, they are not intended to be understood as a definitive list.

Successful implementation of the Agreement depends on the County's ability to effectively control costs in the General Fund following the transfer of Sewer Fund employees to other County Departments. United Water will be unable to utilize every current Sewer Fund employee and the County is not implementing layoffs. As a result, those employees that do not either retire, separate from County employment, or are not assigned to the Sewer Fund, will require funding for their salary and benefits. The County's current General Fund budget will find it difficult to accommodate the additional personnel costs even with the potential for overtime savings. In addition, vacant positions are also currently underfunded. It is unclear at this time how the County will ultimately implement this portion of the Agreement. Potential possibilities would be to shift some of the Sewer Fund levy to the General Fund levy or utilize a chargeback arrangement between funds.

The Administration will need to appoint adequate personnel to manage the relationship between United Water and the County throughout the life of the Agreement. The Agreement requires that the County provide a representative(s) to essentially act as a liaison. Since the Agreement is a Management and Operation Agreement, the County and United Water will need to ensure strong ongoing communication to successfully maintain the sewer assets and reconcile personnel savings. For example, tools that track pre-agreement staffing levels in comparison to post-agreement levels can be easily compiled.

Additionally, many of the fees that are built into the Agreement are impacted by an inflation index. In the event inflation growth outpaces the County's revenue collection, it may result in the County devoting a larger portion of the County-wide budget to the maintenance of this Agreement.

Although increased maintenance and capital costs are expected, it is important to note that the County may experience related costs outside the 20 year Agreement budget projections, as presented. United Water is responsible for the first \$50,000 of all maintenance events. Based on discussions with the Administration, it is our understanding that the vast majority of the current maintenance events do not exceed \$50,000. However for those occurrences that do exceed this amount, the County would likely have to pay for the cost out of either the operating funds or debt proceeds. In addition, in the initial agreement, a portion of the \$57.4 million payment is related to the ABM Amount. Following the first five years of the Agreement, this figure could be renegotiated and potentially increase or decrease the overall Agreement cost to the County.

Potential Intangible Benefits

If this agreement is successfully implemented, the County will benefit from a number of intangible benefits. United Water's operation of the County's wastewater treatment system can produce positive effects that cannot be measured nor assigned a monetary value. The intangible benefits break down into two categories, environmental and governmental operations.

United Water relieves the County of some administrative burden. The County will still be responsible for obtaining and maintaining all permits necessary for the operation of the wastewater treatment system. However, the County will benefit by a requirement that United Water be responsible for all other aspects of the permitting process. United Water has agreed to cover all standard permit and filing fees and will provide all materials necessary to support the various permit applications. United Water's take-over of clerical duties such as permitting, eases the County's administrative burden. United Water has also agreed to attend all required hearings and meetings.

United Water's planned process improvements and its contractual commitment to collaborate with environmental groups will produce intangible environmental benefits. Significantly, in the Performance Guarantee section of the Agreement, United Water has agreed to reduce fugitive dust, noise, odor, and light pollution around County wastewater facilities. It will document the achievement of these standards by setting up sensors and maintaining a telephone complaint line. There are service fee implications if United Water fails to meet these pollution reduction standards. While changes to the service fee are tangible, the potential to improve the quality of life for residents living near wastewater facilities is immeasurable.

The other main environmental benefits are borne from a MOU that the County and United Water signed with a number of local conservation groups. United Water codified the MOU in its Agreement with the County. In the MOU, United Water agreed to set up an online public portal or dashboard. This dashboard will provide the public with a wealth of real time information, including a video stream of certain facilities, to improve transparency in operations. The parties also agreed that United Water will attempt to engage in denitrification efforts at the Bay Park facility.

The current wastewater treatment means and methods employed by the County are inefficient and have contributed to the over-nitrification of the Western Bays. According to the Environmental Protection Agency (EPA), high levels of nitrogen in the water can lead to the growth of algal blooms which deplete oxygen levels in water, killing fish and other flora and fauna. United Water has established that they will study the use of biological nutrient removal at Bay Park. United Water estimates that they can convert 20 percent of the facility to run on the biological nutrient removal process. If successful, the conversion to biological nitrogen removal should help slow down the pollution of the Western Bays.

Agreement Highlights

The following attachment highlights specific sections of the Agreement but should not be considered a definitive review of the entire transaction. OLBR has attempted to identify areas of the Agreement that have either a direct financial impact or are important as to the successful implementation of the Agreement.

Transition Period - Article V

The anticipated 120 day period between the dates the Agreement is executed (Agreement Date) and operations are officially turned over to United Water (Operation Date) is considered to be the Transition Period. This time frame is intended to provide a successful transition where United Water may mobilize personnel and equipment and the County can transfer responsibilities to the company. During this time, United Water, with the County's cooperation, will have the right to access the Managed Assets for the mobilization process. The County will be responsible for satisfying certain requirements, such as obtaining Government Approvals prior to the Operation Date. The Transition Period can be extended if both parties agree. Each party has the option to terminate the Agreement in the event either party is unable to meet the stated Transition Period contractual requirements.

System Description - Article VI

United Water acknowledges that it is familiar with the system to the extent needed to commit to the Agreement. United Water arrived at this determination after reviewing design drawings and inspecting the Managed Assets, among other inquiries. The Agreement is based on United Water's acknowledgement that it has the ability to manage the system and meet the Performance Guarantees based on the "as-is" condition of the system. United Water will perform additional due diligence for one year following the Operation Date to determine damage related to Superstorm Sandy. If additional damage is identified, this section outlines the process for both parties to agree on a repair plan. The County would address any damage identified through the Capital Improvements Plan. Any damage identified following the one year time frame would be the responsibility of United Water, as long as it did not surpass the Maintenance Threshold. An exemption is made in the event of an Uncontrollable Circumstance. An Uncontrollable Circumstance is any event or condition beyond the control of either party where failure to perform any obligation of this contract is not a result of the willful or negligent act, error, omission or breach of this Agreement. The Glen Cove facility will be subject to the same one-year due diligence period upon the expiration of the Severn Trent contract.

Operation, Maintenance, and Management - Article VII

Operation

United Water will operate all of the County's wastewater treatment system assets including buildings, equipment, pump stations, etc. They are also referred to as the "Managed Assets". The County retains ownership of the wastewater treatment system and remains ultimately responsible for obtaining and maintaining all state and federal permits. However, United Water will cover the cost of permit filing fees and has agreed to provide all material necessary to support the various permit applications. This includes attendance at all required hearings and meetings. United Water is responsible for ensuring that County facilities operate within

applicable environmental law and regulation and meet further enhanced standards imposed by the County. United Water would be held responsible if the actions of the company, or its subcontractors, caused the County to be noncompliant.

Maintenance

United Water is responsible for performing the maintenance of the wastewater treatment system, including all facilities, vehicles, machinery, equipment, property, and grounds. United Water's responsibility encompasses all labor, material, equipment, and services necessary to keep the system operational. The County and United Water have agreed upon a Maintenance Threshold and an Annual Budgeted Maintenance Amount (ABMA) to share in maintenance costs.

The Agreement sets the initial ABMA at \$3.0 million which is included in the first year's contract Base Service Payment. The ABMA covers the parts, materials, and non-company labor required to maintain the wastewater treatment system. Importantly, the ABMA is not considered a hard cap on aggregate maintenance costs; however, United Water is responsible for aggregate maintenance costs that exceed the ABMA. The ABMA is also subject to certain multipliers intended to accommodate inflation. Every fifth year, the County and United Water can renegotiate the ABMA based on the average actual maintenance costs for the preceding five years. This mechanism allows the parties to accommodate the changing maintenance needs of the system. The Service Fee will be adjusted to accommodate any increase or decrease to the ABMA. For example, a provision of this Agreement is that United Water act on the County's behalf at the Glen Cove facility. United Water will administer the County's contract in Glen Cove and assume the County's payment obligations under the contract, which amount is included in the Service Fee. Once the County's contract expires, United Water will fully operate the Glen Cove facility. The ABMA could increase to accommodate this added expense.

The Maintenance Threshold that United Water agreed to is \$50,000 for each maintenance incident. In the event a given maintenance incident surpasses the threshold, the County would be responsible for any amount in excess of \$50,000. According to the Administration, the vast majority of current maintenance events do not exceed the \$50,000 threshold. Depending on the project, United Water can write maintenance events off against the ABMA or the Initial Capital Fund. Once the Initial Capital Fund is exhausted, all maintenance will be attributed to the ABMA.

Management

The Agreement is highlighted by measures designed to give the County, non-governmental organizations, and residents more transparency into United Water's operation of the sewer system. The Agreement includes other more standard measures, such as guaranteeing the County's participation in the development of Standard Operating Procedures and Emergency Response Procedures. Another step in addressing residents' concerns is United Water's Agreement to maintain customer service telephone lines to receive general complaints and feedback during normal business hours and emergency reports and odor complaints 24 hours per day.

United Water will track maintenance costs in a database known as the Computerized Maintenance Management System (CMMS). The County will have access to the CMMS

database in order to verify United Water's maintenance claims against the ABMA and the Initial Capital Fund.

The County and United Water signed a Memorandum of Understanding (MOU) with a number of local conservation groups and it was codified in the Agreement with the County. In the MOU, United Water agreed to set up an online public portal, or dashboard. This dashboard will provide the public with a wealth of real time information, including a video stream of certain facilities, to provide added transparency into United Water's operations. Other large water and wastewater systems, such as District of Columbia Water and Sewer, make this kind of information available to the public.

Operations Monitoring and Review – Article IX

This article of the Agreement outlines reporting requirements by which United Water must abide. On a monthly basis, United Water is required to meet with the County to review operations, costs, and other data. They will also be required to provide the County with a variety of records and statements. Certain provisions govern the process by which the County receives the records, but the County is entitled to the following information: system records, maintenance records, financial records, performance records, odor complaint tracking records, and residual management records.

In addition to annual maintenance inspections, on the fifth anniversary and every fifth year after that, the County can conduct an inspection and review of the facility at the County's own expense. The County is empowered to then submit an outline of any deficiencies and can request a remediation plan from United Water. They can challenge and counter the County's deficiency report with its own remediation plan. The County can then accept United Water's counter or it can reduce its service fee by the estimated cost of remediation. Finally, the County reserves the right for unscheduled inspections.

Residuals Disposal – Article X

The Company shall continue the existing Residual Disposal method until the County's existing contract expires in early 2018. After the expiration of this contract, United Water will be responsible for the risk associated with the transportation and disposal of Residual Management Services. United Water will cover the cost of the current residual disposal contract in the Base Service Fee.

Personnel – Article XI

United Water guarantees a cost savings of \$10.0 million to the County related to personnel. The savings is achieved through United Water's direct employment of current County employees that will separate from County service and the usage of assigned County employees. In the event that United Water is unable to meet the \$10.0 million cost savings through direct employment or the utilization of assigned County employees, the County would receive a direct payment for the difference.

The various ways in which current Sewer Fund employees are expected to be impacted by the proposed Agreement are discussed in the following section. The Administration believes that employees have four basic options following the implementation of the Agreement.

- An employee can leave or if applicable, retire, from County employment. This would yield budgetary savings equal to the base salary and fringe benefits.
- An employee may leave or if applicable, retire from County employment and, if hired, begin employment as a United Water Employee.
- A current employee can remain a County employee but be reclassified or reassigned to vacant or unfilled positions with other County departments.
- A current employee can remain a County employee and potentially remain within the Sewer Fund. These placements are made based on department needs.

The personnel discussion will focus on the last three possibilities as their budget impact varies.

United Water maintains the right to interview current sewer employees (CSE) that apply to United Water for employment. United Water maintains full discretion for hiring employees that interview for positions. In the event that an employee is hired by United Water, that employee is no longer an employee of the County. When an employee accepts a position with United Water it will result in a cost savings to the County equal to 100% of the total annual costs that the County expends for that employee. The calculation is based on the base salary in effect as of the Agreement date and corresponding fringe benefits (including health benefit and retirement costs).

An employee may also decide to remain a County employee, but based on various qualification needs, the County may make them available for sewer operations. In this situation, the employee would continue to work in the Sewer Fund for the entirety of the United Water Agreement. The decision on which employees will be “County Assigned System Employees” (CASE), is based on a mutual Agreement in writing between the County and United Water. OLBR believes this provision is a fairly unique aspect of the Agreement compared to other Operation and Maintenance Agreements. When a County employee becomes a CASE, United Water will reimburse the County for the current base salary plus 60% of base salary each year. The salary for each CASE will continue to escalate in accordance with the collective bargaining Agreement requirements and United Water will reimburse the County based on the then current base salary amount. If the cost of health care benefits is more than the 60% amount, United Water will make up the difference in an additional payment. However, if an employee leaves County employment during the terms of the Agreement, United Water will not be required to replace the employee.

Service Fee and Other Payments – Article XII

The article details the method under which United Water is paid its Service Fee. The Service Fee is made up of the Base Fee, Pass-Through Costs, and any Extraordinary Items - Charge or Credit. The Base Fee includes the Base Service Payment (initially \$57.4 million) and the Variable Component. The Variable Component includes additional compensation for United Water in the event of additional Flows and Loadings that occur in excess of the predetermined threshold. In addition, the Variable Component also includes the Natural Gas Savings Element and Diesel Fuel Savings Element. Essentially, the Agreement is structured to incentivize United Water to control the usage of both Diesel Fuel and Natural Gas. A schedule based on the amount of gas and fuel utilized by the system has been agreed upon by both parties where the savings

would be shared between parties, or if additional fuel is required, cost sharing. The Pass-Through Costs, the second part of the Service Fee formula, are the payments made to unrelated third parties for real property taxes levied against the United Water and require United Water to provide Cost Substantiation. As the assets will remain publicly-owned, it is not anticipated that any real property taxes will be levied against the Company. The final calculation is Extraordinary Items Charge or Credit which is the net value of various types of charges. These charges include costs incurred by the Company but payable by the County in the event of Uncontrollable Circumstances that increase operation or capital costs. It would also account for the costs that United Water owes the County for adjustment to the Service Fee based on Capital Improvements, liquidated damages or reimbursement payments that result from nonperformance, expenses that the County incurred in the operation of the facility that the Company is responsible for, and any indemnification payments owed by the company.

On an annual basis, the Base Fee is increased by an inflation index agreed upon between the County and United Water. It integrates the U.S. Department of Labor Consumer Price Index for all urban consumers in the Northeast Area and the U.S. Department of Labor, Bureau of Labor Statistics, Employment Cost Index (Northeast, Private Industry).

The Agreement requires that the County's annual budget include an appropriation in a reasonable amount for the payment of the Service Fee. The County will pay 1/12th of the annual service fee monthly following the receipt of an invoice from United Water. An invoice for any Pass-Through Costs or Extraordinary Items will be provided to the County monthly. However, the Variable Component will be paid on a monthly or annual basis depending on the type of expenditure. In addition, within 90 days of the completion of a Contract Year United Water will provide an Annual Settlement Statement. It is intended to aggregate all payments, credits, and costs between the two parties and act as reconciliation.

Another key aspect of the Agreement allows the sewer system to maintain its tax status that allows the system to issue tax-exempt bonds. A key requirement is that the County's Base Service Payment must account for at least 80% of United Water's compensation for services. United Water's compensation may not be based on net profit.

Performance Guarantee – Article XIII

The Performance Guarantee article of the Agreement establishes performance standards to which United Water will be held. United Water's operation will be measured in a number of ways. Among these measures are standards for effluent, odor, trucked-in material, and residual disposal. In addition to meeting all required standards, United Water will also be subject to enhanced standards for certain effluent requirements. A penalty schedule is included for each performance standard. United Water would be assessed a fine if it exceeds certain measures, such as effluent standards. The fines for effluent violations range from \$500 for the violation of a daily effluent requirement to \$10,000 for discharge events causing water quality and/or health problems (i.e. oil sheens, beach closings). In other instances, United Water would be subject to a service fee reduction. For example, the County can reduce United Water's service fee up to \$20,000 for a sustained odor incident.

Initial Capital Improvements – Article XIV

The County is in the process of implementing a number of capital improvements related to Superstorm Sandy. The County, jointly with United Water, shall create an Acceptance Test protocol for each Initial Capital Improvement. Upon acceptance and operation of the Initial Capital Improvement, the project will become a Managed Asset that United Water is responsible to operate. United Water will be required to operate the new Managed Assets subject to compliance with the Performance Guarantees, Contract Standards and Applicable Law. United Water shall be excused from compliance to the extent that its failure to meet the Performance Guarantee was related to the Initial Capital Improvement that failed to meet the Acceptance Test. The County shall fund a series of Efficiency Capital Projects to enhance the operational efficiency of the sewer system in an amount equal to \$40.0 million. United Water will be responsible for any amount in excess of \$40.0 million spent on the cost of the Efficiency Capital Improvements and any amount attributable to United Water for Capital Maintenance Events.

Capital Improvements – Article XV

The Company shall develop a five year Capital Improvement Plan which establishes capital improvements to be financed and constructed on an annual basis by the County beginning in the sixth Contract Year. The plan shall be updated annually and will identify major expenditures necessary to restore, maintain, replace or update the Managed Asset or System for efficiency, safety, function and compliance with Applicable Law. United Water is responsible for preparing “statements of necessity” for each Capital Improvement and will submit to the County by March 31st of each Contract Year. The design and construction costs of any such Capital Improvement shall be borne by the County. The County maintains the final approval for Capital Improvement Plans and may make any and all Capital Improvements it deems appropriate at any time. In addition to the \$40.0 million of initial improvements, this Agreement anticipates the need for \$20.0 million in annual capital improvements during the final 15 years of the Agreement term.

Indemnification, Limitation of Liability and Uncontrollable Circumstances – Article XVI

United Water shall indemnify, defend and hold harmless the County and related third parties against any and all Loss-and-Expense incurred as a result of the failure by the United Water to perform its obligations due to negligence or willful misconduct under this Agreement.

To the extent permitted by Applicable Law, the County will indemnify and hold harmless United Water and related third parties from and against all Loss-and-Expense asserted by any third party, to the extent arising directly out of or resulting from any breach of this Agreement by the County or related parties. In addition, if the County does not approve of a Capital Improvement recommended by the United Water that is considered reasonable according to Good Engineering and Construction Practice and Prudent Industry Practice for repair or replacement, and such determination has been rendered by the Independent Engineer, the County shall indemnify and hold the Company harmless from any documented cost increases above current costs or liability suffered by the Company as a result of the County’s denial.

The aggregate liability of United Water to the County for re-procurement costs shall not exceed \$1.0 million as adjusted annually by the Inflation Index, and the total aggregate liability of the Company to the County under this Agreement for any damages of any type paid or to be paid by

the Company or Guarantor during the Term shall not exceed \$100.0 million, as adjusted annually by the Inflation Index.

Dispute Resolution – Article XVII

The Article defines a procedure for the parties to follow in the event a dispute arises. Both parties will participate in good faith negotiations. Most disputes will first go through a Coordination Committee which is made up of three representatives from each party for a total of six members. If a solution is not identified and the dispute does not exceed \$1.0 million or is related to Capital Improvements, both parties have agreed to utilize the Streamlined Arbitration Rules or a mutually agreeable alternative dispute resolution. These proceedings will occur in Nassau County, unless otherwise agreed.

If the dispute is over \$1.0 million, it will be subject to the jurisdiction of the Supreme Court in Nassau County, New York.

Events of Default – Article XIX

This article identifies particular events, occurrences, acts, and circumstances where both parties are able to end the Agreement. Several of the more important events of default where the County can end the Agreement include the failure of United Water to perform any material obligation of the Agreement, United Water's inability to meet certain effluent requirements, the failure of United Water to provide sufficient security for performance, the failure of United Water to comply with applicable law, insolvency, or bankruptcy. County events of default include the failure of the County to timely pay United Water for their services and the failure of the County to fund the Initial Capital Improvements or any necessary Capital Improvement.

Termination – Article XX

Based on the various events discussed in Article XIX, both parties are able to terminate the Agreement. However, Article XX provides a framework of cooperation so the system is not adversely impacted and payment obligations are met.

Miscellaneous – Article XXII

This article includes provisions for Cost Substantiation requirements addressed in previous articles, details on Contract Administration, the use of subcontractors, identifies Authorized Representatives for both parties, and various other provisions. As discussed previously, this article addresses the County's requirement to maintain a representative to administer the Agreement.