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Attorney for Plaintiff,
BROOKTRAILS TOWNSHIP COMMUNITY SERVICES DISTRICT

SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF MENDOCINO

BROOKTRAILS TOWNSHIP COMMUNITY SERVICES DISTRICT, a Public Agency, Plaintiff, v. CITY OF WILLITS, a General Law City; and DOES 1 through 100, inclusive, Defendants.	UNLIMITED Case No. SCUK-CVG-10-56037 FIRST AMENDED COMPLAINT FOR DECLARATORY RELIEF ON WRITTEN CONTRACT; FOR BREACH OF CONTRACT; FOR DAMAGES; AND FOR MONEY HAD AND RECEIVED

Comes now, plaintiff BROOKTRAILS TOWNSHIP COMMUNITY SERVICES DISTRICT, a public agency (the "District") for cause of action states as follows:

1. Plaintiff is now, at all times mentioned in this Complaint has been a duly organized community services district, created under the Community Services District law.

2. Defendant is now, and at all times mentioned in this Complaint has been, a General Law City located in the County of Mendocino.

3. The true names and capacities, whether individual, corporate, associate or otherwise, of defendants sued herein under the names of DOES 1 through 100, inclusive, are unknown to plaintiffs at this time. Plaintiff sues such defendants by such fictitious names pursuant to Code of Civil Procedure § 474 and will amend this Complaint to allege such defendants' true names and capacities when ascertained. Plaintiff is informed and believes and on such basis alleges that defendants DOES 1 through 100, inclusive, and each of them, are in some manner

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liable to plaintiff, or claim some right, title, or interest in the subject property that is junior and inferior to that of plaintiff, or both.

4. At all times mentioned in this Complaint, defendants and each of them were the agents, servants, and employees of the other defendants, and in doing the things alleged in this Complaint, defendants were each acting within the scope and authority of such agency and/or employment, with the knowledge and consent or ratification of each of the other defendants in doing the things alleged herein.

5. On or about November 19, 1975, Plaintiff and Defendant entered into a written agreement, a true and correct copy of which is attached hereto as Exhibit "A" and incorporated herein by this reference as though fully set forth at length (the "Agreement"). Generally, the Agreement provides for the acceptance of sewage from the District for treatment and processing at the City of Willits Sewer Plant and the contribution by the District of certain costs of treatment on the terms as provided in the Agreement.

FIRST CAUSE OF ACTION

(Declaratory Relief)

6. Plaintiff realleges and incorporates by reference as though fully set forth herein paragraphs 1 through 5 of this Complaint.

7. The Agreement provides at Section 9 that the City shall have the right to control the design and construction of improvements to the City Sewer Plant so as to produce an efficient and economical cost and further to provide Plaintiff with the right to review, make suggestions, and approve for their adequacy, plans, specifications and cost estimates prior to their approval by the City Council of the City subject to certain qualifications not relevant here.

8. On or about May 21, 2003, Defendant signed an agreement to purchase 125 acres of property adjacent to the City of Willits Sewer Plant for $600,000, with a provision for leasing back the grazing rights to the seller.

9. On or about October 14, 2003, Defendant purchased said property for the price of $750,000, or $6,000 per acre, paying for it entirely with cash from the City of Willits Sewer

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Enterprise Fund (hereinafter referred to as the "Real Estate Purchase").

10. Prior to the time of making such Real Estate Purchase, Defendant failed to honor Paragraph 10 of the Agreement in that it did not provide the District with any advance notice of its intention to purchase the property as required by Section 10 of the Agreement.

11. In August 2007, the City of Willits made a demand upon Plaintiff for payment of 38.79% of the cost of the Real Estate Purchase. Had the District been consulted prior to the Real Estate Purchase, the District would have objected to the price which was unsupported by a qualified appraisal, and represented a price at least twice the amount of fair market value of such property, and also would have objected to the intention to pay cash for the property rather than to include it in the project financing costs for the then-undesigned Willits Sewer Plant improvements. In that the Defendant did not advise Plaintiff of its intention to enter into the Real Estate Purchase prior to the approval by the City Council, it was materially deprived of the opportunity to review, make suggestions and approve for adequacy plans, specifications, and cost estimates prior to the approval of the City Council of the City of Willits.

12. An actual controversy has arisen and now exists between the District and the City of Willits regarding their respective rights and duties under the Agreement as it applies to the Real Estate Purchase.

13. Plaintiff desires a judicial determination of its rights and duties and a declaration as to the obligation of the District to contribute to the cost of the Real Estate Purchase under circumstances where the defendant failed to comply with the express provisions of the Agreement including, but not necessarily limited to, acquisition at an efficient and economical cost, and failure to afford the opportunity of Plaintiff to make suggestions and approve for the adequacy, plans, specifications and cost estimates, prior to the approval of the City of Willits.

14. A judicial declaration is necessary and appropriate at this time under all of the circumstances so that plaintiff may determine its rights and duties under the Agreement.

15. A declaration is necessary as there remains a substantial controversy between two public entities as to their respective rights and obligations under the Agreement.

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16. No notice to cure is appropriate under these circumstances as the Real Estate Purchase has already been consummated by the City of Willits and there is no basis for it to cure the obligation.

WHEREFORE, Plaintiff prays for judgment as hereinafter set forth.

SECOND CAUSE OF ACTION

(Declaratory Relief)

17. Plaintiff incorporates the allegations of Paragraphs 1 through 16, inclusive which are re-alleged for Plaintiff's Second Cause of Action which is stated as follows:

18. On or about April 14, 2010 Plaintiff issued to Defendant a Notice of demand to cure and correct certain breaches of the agreement, (the "April 14, 2010 Notice") in accord with Section 23 of the Agreement in the form as that attached hereto as Exhibit "B" and incorporated herein by this reference. The April 14 Notice outlined the Plaintiff's position that the Defendant had breached the Agreement in twenty–four categories, and further that if such breaches were not cured that the Plaintiff would be entitled to credits by way of refund of amounts already paid constituting a total of approximately $1.8 million over the preceding four fiscal years and entitlement to disregard billings for amounts billed by the Defendant, but not yet paid.

19. On or about May 13, 2010 the Defendant replied to the April 14, 2010 Notice in the form as that attached hereto as Exhibit "C" and incorporated herein by this reference, disputing eighteen of the twenty-four categories of the notice, expressing willingness to credit $7,538 for improperly billed costs, and willingness to provide an unspecified credit for failure to account for refunds. Eighteen of the twenty-four categories of the April 14 notice remain in dispute by reason of the May 13, 2010 response by Defendant, specifically categories numbered 1-11; 13-16; 18; 20-21 and, further Defendant has issued no credits. As to those categories, the willingness to do so was expressed in response to categories numbered 12 and 17, and those categories likewise remain in dispute, and are hereinafter referenced as the "April 14, 2010 Notice Categories in Dispute."

20. With respect to the April 14, 2010 Notice and the Defendants response thereto, there exists an actual controversy between the parties as to their respective interpretation of the Agreement

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and the respective rights and obligations under the Agreement.

21. Because the Agreement is ongoing and the interpretations by the Defendant leading to the specification of the aforesaid categories in the April 14, 2010 Notice are likely to reoccur from year to year, a judicial interpretation as to the same will avoid future disputes between the parties on the same subject matter, separate and apart from an application for damages for completed breaches of the Agreement.

22. By reason thereof, declaratory judgment is necessary to determine the respective rights, duties and obligations of the parties specifically as follows:

a) That the Defendant is required to differentiate between capital costs and operating costs in accord with good municipal accounting practices;

b) That the Defendant is required to maintain functional properly calibrated meters in accord with the Agreement to measure the respective flows of the parties for the purpose of apportioning costs pursuant to the Agreement;

c) That as to capital costs for projects which might possibly have a significant impact upon the environment the Defendant is required to comply with the California Environmental Quality Act as a prerequisite to apportioning capital costs to the Plaintiff;

d) That as to projects subject to the California Environmental Quality Act to which the Defendant intends to or seeks to apportion capital costs to the Plaintiff, the Plaintiff is a "Responsible Agency" within the meaning of the California Environmental Quality Act;

e) That in accord with good municipal accounting practices the Defendant may apportion indirect operating costs to Plaintiff under the Agreement only with reference to a reasonable, written Cost Recovery Policy, outlining the circumstances and basis for cost allocation which is adopted by its governing body after public notice;

f) That it is not a good municipal accounting practice as required by the

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Agreement to allocate vehicles to the sewer operation budget unless such vehicles are empirically shown to be related to sewer plant operations and further are not properly accounted for as capital costs for the sewage plant;

g) That it is not a good municipal accounting practice as required by the Agreement to charge "Franchise Fees" as a non-cash item to the Sewer Operations Fund which is apportioned to Plaintiff;

h) That is improper under the Agreement to charge the costs of Defendant's operation and maintenance of its sewer collection system to the Plaintiff;

i) That office furniture and similar fixed assets not directly utilized for the sewer plant operation is not properly charged under the Agreement as an operational expense charged to the Plaintiff under the Agreement as an administration expense pursuant to the Agreement;

j) That auxilary revenues such as refunds of apportioned costs and sales of by products should be credited to the portion of the funds maintained by Defendant the liability for which is apportioned between the entities.

WHEREFORE, Plaintiff prays for judgment as hereinafter set forth.

THIRD CAUSE OF ACTION

(Declaratory Relief - Audit)

23. Plaintiff incorporates the allegations of Paragraphs 1 through 22, inclusive, which are re-alleged for Plaintiff's Third Cause of Action which is stated as follows:

24. On or about August 16, 2010 Plaintiff issued to the Defendant a notice of demand pursuant to Section 23 of the Agreement to cure and correct the City's failure to provide an audit in accord with the Agreement (hereinafter "the Audit Demand") in the form as that attached as Exhibit "D" and incorporated herein by this reference. The Audit Demand among other matters may be summarized as a demand for the Defendant to provide annually to Plaintiff in accord with the Agreement an Audit attesting that the charges to the Plaintiff are in compliance with the Agreement, rather than a Financial Statement Audit which merely documents the City's financial

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position at various times. The Audit Demand also demanded that the Audit not expressly exclude reliance by the Plaintiff and also demanded that the accounts and funds of the City be separately stated in the Audit as required by the Agreement.

25. The Defendant replied to the Audit Demand in the form as that attached as Exhibit "E" and incorporated herein by this reference.

26. By reason of the demand, and the response thereto by the Defendant there exists an actual controversy between the parties as to their respective interpretations of the Agreement and respective rights and obligations of the parties under the Agreement as it relates to financial accounting and verification.

27. Because the Agreement is ongoing and the interpretations by the Defendant leading to its contracting for and furnishing a Financial Statement Audit to Plaintiff, reliance upon which is expressly forbidden by Plaintiff, and which does not separately treat expenses separately apportioned to Plaintiff from non-apportioned expenses, the interpretations are likely to reoccur from year to year, including the current fiscal year. Resolution of this matter separate and apart from the issue of damages for past breaches is necessary and desirable to avoid future disputes between the parties on the same subject matters.

28. By reason thereof, declaratory judgment is necessary to determine the respective rights, duties and obligations of the parties specifically as follows:

a) That the Agreement contemplates that the Defendant is required to annually cause to be made an audit of its accounts for the previous fiscal year which attests to the Defendant's establishment and maintenance of books of accounts in conformance with the Agreement and in conformance with good municipal accounting practices separately and distinctly treating properly apportioned costs from non-apportioned costs and that the failure to do so is a breach of the Agreement;

b) That the agreement contemplates that the annual audit of the Defendant's accounts may be relied upon by the Plaintiff, and that the exclusion of the

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Plaintiff as a party entitled to rely upon the attestation of the Defendant's audit as required by the Agreement is a breach of the Agreement;

c) That the designation of a "Sewer Enterprise Fund" in the Audit which includes apportioned and non-apportionable operating and capital costs under the Agreement constitutes a breach of the Agreement to provide an audit separately treating apportioned and non-apportioned costs.

WHEREFORE, Plaintiff prays for judgment as hereinafter set forth.

FOURTH CAUSE OF ACTION

(Breach of Contract Damages)

29. Plaintiff incorporates the allegations of Paragraphs 1 to 28 inclusive which are re-alleged for Plaintiff's Fourth Cause of Action which is stated as follows:

Property Purchase Breaches

30. Defendant purchased approximately 125 acres near the City limits in 2003 from Walter Niesen, "The Niesen 125 Acre Parcel." In breach of the Agreement Defendant apportioned a percentage of the cost thereof to Plaintiff in the amount of approximately $300,000. The apportionment was in breach of the Agreement because the property was purchased for a purpose other than for the sewer plant project, specifically for financial speculation by the Defendant. Plaintiff is informed and believes that all the purposes for the purchase have not been discovered by Plaintiff and this Complain will be amended when the purposes are discovered.

31. To the extent that the purchase of the Niesen 125 Acre Parcel is deemed by the Court to be properly apportioned to the capital costs of the sewer plant project as a component of such project, the Defendant failed to comply with the California Environmental Quality Act as required by Section 25 of the Agreement, which non-compliance effectively prevented actual advance notice not only to the public, but also to Plaintiff.

32. To the extent that the purchase of the Niesen 125 Acre Parcel is deemed by the Court to be properly apportioned to the capital costs as a component of the of the sewer plant project, the Defendant breached the agreement by failing to comply with Section 10 of the Agreement extending

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to the Plaintiff the right to review, make suggestions and approve for their adequacy, plans, specifications and cost estimates prior to their approval by the City Council of the City. The purchase was approved by the City Council on or about December 10 2003, but the Defendant did not provide notice to the Plaintiff until the year 2007. Had the City provided notice to the Plaintiff questions by the Plaintiff as to the amount of the purchase price for the Niesen 125 Acre Parcel would have been addressed prior to the demand by the Defendant to the Plaintiff for contribution for the purchase as contemplated by the Agreement.

Accounting Breaches

33. For Fiscal Years ending 2005, 2006, 2007, 2008, 2009 (the "Years in Controversy") the Defendant breached the Agreement by failing to maintain its books and accounts in compliance good municipal accounting practices in that Defendant apportioned indirect costs to the Plaintiff for reimbursement without having adopted a policy for the assignment of indirect costs as is required by good municipal accounting practices.

34. For the Years in Controversy Defendant breached the Agreement by failing to maintain accurate books of accounts of capital costs as to its sewage treatment plant in compliance with good municipal accounting practices by apportioning non-capital costs to its accounts of capital costs, the full extent of which is unknown to Plaintiff, but including and not necessarily limited to the improper apportionment of furniture, property purchases and vehicle costs to the capital account.

35. For the Years in Controversy Defendant breached the Agreement by failing to maintain both its sewage capital expense accounts and its sewage plant operations account in compliance with the Agreement, specifically by failing to maintain such accounts separately and distinct from other accounts of the City.

36. For the Years in Controversy Defendant breached the Agreement by failing to maintain both its sewage capital expense accounts and its sewage plant accounts in compliance with good municipal accounting practices

Audit Breaches

37. For the Years in Controversy, except for Fiscal Year ending June 30, 2009 Defendant

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breached the Agreement by failure to timely provide audits on an annual basis to the Plaintiff.

38. For the Years in Controversy, Defendant breached the Agreement by failing to provide Plaintiff with audits as contemplated by the Agreement, specifically by presenting audits of its financial statement, rather than for its compliance with the Agreement.

39. For the Years in Controversy, Defendant breached the Agreement by failing to provide Plaintiff with audits as contemplated by the Agreement, specifically by providing audits which expressly prohibited reliance by Defendant.

40. For the Years in Controversy, Defendant breached the Agreement by failing to provide Plaintiff with audits separately stating apportioned costs with non-apportioned costs.

41. Each failure of the Defendant with respect to compliance with the audit requirements of the Agreement had the effect of concealing from Plaintiff the expenses being apportioned to it under the Agreement.

42. Each breach of the Agreement referenced in this Fourth Cause of Action is and was material.

43. Plaintiff has demanded compliance with the Agreement as to the matters stated herein as to breach and Defendant has not only failed to correct the breaches, but remains in continuing breach of the Agreement.

44. Plaintiff has demanded by its Audit Demand a credit for all costs apportioned to it in breach of the Agreement, but Defendant has issued no credit to Plaintiff although acknowledging Plaintiff's entitlement to some credits. For the next preceding four fiscal years Plaintiff paid Defendant approximately $1.8 Million dollars, credit for which Plaintiff is entitled until such time as Defendant complies with the accounting practices required of it by the Agreement, and a credit for all property purchases made without compliance of the Agreement.

45. By reason of the breaches as aforesaid Plaintiff has been damaged in an amount presently unknown and which will be shown by proof.

46. Plaintiff as a public entity is excused from claim presentation requirements pursuant to the Government Claims Act. Plaintiff is excused from any unique claims requirement adopted by

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Defendant after the execution of the Agreement containing a claims presentation requirement inconsistent with the Agreement as any such purported requirement would result in an unconstitutional impairment of contract. Plaintiff has complied with all claims presentation requirements set forth in the Agreement.

WHEREFORE, Plaintiff prays for judgment as hereinafter set forth.

FIFTH CAUSE OF ACTION

(Money Had and Received)

47. Plaintiff incorporates the allegations of Paragraphs 1 to 46 inclusive which are re-alleged for Plaintiff's Fifth Cause of Action which is stated as follows:

48. Within the past for years Defendant became indebted to Plaintiff for money in the approximately amount of $1.8 million paid to Defendant at Defendant's special instance and request.

49. The sum of approximately $1.8 million is the reasonable value due and unpaid despite Plaintiff's demand, plus prejudgment interest according to proof.

WHEREFORE, Plaintiff prays for judgment as follows:

1. A declaration of the Court that the defendant is in material breach of the Agreement in that it did not conduct such Real Estate Purchase in an efficient and economical manner, and further, did not provide Plaintiff with its contractual rights under Paragraph 10 of the agreement so that Plaintiff has no obligation to contribute to the cost of the Real Estate Purchase;
2. For declarations set forth in Paragraphs 22 a) through j), inclusive;
3. For declarations set forth in Paragraphs 28 a) - c), inclusive;
4. For damages for breach of contract in an amount to be shown according to proof;
5. For money had and received in the amount of approximately $1.8 million representing the amounts paid during the periods that Defendant was not in compliance with the Agreement;
6. Attorneys' fees;
7. For costs of suit incurred herein; and

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8. For such other and further relief as the Court considers appropriate under all of the circumstances, including any necessary injunctive relief to maintain the *status quo* pending determination of this controversy.

DATED: November 17, 2010

CHRISTOPHER J. NEARY
Attorney for Plaintiff,
BROOKTRAILS TOWNSHIP
COMMUNITY SERVICES DISTRICT

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AGREEMENT BY CITY OF WILLITS
FOR DISPOSAL OF SEWAGE FROM
BROOKTRAILS RESORT IMPROVEMENT DISTRICT

THIS AGREEMENT made this 11th day of September, 1967, between CITY OF WILLITS, a Municipal Corporation of California, herein called "CITY", and BROOKTRAILS RESORT IMPROVEMENT DISTRICT, herein called "DISTRICT", both in Mendocino County, California,

W I T N E S S E T H:

This Agreement is predicated upon the facts that:

(a) City has constructed and owns a sanitary sewage treatment plant which provides primary and secondary treatment to its sewage;

(b) Said plant has a design capacity of 800,000 gallons average daily dry weather flow, for an estimated ultimate population of 8,000 people, and City's present population is less than 4,000 persons;

(c) The estimated present replacement value of said plant is $356,000 and the value of a disposal right to 1/4th of its capacity or 200,000 gallons average daily dry weather flow is $89,000;

(d) Said plant and other sewer facilities of the City are in need of certain improvements and the public interest and economy of the City will be served by the City selling said disposal right and using the funds derived from said sale to make such improvements, or to retire a portion of the City's bonded indebtedness incurred in the construction of said plant and sewer facilities;

(e) District lies northwesterly of, but not contiguous to, said City and is proposed to be subdivided into upwards of 6,000 lots with public improvements provided in accordance with standards of Mendocino County, including a sanitary sewerage system for the greater part thereof; and

EXHIBIT A

(f) The public interest and economy of the District will be served by its acquiring a right of disposal in the City plant rather than constructing and operating its own plant.

NOW, THEREFORE, IT IS AGREED, as follows:

1. Sale of Disposal Right. City hereby sells to District a right of disposal of District's sanitary sewage (but not storm waters), in the amount of 1/4th the estimated capacity in City's plant, said 1/4th being an estimated 200,000 gallons average daily dry weather flow, and City will receive, treat and dispose of said sewage.

2. Purchase Price and Payment. District will pay the City for said right of disposal the sum of $89,000, of which $33,600 will be paid on December 31, 1967, and $27,700 on each of December 31, 1968 and 1969. District guarantees to City that no sewage would be delivered to City for treatment until said entire $89,000 shall have been paid to City.

3. Burden of Costs: Inspection of Work. City shall bear the cost of inspection by City of sewer installations in District. Should City plan to inspect proposed sewer installations in District City shall in advance notify District of such intent, and District agrees to notify City in advance as to construction or extension of sewer facilities in District, to permit inspection thereof by agents of City.

4. District Collection System. District will construct, own, maintain and operate in good repair, a sanitary sewerage system to serve its tracts as they shall have been required by subdivision agreements requested by the County of Mendocino.

5. District Outfall. District shall also construct, own and maintain and operate in good condition and repair an outfall trunk sewer main from its sewerage collection system to a point of connection to the City sewerage system estimated at 10,000 feet.

6. Construction Standards. All facilities to be constructed by District shall be of the sizes, dimensions and material and at the locations, elevations and grades established therefor by said County, shall be of good sanitary sewerage engineering design, and shall be installed under good engineering supervision and inspection by competent engineers appointed therefor by District, and to such supervision and inspection as is customarily provided by the County Engineer or other official performing his duties and to the satisfaction and acceptance thereof by him, all to the end that said system shall be tight and free from infiltration of flood, storm and other waters from the outside. All facilities constructed by District shall also comply with the provisions of District's "Ordinance Regulating The Use of ... Sewers and Drains ... Installation of Sewers," which Ordinance was heretofore adopted by the Board of Directors of District on the 21st day of April, 1965.

7. Monthly Service Charges. District will pay City, on the first day of each calendar month, commencing with the first day of the month following the receipt of District sewage in the City system a sum equal to $1.50 per single family residence, and 10¢ (ten cents) per fixture unit, according to Table 10-1 (Section 1009) of the Uniform Plumbing Code, 1964 Edition, in resorts, motels and commercial structures and other structures in District other than single family residences, and connected to said sewerage system. District, by its Board of Directors, agrees that in the event District shall fail to remit to City the sums hereinabove specified, at the times and in the manner hereinabove provided, said City may collect said sums direct from property owners in said District, and all said property owners are hereby given notice of the City's right to collect said sewer charges from individual property owners in the event District shall default in payment to City of the sewer charges provided herein.

8. Excess Flows, Charges Therefor. District shall install at District's expense and City shall maintain in operative condition a recording stream flow measuring device in the outfall sewer, immediately upstream from its connection with City's system. Provision by District will also be made for the convenient and accurate taking of samples for testing of the quality of the sewage being delivered into City's sewer system. City is hereby granted the right of charging District for flows, coming from whatever source which exceed the normal daily dry weather flows by more than twenty-five percent (25%). The amount of such charges shall be based upon the City's cost and liability for treating and handling such excess flows, and for the extraordinary measures that City may be required to provide in order to handle such flows. City is also granted the right to charge District for handling and treating sewage of strength in excess of that measured during normal dry weather flows. Such charges shall become operative when the peak BOD loading exceeds three hundred (300) parts per million (five (5) day Standard Methods test). The amount of such extra charges for such excess flows and for such sewage of strength in excess of normal as above stated, shall be determined by negotiation between City and District and will be based upon the additional cost required of City to provide the facilities to handle and treat such sewage.

9. District Records. District shall establish and maintain to good accounting standards, books and records of the number and type of connections to said system at each payment period, which shall be open to inspection by City at all reasonable hours.

10. Written Statements. District shall accompany each payment with a written statement which shall be in sufficient detail that City may ascertain the amounts from the numbers of the several different types of use represented therein.

11. Understatement. In the event that it shall be ascertained that any payment shall be less than the true amount due therefor, District shall pay and City may collect the difference with interest at six (6) percent per annum, plus costs and a reasonable attorney's fee to be fixed by the court in the event of suit.

12. Basis of Service Charges. It is the intent of the City that any future cost of construction of sewerage facilities of the City arising out of the necessity of (1) expanding the treatment plant and facilities to handle in excess of 200,000 gallons average daily flow from the District, or (2) installing additional treatment facilities to bring the quality of the effluent arising out of the flow from the District up to standards required by the State Water Quality Control Board or successor agency, be paid for by the District. The service charges provided have been estimated to be sufficient to pay the District's share of the City's cost of administration, maintenance, operation and repair of the treatment plant and facilities used by the District, and for such future construction. City shall have the power to revise the schedule of service charges from time to time to defray City's cost of administration, maintenance, operation and repair of the treatment plant, works, and for future construction. Any revision of the said service charges shall be governed by standard and accepted engineering and accounting practices normally utilized for apportioning costs in like joint uses and considering necessary future expansions, and shall take into account moneys already paid by the District for such expansions.

13. City Records. City shall budget and keep and maintain books of record and accounts which shall reflect, separately from its sewerage collection system, records and accounts of its costs of administration, maintenance, operation and repair of its sewerage treatment and disposal work and system, and of new construction,

in sufficient detail and categories that the different categories and proofs of costs may be reasonably ascertained.

14. Competent Supporting Data. A request for renegotiation of service charges shall be supported by competent reports and analyses in sufficient detail that District may understand the need for such renegotiation, and District shall have the right to inspect City's books, records and accounts in order that it may competently understand and affirm the need for such renegotiation.

15. Storm Waters. District shall not suffer or permit storm water drains, or waters collected on roofs, patios or other improved portions of premises to be connected to its sewerage system, and shall establish and enforce rules and regulations therefor.

16. Police Powers. The parties shall be subject to all statutes, ordinances, rules and regulations adopted in the exercise of State and Local police powers, that are reasonable and customary in the operation of sanitary sewerage works and systems.

17. Indeterminate Term. The term of this agreement shall be continuing and indeterminate and is intended to provide the rights of future populations to the extent of its provisions.

18. Breaches. Sixty days after mailing written notice by one is established as a reasonable period within which the other party shall correct any breach of the provisions hereof. No lateness in giving such notice or greater time alloted or taken in correcting a breach shall constitute a waiver or termination of this provision.

19. Transfer. The rights of either party under this agreement shall transfer by operation of law in the case of merger, but shall not be otherwise transferable without the consent of the other party expressed by resolution of its legislative body.

20. Amendments. This agreement may be altered, amended, modified or supplemented from time to time, in writing and executed as herein provided, upon written authorization by resolutions of the respective legislative bodies of the parties hereto. It is the intention of the parties that this agreement be amended from time to time in accordance with experience, to reflect then existing and anticipated circumstances.

IN WITNESS WHEREOF, the parties hereto have caused these presents to be executed by their respective officers, thereunto authorized by resolutions of their respective legislative bodies, the day and year first above written.

CITY OF WILLITS

By Leo S. Hulett
Leo S. Hulett, Mayor

ATTEST:

Eunice S. Southwick
Eunice S. Southwick,
City Clerk

(Seal)

BROOKTRAILS RESORT IMPROVEMENT DISTRICT

By Harvey Sawyer
President

COUNTERSIGNED:

Lorene K. Long
Secretary and Clerk

(Seal)

FIRST AMENDMENT

TO

AGREEMENT BY CITY OF WILLITS

FOR DISPOSAL OF SEWAGE FROM

BROOKTRAILS RESORT IMPROVEMENT DISTRICT

THIS AMENDMENT TO AGREEMENT, made this 17th day of April, 1970, between CITY OF WILLITS, a municipal corporation of California, herein called "City" and BROOKTRAILS RESORT IMPROVEMENT DISTRICT, herein called "District" both in Mendocino County, California,

W I T N E S S E T H:

WHEREAS, the parties hereto, on September 11, 1967, made and entered into an agreement entitled "Agreement by City of Willits for Disposal of Sewage from Brooktrails Resort Improvement District", herein called the "agreement";

NOW THEREFORE, the parties agree that the agreement is amended and supplemented as follows:

1. The facts upon which the agreement is predicated include the following additional facts:

(a) A portion of the District's sewer system, including collector lines and outfall line connecting the collection system into the City sewer system at Commercial Street and Mill Creek Drive, has been completed and accepted by District;

(b) District has a few residents servable by the completed and accepted portions of the District's sewer system and who are in immediate need of sewer service, and has a substantial portion of its system still under construction;

(c) City and District have previously informally agreed that the location of the stream flow measuring device in the outfall line be moved upstream, from the point of connection with the City's system to the District's boundary, in order to permit the City to connect to said outfall line below such measuring device.

agreement as to the pro-rata share of maintenance and repair is reached with the District.

2. The following is added to Section 4, "District Collection System":

District shall block off from flow into City's plant of any water, waste or matter accumulating in those portions of the collection system which shall not have been accepted by District as complete, and in those portions which shall have been completed and accepted but which are not then required for service of residents and within which the infiltration is known by the District to be excessive. District shall take prompt action to remedy excessive infiltration in those portions which shall have been completed and accepted and which are required to serve residents desiring service.

3. The following is added to Section 5, "District Outfall":

The portion of said outfall main from the measuring device at the District's boundary to the connection into the City's system shall be re-tested for excessive infiltration within two weeks of the date of this amendment. Said re-test shall be a water test, shall include manholes, and shall be conducted by District using standard testing procedures for measuring infiltration. City shall be given notice of and an opportunity to observe the conduct of the test. Any excessive infiltration shall be promptly remedied by District.

4. The edition of the Uniform Plumbing Code which shall be used in determining the fixture units forming the basis for charges, as [illegible] edition.

5. The following additional section is added:

7.A. Minimum Monthly Charge

District will pay City, on the first day of each calendar month, commencing with the first day of the month following the receipt of District sewage in the City system, a minimum monthly amount of $100.00, which amount shall be in lieu of the service charge payable pursuant to Section 7, "Monthly Service Charge", for those months in which the service charge payable pursuant to such section would be less than $100.00

6. The first sentence of Section 8, "Excess Flows, Charges Therefor," is amended to read as follows:

District shall install at District's expense and shall maintain and operate a recording stream flow measuring device in the outfall sewer, at or near the District's boundary.

7. The following section is added to the Agreement:

21. Beginning of Service

The date upon which service pursuant to this agreement shall commence and upon which City shall accept and receive the flow shall be April 17, 1970, or as soon thereafter as District can effect physical connection of its outfall to City's system.

IN WITNESS WHEREOF, the parties hereto have caused these presents to be executed by their respective officers, thereunto authorized by resolutions of their respective bodies, the day and year first above written.

CITY OF WILLITS

BY: Ottis E. Smith

Ottis E. Smith, Mayor

ATTEST:

Eunice S. Southwick

Eunice S. Southwick, City Clerk

BROOKTRAILS RESORT IMPROVEMENT DISTRIC

BY: Harvey Sawyers

Harvey Sawyers, President

COUNTERSIGNED:

Lorraine B. Loser

Lorraine B. Loser, Secretary and Clerk

CITY OF WILLITS

MENDOCINO COUNTY

Willits, California 95490

RESOLUTION NO. 70-492

RESOLUTION AUTHORIZING CITY TO ENTER INTO FIRST AMENDMENT TO AGREEMENT BY CITY OF WILLITS FOR DISPOSAL OF SEWAGE FROM BROOKTRAILS RESORT IMPROVEMENT DISTRICT.

BE IT RESOLVED by the City Council of the City of Willits, California, at a special meeting of said Council held the 17th day of April, 1970, that the Mayor and the City Clerk be authorized to sign the First Amendment to Agreement By City of Willits for Disposal of Sewage From Brooktrails Resort Improvement District dated September 11, 1967, as per amendment read by Council members and approved by said Council.

Mayor

ATTEST:

City Clerk

I hereby certify the above to be a true and correct copy of Resolution No. 70-492 duly and regularly passed by the Willits City Council at a special meeting held on the 17th day of April, 1970.

City Clerk

wJML:JEB:sc:Rev:11/19/75

SECOND AMENDMENT
TO
AGREEMENT BY CITY OF WILLITS
FOR DISPOSAL OF SEWAGE FROM
BROOKTRAILS RESORT IMPROVEMENT DISTRICT

THIS AMENDMENT TO AGREEMENT made this 21 day of Nov., 1975, between the CITY OF WILLITS, a municipal corporation, herein called "City" and BROOKTRAILS RESORT IMPROVEMENT DISTRICT, a public corporation, herein called "District", both in Mendocino County, California,

W I T N E S S E T H:

That this agreement is predicated on the following facts:

a. On September 11, 1967, the parties hereto entered into a written agreement entitled Agreement by City of Willits for Disposal of Sewage From Brooktrails Resort Improvement District, herein called Agreement;

b. On April 17, 1970, the parties hereto entered into a further written agreement entitled First Amendment to Agreement by City of Willits for Disposal of Sewage From Brooktrails Resort Improvement District, herein called Amendment;

c. The Division of Water Quality of the State Water Resources Control Board has ordered the City to undertake the construction of improvements to its sewage treatment plant which will improve the quality of the effluent emanating therefrom;

d. The total estimated cost of said improvements to provide 640,000 gallons per day dry weather flow capacity, as determined by Brown & Caldwell, engineers for the City, is $2,487,656, of which $2,165,816 will be provided by the Environmental Protection Agency and the State of California, and the balance of $321,840 is for improvements to the City sewage treatment plant and land disposal facilities;

e. The District wishes to purchase capacity in said sewage treatment plant, of 160,000 gallons per day average daily dry weather flow which is one quarter of the dry weather flow capacity;

f. Average daily dry weather flow shall be the average daily dry weather flow for the period commencing May 1 and ending September 30 of each year;

g. The public interest and general welfare will be served by clarifying the manner of apportioning and payment of costs between the City and the District.

NOW, THEREFORE, IT IS DETERMINED and AGREED, as follows:

1. The Agreement be, and is hereby, amended by deleting sections 5, 7, 8, 10, 11 and 12 therefrom.

2. The Amendment be, and is hereby, repealed as of the effective date of this second amendment.

3. City Ownership. The present sanitary sewage treatment and disposal facilities, and all future improvements thereto, shall be, become and remain the exclusive property of the City, and the City shall have sole jurisdiction over its operation and possession. Any liability for malpractice in the treatment and disposal of wastewater shall not pass to District in the event that the quality and quantity of wastewater received from District is within the specifications as hereinbefore stated or hereafter agreed to.

4. District Capacity. The District shall have the exclusive right to dispose of sanitary sewage in said plant up to 160,000 gallons per day, dry weather average daily flow, which is estimated to constitute 25% of the capacity therein.

5. Additional District Capacity. The District may purchase additional capacity in said plant at a replacement cost which shall be the portion of $2,814,876 times an inflation factor that the amount of dry weather average daily flow so acquired bears to 750,000 gallons average daily dry weather flow, provided that the City, by resolution adopted by its City Council prior thereto, shall have

determined there is reason to believe that the capacity to be sold is surplus City capacity. The inflation factor shall be the ratio of the 1913 ENR Construction Cost Index for San Francisco prevailing at the time of purchase of additional capacity to 2800.

6. Capacity Improvements. The cost of improvements to the City sewage treatment plant which will result in increasing its capacity beyond 750,000 gallons per day average dry weather flow shall be charged to and paid for by the party who will become entitled thereto. Costs of increase in capacity for both parties shall be prorated according to capacity needed and assigned to each. Capacity assigned shall be in gallons average daily dry weather flow, as peak and winter conditions will be anticipated in design. No additional capacity shall be assigned by the City to the District without the approval of the District, expressed by supplement or amendment to this agreement.

7. Overuse by District. In the event that sewage flow from District shall so increase as to exceed its capacity allotment, the City Council may elect to require that it either purchase additional capacity in the existing plant, or the City may undertake to construct additional improvements which will provide such capacity. During the interim, the City shall have the right to collect an additional capacity charge per year from the District which shall be determined by multiplying that part of the then cost of the treatment plant that the overage capacity used bears to its then total capacity (multiplicant) by .07264891 (being the annual factor for 30 years amortized at 6% per annum) (multipler). The then value of the treatment plant shall be $2,814,876 times an inflation factor as defined in Section 5 plus costs of any improvements thereto, hereafter made, whether to capacity over 750,000 gallons per day average dry weather flow or to quality of treatment.

8. Quality Improvements. The parties acknowledge that the City is currently obligated to make improvements to the City sewage treatment plant which will result in improving the quality of its

effluent or meet other requirements of State and Federal agencies, commissions and departments having jurisdiction thereover. The local share costs of such improvements to the District for 160,000 gallons per day average dry weather flow capacity is $111,333.00

The District agrees to pay $100,000 within 90 days of acceptance by both City and District of this second amendment to the agreement and the remaining $11,333 within 60 days of the time the City accepts a construction bid to increase average dry weather flow capacity beyond 640,000 gallons per day to replace all or a portion of the 110,000 gallons per day of the City's future capacity assigned to the District.

8A. Future Quality Improvements. The parties acknowledge that the City may be required to make improvements to the City sewage treatment plant in the future to meet more stringent effluent quality requirements by State and/or Federal agencies than are currently in effect. The costs of such improvements shall be apportioned between the parties in the ratio of their then respective dry weather flow treatment capacities in the plant.

9. City Control as to Improvements. The City shall have the right to employ engineers of their selection to design and provide improvements to the City sewage treatment plant, both as to capacity and quality, provided, however, that such engineers shall be experienced and recognized engineers as to such work. All such work shall be designed so as to produce an efficient and economical cost, both as to construction and as to maintenance and operation, and not constitute overdesign.

10. Plan Review by District. The Board of Directors of District, with the advice of its engineers, shall have the right to review, make suggestions and approve for their adequacy, plans, specifications and cost estimates prior to their approval by the City Council of the City, provided, however, that its approval shall not be unreasonably withheld.

11. District Inspection. The Board of Directors of the District, through its engineering representatives, shall have the right at all reasonable business hours, to inspect the City sewage treatment plant, and also any improvements during their construction.

12. Capital Costs. The City shall establish and maintain accurate accounts of all capital costs as to its sewage treatment plant, separate and distinct from all other accounts of the City, in conformance with good municipal accounting practices. The Board of Directors of the District, through its representatives, shall have the right to examine and make copies of said accounts at all reasonable business hours.

13. Operation Costs. The City shall establish and maintain books of account of all costs of administration, maintenance, operation and repair of the City sewage treatment plant, separate and distinct from all other accounts of the City, and distinct from capital improvements thereto, in conformity with good municipal accounting practices. The Board of Directors of the District, through its representatives, shall have the right to examine and make copies of said accounts at all reasonable business hours.

14. Annual Report. The City shall annually cause to be made an audit of its accounts for the previous fiscal year which shall separately treat therein the accounts relating to the City sewage treatment plant. On or before October 1 of each year, the City shall deliver to the District's Manager a copy of the parts thereof relating to its sewage treatment plant.

15. Measuring Facilities. The City shall provide a measuring weir and metering recording facilities, on the District outfall line at the City boundary, from which the District flow may be ascertained and recorded. The City shall be responsible for maintaining the records. The City shall also provide similar facilities to keep records as to its gross flow. The District may inspect flow records at all reasonable business hours. Title to sewer facilities from the

new metering station to discharge on East Commercial Street; consisting of 14" sewer trunk lines and manholes and running from station approximately 1.00 to 24.53 as shown on Water and Sewer Construction map dated August 1, 1966 and approved by the County Engineer, be and they are hereby dedicated by the District to the City of Willits and the City of Willits hereby accepts said facilities as part of the City's sewerage system.

16. Apportioning Operating Costs. All costs of administration, maintenance, operation and repair of the City sewage treatment plant shall be apportioned annually by the City according to the ratio of flow of the District to the total flow entering the treatment plant. Annually, the City shall file with the District's Manager a copy of the part of its budget which concerns the plant, and a statement of the amount of the District's share of the estimated costs of administration, maintenance, operation and repair for the forthcoming fiscal year, in sufficient time for District to budget and provide for payment of same. For the purpose of estimating such costs, the flow ratio established for the preceeding fiscal year shall be used. In each subsequent fiscal year, the City shall recompute the charge from the actual flow records established by the flow records for said year and debit or credit the District with any underage or overage of the estimate cost.

17. Replacement Costs. All costs of replacing plant equipment, machinery or facilities resulting from breakage or obsolescence shall be apportioned in the ratio of average dry weather flow capacity allocated to City and District. All replacement costs thereof for ordinary use and wear shall also be apportioned in the ratio of average dry weather flow capacity. Replacement costs may be paid from the Wastewater Capital Recovery Funds. Said apportionment of costs between City and District shall be District's proportionate share of average dry weather flow capacity, less any governmental subventions.

18. Auxiliary Revenues. All revenues derived by the City from the sale of water or other by-products of the City sewage treatment plant shall be credited to costs of maintenance before proration thereof between the parties hereto.

19. Method of Raising Funds. Each party shall have reserved to it the right to determine and utilize the method by which it raises its share of any funds under this second amendment to the agreement. Funds raised from taxes shall be paid by the District to the City semiannually on or before January 2 and on or before July 1 of each year. District's proportionate share of charges for operation and maintenance shall be paid by District to the City monthly.

19A. Wastewater Capital Recovery Fund. The District agrees to establish and maintain a Wastewater Capital Recovery Fund (WCRF) for its proportionate share of plant capacity in accordance with regulations and guidelines of the California State Water Resources Control Board and the Environmental Protection Agency. For purposes of computing WCRF requirements, the District's WCRF requirement is one quarter of the sum of construction cost of the treatment plant improvements plus the value of the currently existing plant incorporated in the improved plant. The total cost is $2,071,156 plus $280,000 which is $2,351,156. One quarter of this sum is $587,783. Subject to approval of the California State Water Resources Control Board, the District agrees to deposit each year one sixteenth (1/16) of $58,778, which is ten percent of the District allocated cost. The District is entitled to make bond principal payments for treatment plant construction from the WCRF and also to disburse amounts from the WCRF for replacement or preservation of treatment plant facilities or for expansion and improvement of treatment works except pipelines smaller than 12 inches in diameter and appurtenances thereto. After the minimum balance is reached, the District agrees to maintain its WCRF balance at or greater than the ten percent minimum requirement of $58,778 over the 30 year life of the treatment plant, or after disbursements for treatment plant facilities replacement or expansion, the District

agrees to restore the minimum WCRF balance to $58,778 at the rate of at least one sixteenth (1/16) of $58,778 per year less disbursements allowed by regulations of the State Water Resources Control Board and the Environmental Protection Agency. The District WCRF shall not apply to any additions which the City of Willits may have to make in order to insure 160,000 gallons per day average dry weather flow to the District.

19B. Industrial Cost Recovery. Under EPA regulations, a grantee must recover from industrial users an amount equal to the portion of the Federal grant allocable to industrial users. The District agrees to make payments to Willits to meet these requirements in the event that any industrial user connects to the District sewer system. The minimum Federal grant cost allocated to an industrial user connected to the District system shall be 75 percent of the District's proportionate share of $2,487,656 times the ratio which dry weather flow capacity allocated to the industrial plant bears to the District's proportionate share of 640,000 gallons per day total capacity. Engineers of the City of Willits may also compute and include in the allocated Federal grant cost additional industrial strength surcharges based on BOD, suspended solids or other waste characteristics in accordance with regulations and guidelines of the State Water Resources Control Board and the Environmental Protection Agency. One thirtieth (1/30) of the allocated Federal grant cost for each industry connected to the District sewer system shall be paid by the District to the City beginning with the year of that industrial connection and extending for a 30 year period or until the City's responsibility for industrial cost recovery payments to the Federal government ends, whichever period is less.

20. Abandonment by District. In the event that the District shall have abandoned its use of the City sewage treatment plant it shall forfeit its interest therein and the plant shall remain available for use by the City.

21. Replacement by City. The City may relocate its sewage treatment plant and abandon the use of its present plant by reason of orders of State or Federal agencies, commissions and departments having jurisdiction thereover, or by reason of predominating factors of economy or ecology. In such event the former plant and property shall be sold for its highest and best use and price and the moneys realized shall be apportioned between the parties and applied on account of the costs of the new plant according to their capacity interests. The District may elect to have a capacity in the new plant determined by it. In such event the moneys so realized shall be prorated as a credit per its former proportion of capacity, and the balance of costs shall be prorated in proportion to the ratio of capacity in the new plant.

22. City Regulations. The District shall abide by all rules and regulations of the City concerning the type and condition of the sewage permitted to be discharged to the sewers of the City and the District shall regulate and prohibit the residents of the District from depositing in said sewerage system any sewage or matter which, by the rules and regulations of the City, the people of said City are denied the right to deposit in its sewerage system.

23. Breach of Covenants. In case of a breach or alleged breach on the part of either party in the performance of any of its obligations hereunder, not less than thirty (30) days notice of said breach shall be given to it in writing by the other party, delivered to the office of Manager thereof, or mailed to said office registered mail, postage prepaid, and said party shall have thirty (30) days from the date of said delivery or registration of said mail to cure said breach. However, none of the rights or privileges granted to either party shall, in any event, be forfeited unless it shall be so decreed by a court of competent jurisdiction.

24. Delinquent Payments. In the event that the District shall fail to make any payments herein provided within thirty (30) days

from the due date thereof, interest at the rate of six percent (6%) per annum shall accrue thereon from the due date thereof until paid. In the event the District shall fail to conform its operation within said thirty (30) days or to pay the City any amount provided herein within six (6) months from the due date thereof, the City, at its election, may file and prosecute to judgment a suit to recover, or in mandate, or in mandatory or prohibitory injunction, or other legal or equitable remedy. Recoverable costs shall include court costs and a reasonable attorney's fee to be fixed by the court in the event of suit.

25. Entity Obligation. Each party shall maintain and operate its sanitary sewerage facilities in full conformity with all State and local sanitary laws, rules and regulations, and in an efficient and economical manner. In the event of breach by either party, and following notice by the other to it in the manner provided in section 23, such innocent party may enforce conformance by court action.

26. Remedies. For the breach of any duty hereunder by either party, the other or its successor, or any taxpayer thereon for himself or in a representative capacity on behalf of all other taxpayers of either party, or any bondholder of any of the sewer bonds of either party for himself or in a representative capacity on behalf of all such bondholders, shall have the following remedies against the other:

(i) Accounting. By action in law or suit in equity, to require such party to account as a trustee of an express trust;

(ii) Injunction. By such action or suit, to enjoin any acts or things which may be unlawful or in violation of any provision hereof; and

(iii) Mandamus. By such action, suit or proceeding, to enforce the rights of such party hereunder, and to require and compel such party to perform and carry out its duties and obligations under the law and its convenants agreements herein.

27. Nature of Remedies. As to the remedies of either party aggrieved hereunder:

(i) Cumulative. No remedy conferred hereby or by the law is intended to be exclusive of any other remedy, but each such remedy is cumulative and in addition to every other remedy and may be exercised without exhausting and without

(ii) Waiver. No waiver of any default or breach of duty or contract shall extend to or shall affect any subsequent default or breach of duty or contract or shall impair any rights or remedies herein.

(iii) Delays. No delay or omission to exercise any right or power accruing upon any default shall impair any such right or power or shall be construed to be a waiver of any such default or acquiescence thereof.

(iv) Enforcement. Every substantive right and every remedy conferred may be enforced and exercised from time to time and as often as may be deemed expedient.

(v) Status Quo. In case any suit, action or proceeding to enforce any right or exercise any remedy shall be brought or taken and then discontinued or abandoned, or shall be determined adversely, then, and in every such case, said Entity shall be restored to its former position and rights and remedies as if no such suit, action or proceedings had been brought or taken.

28. Arbitration. In case any dispute, difference or controversy should arise between the parties hereto regarding the construction, meaning or effect of this agreement or any of its provisions, or the rights, privileges, duties or obligations of the parties hereto or either of them, the parties hereto may agree that such dispute, difference or controversy shall be arbitrated and decided by two arbitrators, one of whom shall be selected by the Council of the City, and the other by the Board of the District; provided, however, that if the two arbitrators are not able to agree, they shall appoint a third arbitrator.

(i) Arbitrators - Qualifications. The persons appointed shall be trained and qualified in the matter to be passed upon by them. If the matters principally involve engineering, the arbitrators shall be Registered Civil Engineers. If they involve accounting, the persons appointed shall be Certified Public Accountants. If the matters involve law they shall be passed upon by duly Licensed Attorneys. Where problems in controversy are complex in nature, to the extent practicable they shall be divided and the separate matters assigned to persons qualified.

(ii) Id. - Appointment, Vacancies. The arbitrators appointed shall be notified in writing as well as the parties hereto, by the appointing party. If an arbitrator shall refuse to act or shall resign, another shall be appointed in his place by the party making the original appointment. If there is a failure or refusal to appoint an arbitrator for thirty (30) days after written demand, a party or arbitrator may apply to the Superior Court for Mendocino County and said Court shall designate and appoint such arbitrator or arbitrators.

(iii) Hearings. All arbitrators appointed shall sit at any hearing. The arbitrators may require any person to attend before them as a witness and in a proper case to bring with him any book or written instrument. The fees for such attendance shall be the same as the fees for witnesses in other actions at law. The arbitrator shall have power to approve the taking of depositions, to appoint a time and place for hearing, to adjourn from time to time, to administer oaths to witnesses, to hear the allegations and evidence of the parties and to make an award thereon.

(iv) Subpoenas. Subpoenas shall issue in the name of the arbitrators or a majority of them, and shall be signed by the arbitrators or a majority thereof and shall be directed to said person and shall be served in the same manner as subpoenas to testify before a court of record in this State. If any person or persons so summoned to testify shall refuse or neglect to obey said subpoenas, upon petitions, said Superior Court may compel the attendance of such person or persons before said arbitrators, or punish said person or persons for contempt in the same manner now provided for the attendance of witnesses or the punishment of them in the courts of this State.

(v) Depositions. Upon petition approved by the arbitrators or a majority of them, said Superior Court may direct the taking of depositions to be used as evidence before the arbitrators, in the same manner and for the same reasons as provided by law for the taking of depositions in suits or proceedings pending in said Superior Court.

(vi) Award. The award shall be in writing, signed by at least two arbitrators, and acknowledged or approved in like manner as a deed for the conveyance of real property, and delivered to the Manager of each of the parties.

(vii) Id. - Vacation. On application by either party, said Superior Court may make an order vacating the award for fraud, misconduct, acts in excess of power, or other grounds provided by law. A rehearing may be directed.

(viii) Modification. On application of either party, said Superior Court may make an order modifying or correcting the award, because there was an evident mistake, the award was for a material matter not submitted, is in imperfect form, or other grounds provided by law.

(ix) Order Confirming Award. At any time within three months after the award is made, unless the parties shall extend that time in writing, and if said award shall not be accepted in writing by the other party, the other party may apply to the Superior Court for an order confirming the award. Said Court shall grant said order unless the award is vacated, modified or corrected as herein provided by law.

(x) Id. - Form. Upon the granting of an order confirming, modifying or correcting an award, judgment may be entered in conformity therewith in said Court. The party applying for the order shall attach to such application copies of this agreement; the selection or appointment of the arbitrators and the umpire, if any; each written extension of time, if any, within which to make the award; and the award. The judgment when rendered by the Court shall be docketed as if it were rendered in an action.

(xi) Id. - Effect. The judgment so entered shall have the same force and effect, in all respects, as, and be subject to all of the provisions of law relating to, a judgment in an action; and it may be enforced, as if it had been rendered in an action in the Court in which it is entered.

(xii) Appeal. An appeal may be taken from an order confirming, modifying, correcting, or vacating an award, or from a judgment entered upon an award, as from an order or judgment in an action.

(xiii) Law Applicable. Title IX (commencing with Sec. 1280) of Part III of the Code of Civil Procedure, as now or hereafter provided, shall apply.

29. Incorporation. In case the District should become incorporated, or shall merge or consolidate or reorganize or annex into any other public or municipal corporation, then such corporation shall succeed to all the rights, privileges, duties and obligations devolving upon the District under the terms of this agreement, so far as the same may be done under law; provided, nothing herein contained shall be deemed to absolve the District from continuing payment of its share of the cost of maintaining and operating and other costs of the City hereunder, so long as the City sewer facilities shall be used by the District; provided, further, that in the event of such change in character, as aforementioned, nothing herein will be deemed to prevent the parties hereto from entering into a supplementary agreement.

30. Duplicate Agreement. This agreement shall be executed in duplicate.

31. Effective Date. The provisions of this agreement relating to the costs of administration, maintenance, operation, repair and replacements shall become effective upon recordation of Notice of Completion of said improvements by City and the installation of the measuring devices by City, and shall become effective in all other regards except as otherwise herein provided, as of its date.

32. Agreement Indeterminate. The term of this agreement shall be indeterminate. In the event the parties shall mutually agree on a termination of this agreement, their interests shall be compensated from liquidation or sale of the plant and property to the extent of

funds realized.

IN WITNESS WHEREOF, the parties hereto have caused these presents to be executed by their respective officers, by resolution of the City Council of the City and the Board of Directors of the District, the day and year above written.

CITY OF WILLITS

By _____
Mayor

ATTESTED:

_____
City Clerk

APPROVED AS TO FORM:

MERLE P. ORCHARD
Suite 200 Mendo-Lake Building
Ukiah, California 95482

_____
Merle P. Orchard
City Attorney

BROOKTRAILS RESORT IMPROVEMENT DISTRICT

By _____
President

ATTESTED:

_____
Secretary

APPROVED AS TO FORM:

WILSON, JONES, MORTON & LYNCH
630 North San Mateo Drive
San Mateo, California 94401

_____
Joan E. Briody
Attorney for District

WJML:JLB:nd:11/14/75:12c

RESOLUTION NO. 145

A RESOLUTION APPROVING AND AUTHORIZING EXECUTION OF SECOND AMENDMENT TO AGREEMENT

BROOKTRAILS RESORT IMPROVEMENT DISTRICT

RESOLVED, by the Board of Directors of the Brooktrails Resort Improvement District, Mendocino County, California, that the Second Amendment to the Agreement between this District and the City of Willits, Mendocino County, California, for sewage disposal by said City for this District, a copy of which is attached to this Resolution, be entered into by the District, and the President is hereby directed to execute said Second Amendment and the Secretary to countersign same and affix thereto the corporate seal of this District

* * * * * * *

I hereby certify that the foregoing is a full, true and correct copy of a resolution duly passed and adopted at a regularly held meeting of the Board of Directors of the Brooktrails Resort Improvement District on the 18th day of November, 1975, by the following vote:

AYES, and in favor thereof, Directors: Mills, Ecke, Warner, Costa

NOES, Directors:

ABSENT, Directors: Geoghegan

Lorraine B. Loud
Secretary

(SEAL)

Signed Copy

THIRD AMENDMENT
TO
AGREEMENT BY CITY OF WILLITS FOR DISPOSAL
OF SEWAGE FROM BROOKTRAILS RESORT
IMPROVEMENT DISTRICT

This agreement, made on September 8, 1982, is between the City of Willits, a California general law city ("City") and Brooktrails Community Services District, successor in interest to Brooktrails Resort Improvement District ("District").

WHEREAS, the parties make this agreement with reference to the following facts and understandings:

A. On September 11, 1967, City and District entered into a written agreement entitled, Agreement by City of Willits for Disposal of Sewage from Brooktrails Resort Improvement District ("Original Agreement").

B. City and District now have amended the Original Agreement on two separate occasions, by written agreements entered into on April 17, 1970 ("First Amendment") and on November 21, 1975 ("Second Amendment"). By the terms of the Second Amendment, the First Amendment was repealed and rescinded and no longer has any force or effect. The Second Amendment also made substantial revisions to the Original Agreement, and these revisions remain in effect and continue to bind City and District.

C. After City and District entered into the Second Amendment, a new wastewater treatment plant was constructed and now serves both entities. This plant presently is

approaching its design capacity, and the parties to this agreement find it in their mutual interest to provide for certain limited improvements to the plant which are designed to increase its capacity and improve its reliability of operation.

D. City's engineering consultant, Barrett, Harris & Associates ("consultant") has prepared an engineering predesign report entitled, Wastewater Treatment Plant Expansion for the City of Willits (July, 1981), and therein has recommended certain interim improvements which will increase plant capacity.

E. City is in the process of putting out to competitive bid a project designed to carry out the consultant's recommendations for interim plant improvements. These are referred to in this agreement as the "Phase I Improvements" or as "the project", and generally consist of aeration basin dike extensions and related work, an aluminum box extension to the distribution structure, and the addition of a plug valve to the existing waste activated sludge piping. Reference is made to the Phase I Contract Documents, including specifications and drawings, for full particulars as to the scope of the work.

F. City and District wish to share in the cost of the Phase I Improvements and apportion between them the incremental plant capacity resulting from these improvements.

NOW THEREFORE, City and District agree as follows:

1. Effect of Agreement. Except as modified by the express terms of this agreement, the Original Agreement (as

amended by the Second Amendment of November 21, 1975) shall remain in full force and effect.

2. Apportionment of Costs. The parties shall share equally the full cost of all Phase I Improvements. To that end, District shall pay to City $43,244.50 plus an amount equal to Fifty Percent (50%) of any Change Orders as mutually agreed upon by City and District for Phase I Improvements, including but not limited to all costs of engineering, designing and constructing that project.

3. Time and Manner of Payments. The parties understand that City has or will enter into one or more contracts with others for the purpose of engineering, constructing and completing the Phase I Improvements, and that it will become obligated to make payments under such contracts from time to time. When City is required to make any installment or payment of any kind in connection with the Phase I Improvements, it shall invoice District for District's Fifty Percent (50%) share thereof, and District shall pay City the invoiced amount within thirty (30) days after receipt of each invoice.

4. Delinquent Payments. Notwithstanding Section 24 of the Second Amendment dated November 21, 1975, if District shall fail to make any payment required of it under this agreement within thirty (30) days from the due date thereof, interest at the rate of twelve percent (12%) per annum shall accrue thereon from the due date until paid.

5. Additional Capacity. The parties anticipate that completion of the Phase I Improvements will result in an

increase in the capacity of the existing wastewater treatment plant. City and District each shall be entitled to, and shall have the exclusive right to use, Fifty Percent (50%) of the incremental capacity of the plant resulting from completion of the Phase I Improvements. As used herein, "incremental capacity" means that portion of the plant's total capacity, upon completion of the Phase I Improvements, which is in excess of the plant's present capacity measured as of the effective date of this agreement.

5. No Warranties. City has made no representations or warranties regarding the amount of additional plant capacity that may result from completion of the Phase I Improvements. However, City shall certify to District in writing after Phase I improvements are complete the total amount of incremental capacity available and that portion of incremental capacity to which the District shall be entitled.

6. Effective date. This agreement shall take effect when it has been duly executed by authorized representatives of both City and District.

IN WITNESS WHEREOF, the undersigned, being officers of City and District duly authorized to execute this agreement, subscribe their names on the date(s) shown below.

CITY OF WILLITS

By: _____
Mayor

BROOKTRAILS COMMUNITY SERVICES DISTRICT

By: _____
President, Brd. of Directors

B.C.S.D. REVISION NO. 1
08/31/82

ATTEST:

Frances Walters
City Clerk

ATTEST:

William G. Van Cleve
Secretary to the Brd. of Directors

B.C.S.D. REVISION NO. 1
08/31/82

FOURTH AMENDMENT TO AGREEMENT BY CITY OF WILLITS FOR DISPOSAL OF SEWAGE FROM BROOKTRAILS TOWNSHIP COMMUNITY SERVICES DISTRICT

This Agreement is made this 24th day of July, 2007, by and between the CITY OF WILLITS, a California general law city (the "City"), and Brooktrails Township Community Services District, successor in interest both to Brooktrails Community Services District and Brooktrails Resort Improvement District (the "District").

WHEREAS, the parties make this agreement with reference to the following facts and understandings:

RECITALS

A. On September 11, 1967, City and District entered into a written agreement entitled Agreement by City of Willits for Disposal of Sewage from Brooktrails Resort Improvement District (the "Original Agreement").

B. City and District have now amended the Original Agreement on three separate occasions, by written agreements entered into on April 17, 1970 ("First Amendment"); November 21, 1975 ("Second Amendment"), and September 8, 1982 ("Third Amendment"). By the terms of the Second Amendment, the First Amendment was repealed and rescinded and no longer has any force or effect. The Second Amendment also made substantial revisions to the Original Agreement, and those revisions remain in effect and continue to bind the City and District, except to the extent modified by the Third Agreement.

C. After City and District entered into the Second Amendment, a new wastewater treatment plant was constructed which now serves the City and District. The plant has design flows of 1.3 million gallons per day ("mgd") average dry weather and 3.0 mgd peak flows for the plant results in discharge in violation of the Water Quality Control Plan for the North Coast Basin as adopted by the North Coast Regional Water Quality Control Board ("NCRWQCB") under Order No. R1-2001-71. Consequently, NCRWQCB has subsequently issued Cease and Desist Order No. R1-2001-77 requiring City to cease and desist from discharge and threatening to discharge in violation of WDR Order No. R1-2001-71. The NCRWQCB has subsequently issued additional Cease and Desist orders to City, including its Order No. R1-2006-0108 dated November 29, 2006 amending and supplementing Cease and Desist Order No. R1-2004-0095. Order No. R1-2006-0108, among other things, implements a revised schedule which requires City's completion of designated tasks commencing in January 2007 and concluding on October 1, 2009 concerning City's design and construction of an approved sewer treatment project. A copy of Order No. R1-2006-0108 is attached hereto.

D. In response to the Cease and Desist Order, City has prepared an engineering design report entitled "Preliminary Engineering Report, Wastewater Facilities Upgrade, May 2004" ("PER") and therein has recommended two alternatives to bring the wastewater treatment facility substantially into compliance with the discharge requirements enforced by NCRWQCB. The preferred alternative identified in the PER, adopted by City after extensive environmental review, cannot be permitted by NCRWQCB because of policy conflicts. City is now compelled to construct an alternative which is comprised of three stages:

Stage One: headworks, pretreatment, influent pumping and new electrical system, etc.; Stage Two: new aeration treatment systems, ultraviolet disinfection and control building renovation, etc.; Stage Three: storage lagoon/enhancement wetland, outfall structure and off site mitigation. The estimate of probable cost to construct the three stages is $17,255,538.00 as calculated in March, 2007.

E. City has obtained a commitment from Rural Utilities Services, U.S. Department of Agriculture (the "USDA"), for a grant in the sum of One Million Dollars ($1,000,000.00) and a loan amount of Ten Million, Two Hundred Eighty-Five Thousand Dollars ($10,285,000.00) payable over forty (40) years to construct the new plant (the "USDA loan").

F. City and District wish to share in the cost of the new plant and apportion between them the loan payment responsibility and incremental plant capacity resulting from these improvements. This amendment is intended to address the limited issues of apportionment and payment of costs between the District and the City with respect to the USDA loan described herein. The parties acknowledge that the anticipated total cost of the new plant, as described within Recital D, substantially exceeds the subject loan amount. In accordance with the terms of the Original Agreement and amendments thereto, the parties acknowledge that 37.69% of the total cost of the new plant shall be apportioned to the District and 62.31% shall be apportioned to the City, notwithstanding the fact that this amendment only addresses payment of the subject USDA loan amount.

NOW, THEREFORE, City and District agree as follows:

1. **Effective Agreement.** Except as modified by the express terms of this Agreement, the Original Agreement, as amended by the Second Amendment and the Third Amendment, shall remain in full force and effect.

2. **Apportionment of Costs.** The District shall pay 37.69% of the USDA Loan, being the sum of Three Million, Eight Hundred Seventy-Six Thousand, Four Hundred Sixteen and 50/100ths Dollars ($3,876,461.50) as such loan costs are incurred by the City.

3. **Time and Manner of Payments.** The District's contribution toward the repayment obligation to the USDA shall be paid semi-annually in equal installments on the first day of July and the first day of January each year, commencing on January 1, 2008. The District will have in effect at all times that the loan obligation to the USDA is outstanding an ordinance of the District establishing fees, tolls, rates and other charges for and rules and regulations relating to sewer service, which shall raise gross income and revenues earned thereon (except all refundable deposits made to establish credit), which shall hereinafter be referred to as "Revenues," that, beyond all reasonable doubt, yield a sufficient amount equal to the amounts necessary to make the semi-annual payments required of the District herein.

4. **Separate Sewer Revenue Account.** The Treasurer of the District shall establish a Revenue Fund as a separate fund, into which the Treasurer shall deposit all Revenues as they are collected and received by the District (the "Fund").

5. **Right to Audit.** The City shall have the right to audit, at its expense, District's books, records and accounts to insure that the District is raising sufficient funds and segregating such funds for payment to the City sufficient to pay the District's cost share of the USDA Loan repayment.

6. **Security Interest.** The District shall grant a security interest in the Fund to the City.

7. **Default.** In the event the District is delinquent in any payment to the City as required hereunder, District shall pay a late charge of five percent (5%) of the amount of the delinquent payment.

8. **No Warranties.** City has made no representations or warranties regarding the amount of additional plant capacity that may result from the completion of the improvements contemplated hereunder. However, City shall certify to District in writing within thirty (30) days after improvements are complete the total amount of incremental capacity available and the portion of incremental capacity to which the District shall be entitled, consistent with the District's financial contribution hereunder.

CITY OF WILLITS

By: _____
Ross Walker, City Manager

Attest:

_____
Marilyn Harden
City Clerk

Approved as to form:

_____
H. James Lance
General Counsel

BROOKTRAILS TOWNSHIP
COMMUNITY SERVICES DISTRICT

By: _____
George Skezas, President

Attest:

_____
Michael Chapman
Secretary of the Board of Directors

Approved as to form:

_____
Christopher J. Neary
General Counsel

CHRISTOPHER J. NEARY
ATTORNEY AT LAW
110 SOUTH MAIN STREET, SUITE C
WILLITS, CALIFORNIA 95490
FAX (707) 459 - 3018
cjneary@pacific.net
(707) 459 - 5551

April 14, 2010

Hand Delivered

Bruce Burton
Mayor, City of Willits
111 E. Commercial Street
Willits, CA 95490

Re: *Brooktrails Township Community Services District v. City of Willits*

Dear Mayor Burton:

The Board of Directors understands that the City Council of the City of Willits rejected the offer of Brooktrails Township Community Services District (the "District") to compromise all existing controversies in return for the City's willingness to comply with Section 10 of the Agreement in the future with application to both capital and operation costs. As of now the Brooktrails Board consider the March 18 offer terminated.

We understand that the City Council rejected the March 18 proposal in favor of a strict interpretation of the Agreement, as interpreted by the City Council, that Section 10 applies only to capital costs. The District is respectful of the City Council's position that strict interpretation of the Agreement is in order. The District believes that strict interpretation of the Agreement results in the entitlement to the District of substantial credits for amounts charged to the District well in excess of $800,000, some of which have already been paid, and others which are pending. Therefore, this letter is issued pursuant to Paragraph 23 of the Agreement between the parties.

Specifically, the District states that a number of obligations under the Agreement have been breached by the City of Willits and this letter constitutes a demand that within thirty (30) days of said breach, the City of Willits correct such breaches as described herein. The corrections demanded by the District are as follows:

1. Provide an audit of the City's accounts for the last four fiscal years which separately treat therein the accounts relating to the City Sewage Treatment Plant in

EXHIBIT B

conformity with good municipal accounting practices in sufficient detail to demonstrate that all charges to the District are appropriate under the contract, and documented by compliance with good municipal accounting practices.

2. Account for all charges to the District for capital costs for the past four years in sufficient detail to distinguish between direct costs and indirect costs and further the criteria used for distinguishing between the two types of costs as required by good municipal accounting practices.

3. To provide an audited statement without disclaimer or qualification in accord with Good Municipal Accounting Practices for each of the past four fiscal years.

4. Issue to the District a credit for all direct or indirect operating costs charged to it as capital costs and billed to the District for each of the last four fiscal years.

5. Issue a credit to the District for all operational costs billed to the District for each of the past four fiscal years without compliance of the metering requirements as provided for in the Agreement.

6. Issue a credit to the District for all capital costs charged or demanded of the District within the past four fiscal years which were not in compliance with Section 10 of the Agreement.

7. Issue a credit to the District for all operational charges charged to the District upon a flat indirect cost accounting basis in violation of the accounting standard set forth in the Agreement.

8. Issue to the District a credit for all costs charged to the District for construction and reconstruction of the Willits Sewer Plant currently being bid for want of compliance with the California Environmental Quality Act ("CEQA").

9. Issue a credit to the District for all costs associated with the purchase of land from Walter Niessen in 2003 without obtaining a qualified appraisal, without compliance with CEQA, and without compliance with Section 10 of the Agreement and without segregating project property from non-project property, and without accounting for revenue received from the property.

10. Issue a credit to the District for all costs associated with the acquisition of a fan press without compliance with Section 10 of the Agreement.

11. Issue a credit to the District for all costs associated with the acquisition of a loader without compliance with Section 10 of the Agreement.

12. Issue a credit to the District for all vehicles acquired in the Sewer Capital Account and charged to the District.

13. Issue a credit to the District for the acquisition of all vehicles charged to the District without documentation of usage.

14. Issue a credit to the District for any costs charged to it for capital costs without compliance with Section 10 of the Agreement.

15. Issue a credit to the District for all costs attributed to the District without compliance with applicable federal grants for failure to account for industrial cost recovery.

16. Issue a credit to the Sewer Plant Account for all income received on account of the Sewer Plant, including but not limited to fees, rentals, leachate deposits, and septage deposits, proportional to charges to the District.

17. Issue a credit to the District for all income received on account of the Sewer Plant by way of refund, including but not limited to refunds by Pacific Gas & Electric, and insurance refunds.

18. Issue a credit to the District for all costs charged to the District in violation of the requirement for providing a timely audit prior to October 1 of each fiscal year with such audit being in compliance with the terms of the Agreement as otherwise identified herein.

For purposes of this demand for cure, audits in compliance with the terms of the Agreement received on or before February 1 of each year will be treated as being timely under the Agreement.

19. Credit the District with all charges to the Sewer Plant Account for "in lieu franchise fees."

20. Credit the District for all charges billed to the District for costs attributable to the City's sewer distribution system other than those specifically agreed to in writing by the District.

21. Credit the District for all office equipment charged to the Sewer Capital Account, including but not limited to office furniture currently located at the Public Works Department.

22. Credit the District for all costs charged to it related to legal fees incurred in relation to the City's failure to comply with the laws required by the Agreement, and for litigation with third party property owners.

23. Credit the District for all charges to it for lining City sewer mains.

24. Credit the District for the misstatement of actual charges charged to the District on the basis of estimation, rather than actual incurrence, as required by the Agreement.

Yours very truly,

[DICTATED BUT NOT READ]

CHRISTOPHER J. NEARY

CJN.jen

cc: BTCSD Board of Directors
Jim Lance, Esq. (via hand delivery)
Paul Cayler (via hand delivery)

H. JAMES LANCE
ATTORNEY AT LAW

3000 ROBINSON CREEK ROAD
UKIAH, CALIFORNIA 95482
(707) 463-1075

FAX: (707) 462-9386
e-mail: lancelaw@pacific.net

May 13, 2010

George Skezas, President BTCSD
C/O Brooktrails Township
Community Services District
23860 Birch Street
Willits, CA 95490

Re: BTCSD Demand for Cure dated April 14, 2010

Dear President Skezas,

The Willits City Council has carefully considered the letter from District Counsel Chris Neary dated April 14, 2010 to Mayor Burton in which Mr. Neary, on behalf of the District, asserted that the City is in material breach of the parties' agreement. In that letter the District demanded that the City cure each of the 24 alleged breaches and issue monetary credits to the District. The Council has authorized me to submit the following response.

1) Provide an audit of the City's accounts for the last four fiscal years which separately treat therein the account relating to the City Sewage Treatment Plant in conformity with good municipal accounting practices in sufficient detail to demonstrate that all charges to the District are appropriate under the contract, and documented by compliance with good municipal accounting practices.

The City has provided audited financial statements to the District for the last four fiscal years as required by the Agreement. Further, an Agreed-Upon Procedures report was provided for FY 2007/08. It is the City's intention to provide an Agreed-Upon Procedures report for FY 2008/09 and the City has contracted with R.J. Ricciardi, Inc. to provide this report. City staff had been waiting for good faith negotiations to conclude with regards to the Niesen land purchase, the Caterpiller loader, and the Rotary Fan Press prior to completing the Agreed-Upon Procedures report. The City is willing to discuss the need to produce additional audit reports, their content and a reasonable time frame for their production.

EXHIBIT C

2) Account for all charges to the District for capital costs for the past four years in sufficient detail to distinguish between direct costs and indirect costs and further the criteria used for distinguishing between the two types of costs as required by good municipal accounting practices.

See attached.

3) To provide an audited statement without disclaimer or qualification in accord with Good Municipal Accounting Practices for each of the past four fiscal years.

The City has provided audited financial statements to the District for the last four fiscal years in accordance with paragraph 14 of the agreement. The parties' agreement does not require that the City provide audited statements without disclaimer or qualification. See also the City's response to item 1 above.

4) Issue to the District a credit for all direct or indirect operating costs charged to it as capital costs and billed to the District for each of the last four fiscal years.

The City will review and reclassify if appropriate, any operational costs identified by the District which it believes were incorrectly billed within the last four years as capital costs.

5) Issue a credit to the District for all operational costs billed to the District for each of the past four fiscal years without compliance of the metering requirements as provided for in the Agreement.

The City and the District agreed to utilize the operations percentage of 23.62% until such time as the metering station at the treatment plant was replaced. This has now been completed, and the City anticipates that accurate readings will be available for the current dry weather flow season beginning May 1, 2010.

6) Issue a credit to the District for all capital costs charged or demanded of the District within the past four fiscal years which were not in compliance with Section 10 of the Agreement.

Please provide the authority relied upon for this demand. Please also identify each of the capital costs referred to in this demand, and the basis for the assumption that such costs were charged or demanded without compliance with Section 10.

Section 10 does not describe any required procedures for the parties to follow with respect to the District's review of plans, specifications or cost estimates. As such, the District's assertion that the City has failed to comply with its terms is disputed.

Section 10 does not set forth any consequences for the violation its terms. Specifically, Section 10 does not state that the District shall be entitled to a credit for capital expenditures made by the City without prior comment or review by the District. Further, Section 10 does not specifically identify the type of cost to which it applies. Section 10 does not expressly refer to "capital costs." Instead, the only specific reference to "capital costs" or to the replacement of plant equipment, machinery or facilities is within Sections 12 and 17.

Section 10 must be read in the context of Sections 8, 8A and 9, which immediately precede it. Collectively, these sections address (1) the City's obligation to make improvements to the plant which will result in improving the quality of its effluent or meet other requirements of State and Federal agencies; (2) the apportionment of those costs; (3) the City's right to select engineers to design such improvements to produce an efficient and economical cost; and (4) the District's right, with the advice of its engineers, to review and make suggestions concerning these plans. In short, Section 10 is obviously a continuation of sections 8, 8A and 9. As such, the scope of Section 10 is limited to the District's review of plans, specifications and costs estimates of quality related plant improvements which may be required by State or Federal agencies.

The approval of the recently completed plans and specifications for the new waste water treatment plant project was subject to Section 10. The District had the right to review and comment on the City's completed plans for Phases II and III of the project. The District did not exercise that right and the City had no affirmative obligation to invite the District to comment. The District's failure to exercise its right to comment on the plans does mean that the District is now relieved of its obligation to contribute toward the project or that it is entitled to a credit.

In addition to the foregoing, the District's demand for a credit or refund for past capital payments is unreasonable. By making payment on past capital costs charged by the City the District accepted its obligation for such costs and waived any right to later assert that it was deprived of an opportunity to make suggestions or to review information related to that expense.

The District's interpretation that Section 10 applies to every capital cost of the plant, including the cost of replacing worn out or broken equipment is wrong. That interpretation ignores the context and relevance of Section 10 to Sections 8, 8A and 9. The District has apparently developed the belief that its approval is required before the

City makes any capital expenditure; and that it is excused from contributing toward any capital expenditures unless it was first prompted by the City to review plans, specifications and cost estimates. This theory is incompatible with the facts, as set forth within Section 3, that the City owns the treatment plant, and all future improvements thereto; that the plant is the exclusive property of the City and the City has the sole jurisdiction over its operation and possession; and that the City, not the District, has the risk of liability in the treatment and disposal of wastewater, the responsibility for compliance with all applicable regulations and the obligation to pay any assessed penalties and fines which could result from noncompliance. The District's reliance on Section 10 to avoid its payment obligations is also inconsistent with the parties' accepted course of action for the allocation and payment of plant related expenses for the past 35 years.

For each of the foregoing reasons, the City asserts that it has no obligation pursuant to Paragraph 10 of the Agreement to issue any credit to the District.

7) Issue a credit to the District for all operational charges charged to the District upon a flat indirect cost accounting basis in violation of the accounting standard set forth in the Agreement.

The Agreement does not specify what costs were intended to be included as administration costs of the treatment plant. Section 16 refers to "all costs of administration" which means both indirect and direct costs. The City has no reason to believe that it is in violation of the accounting standards set forth in the Agreement. Please provide further information to explain the accounting practice referred to and the provisions of the Agreement which you contend have not been complied with.

8) Issue to the District a credit for all costs charged to the District for construction and reconstruction of the Willits Sewer Plant currently being bid for want of compliance with the California Environmental Quality Act ("CEQA").

No credit is owed. Please indicate the basis for your assumption of noncompliance with CEQA.

9) Issue a credit to the District for all costs associated with the purchase of land from Walter Niessen in 2003 without obtaining a qualified appraisal, without compliance with CEQA, and without compliance with Section 10 of the Agreement and without segregating project property from non-project property, and without account for revenue received from the property.

This matter is the subject of the District's pending lawsuit against the City for declaratory relief. District demands for Niesen related credits will only be addressed in the context of the litigation.

10) Issue a credit to the District for all costs associated with the acquisition of a fan press without compliance with Section 10 of the Agreement.

As stated above, Section 10 has a very limited application which does not include costs to acquire or replace plant equipment. In any event, the District was made aware of the City's anticipated purchase of the fan press in April of 2008. At that time the District made specific reference to the fan press purchase, and the allocation of that expense, in the preparation of its 2008/2009 budget dated 04/21/2008. Despite its advance knowledge of this potential purchase, and the District's reference of the fan press expense within its budget, the District neglected to request information or make any suggestions or comments regarding the purchase. Under the circumstances, the District's demand for a credit and the assertion that the purchase was made in violation of Section 10 is unreasonable.

By operation of the doctrines of waiver and estoppel, the District has effectively lost its right to assert that the purchase was made without an opportunity to request review or to make comments. Further, for each of the reasons set forth in response to item 6, above, the City disputes the District's assertion that it is entitled to a credit; or that the purchase was made without compliance with Section 10; or that this capital purchase was even subject to Section 10 inasmuch as Section 10 is limited to the District's review of planned, engineered improvements and does not apply to the City's purchase of necessary plant equipment or machinery.

11) Issue a credit to the District for all costs associated with the acquisition of a loader without compliance with Section 10 of the Agreement.

It is the City's interpretation that paragraph 10 applies only to engineered plant improvements as outlined in paragraphs 8, 8A and 9, and not to capital costs as outlined in paragraphs 12 and 17. Historically, capital purchases have been billed to the District on a "cash basis" which is why interest and depreciation are excluded from the annual compilation report. All finance charges paid by the City were excluded from the amount billed to the District. Please also see response to item 6, above.

12) Issue a credit to the District for all vehicles acquired in the Sewer Capital Account and charged to the District.

The City is willing to issue a credit to the District in the amount of $7,538 for the Vactor Truck purchased in FY 2006/07.

13) Issue a credit to the District for the acquisition of all vehicles charged to the District without documentation of usage.

The City will provide estimates of usage of all vehicles charged to the District within the past four years.

14) Issue a credit to the District for any costs charged to it for capital costs without compliance with Section 10 of the Agreement.

It is the City's interpretation that paragraph 10 applies only to engineered plant improvements as outlined in paragraphs 8, 8A and 9, and not to capital costs as outlined in paragraphs 12 and 17. Please also see response to item 6 above.

15) Issue a credit to the District for all costs attributed to the District without compliance with applicable federal grants for failure to account for industrial cost recovery.

There were no charges allocated to the District without compliance with applicable federal grants for failure to account for industrial cost recovery.

16) Issue a credit to the Sewer Plant Account for all income received on account of the Sewer Plant, including but not limited to fees, rentals, leachate deposits, and septage deposits, proportional to charges to the District.

There is no provision in the agreement that requires the City to credit the District for revenues received from the Sewer Plant with the exception of the sale of water or other by-products as stipulated in Section 16. There are no revenues of this nature during the previous four years.

17) Issue a credit to the District for all income received on account of the Sewer Plant by way of refund, including but not limited to refunds by Pacific Gas & Electric, and insurance refunds.

The City is willing to issue a credit to the District for Insurance Premium returns, allocated in the same percentages as charges for insurance. Additional time will be required to allow City staff to calculate these credits.

18) Issue a credit to the District for all costs charged to the District in violation of the requirement for providing a timely audit prior to October 1 of each fiscal year with such audit being in compliance with the terms of the Agreement as other identified herein. For purposes of this demand for cure, audits in compliance with the terms of the Agreement received on or before February 1 of each year will be treated as being timely under the Agreement.

The agreement does not specify what remedies are available to the District for the City's failure to provide audit reports by October 1 of each fiscal year. A great effort has been made by City staff over the last two years to bring the City's financial reports up to date, despite adverse circumstances beyond the City's control. This effort was commended by the District Board and staff on many occasions. The audit report for Fiscal Year 2008/09 was completed by February 5, 2010.

19) Credit the District with all charges to the Sewer Plant Account for "in lieu franchise fees."

There were no charges to the District for "in lieu franchise fees" during the previous four years.

20) Credit the District for all charges billed to the District for costs attributable to the City's sewer distribution system other than those specifically agreed to in writing by the District.

There were no charges to the District for costs attributable to the City's distribution system during the previous four years.

21) Credit the District for all office equipment charged to the Sewer Capital Account, including but not limited to office furniture currently located at the Public Works Department.

Section 16 states that "All costs of administration ...shall be apportioned annually by the City." The agreement does not specify what the parties intended to include or exclude as administration costs of the treatment plant. The acquisition of office equipment and office furniture, to the extent such items are used in connection with the administration of the plant, are necessary and appropriate costs of administration.

22) Credit the District for all costs charged to it related to legal fees incurred in relation to the City's failure to comply with the laws required by the Agreement, and for litigation with third party property owners.

The City objects to this demand on the grounds that is vague, ambiguous and unintelligible in that it fails to identify the fees, the laws or the litigation referred to; it is also overbroad by the failure to limit application of the demand to any reasonable time frame.

23) Credit the District for all charges to it for lining City sewer mains.

There were no charges to the District for lining City sewer mains during the previous four years. The District paid $29,000 in FY 2005/06 for lining the sewer pipe that exclusively carries the District's outflow to the treatment plant. Allocation of this cost was agreed to by the District General Manager.

24) Credit the District for the misstatement of actual charges charged to the District on the basis of estimation, rather than actual incurrence, as required by the Agreement.

The alleged misstatement, the charges referred to within this request and the referenced provisions of the Agreement have not been identified or described in any manner whatsoever. As such, this request is vague, ambiguous and unintelligible as presently written. Please clarify this request with sufficient detail to describe your claim and the basis for the demanded credit.

I have enclosed for your review a copy of the City's Answer to the District's lawsuit for declaratory relief.

Yours very truly,

H. JAMES LANCE
Willits City Attorney

HJL:ds

Enclosures 2

cc: BTCSD Board Members
Willits City Council
Paul Cayler, Willits City Manager
Christopher J. Neary, Esq. (By Fax and U.S. Mail)

2 Capital Costs charged to the District:

			Direct Charge	BTCSD Share
2005/06	Sprinkler/Irrigation Guns		2,461	928
	Sewer Pump		28,948	10,911
	Sewer Pump		7,403	2,790
	Clarifier Upgrade		130	49
	Clarifier Upgrade		1,238	467
	Hose Fittings		2,073	781
	Water Level Monitors		1,619	610
	EIR/LTD		(1,059)	(399)
		Total	42,813	16,137
		Rounding		(1)
		Total 2005/06	42,813	16,136

There were no indirect costs charged to the District for capital costs in FY 2005/06

			Direct Charge	BTCSD Share
2006/07	Pump repair - treatment plant		6,239	2,351
	Pump repair - treatment plant		3,517	1,326
	Pump repair - treatment plant		6,239	2,351
	Vactor truck		20,000	7,538
	Construction in Progress - WWTP - Net of Grant Revenues Recei		947,814	357,231
	EIR/LTD		880	332
		Total 2006/07	984,689	371,129

There were no indirect costs charged to the District for capital costs in FY 2006/07

			Direct Charge	BTCSD Share
2007/08	Pump repair - treatment plant		4,370	1,647
	Compact Samplers		6,012	2,266
	Construction in Progress - WWTP - Net of Grant Revenues and Loan Funds Received		133,446	50,296
		Total 2007/08	143,828	54,209

There were no indirect costs charged to the District for capital costs in FY 2007/08

			Direct Charge	BTCSD Share
2008/09	Tractor with Flail Mower		17,439	6,573
	Rotary Fan Press		222,061	83,695
	Caterpillar Loader (Principal Portion only)		127,724	48,139
		Total 2008/09	367,224	138,407

There were no indirect costs charged to the District for capital costs in FY 2008/09

CHRISTOPHER J. NEARY
ATTORNEY AT LAW
110 SOUTH MAIN STREET, SUITE C
WILLITS, CALIFORNIA 95490
FAX (707) 459 - 3018
cjneary@pacific.net

(707) 459 - 5551

August 16, 2010

Bruce Burton, Mayor
City of Willits
111 E. Commercial Street
Willits, CA 95490

Re: Brooktrails Township Community Services District -
Demand for Audit in Compliance with Agreement

Dear Mayor Burton:

This letter responds to your Finance Director's invitation to comment upon City audit practices. This letter also demands that the City bring its audit practices into compliance with the sewage disposal agreement between Brooktrails and the City (the "Agreement").

To bring the City audit practices into compliance with the agreement the City must enter into an engagement with a qualified, licensed, independent outside accountant for preparation of an Attestation Engagement Audit concluding that the amounts charged to Brooktrails are in conformity with the Agreement, are supported by "good accounting practices" and by sufficient proof and in conformity with the Agreement.

The engagement must provide for a delivery date of no later than February 1, 2011 for the FY 2009-10 Attestation Audit.

Furthermore, this letter demands issuance of a credit to Brooktrails of the sum of $1,897,786 representing the amount paid to the City for the Fiscal Years 2004-05; FY 2005-06; FY 2006-07; FY 2007-08; and FY 2008-09 without compliance with the audit requirements of the Agreement. In the alternative to issuing such credit, the City may cause to be prepared an Attestation Engagement Audit for those years whereupon the credit would be reduced by those amounts shown by such audit as being in compliance with the Agreement.

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In the first instance, Brooktrails expects that the City will issue a credit to Brooktrails in the sum of $1,897,786 within thirty days. However, if during that period the City provides Brooktrails with sufficient evidence that the City has engaged an auditor for preparation of an Attestation Audit for the aforementioned fiscal years, Brooktrails will await a reasonable period to permit the City sufficient time to prepare such audits.

Independent of all of the foregoing, the Brooktrails Board, mindful of its position that it is entitled to massive credits for overcharges to it, will consider at its first meeting in October whether or not to suspend all payments to the City until such time as the issue of credits is resolved. A major factor in that decision will be whether or not the City cooperates in addressing the need to provide the audits contemplated by the Agreement.[1]

Background Events

A. Brooktrails' Efforts to Resolve Overcharging

Brooktrails has attempted to resolve the systematic effort by the City of Willits to maximize its recovery from Brooktrails under the contract by accounting practices which are far beyond the contemplation of the Agreement. Prior to filing litigation in this matter, Brooktrails attempted to resolve the problems perceived by Brooktrails in three ways: (1) proposing the creation of a joint powers agency which would separate sewer operations from the City budget; (2) bringing the audit of the City's sewer operations into compliance with the Agreement between the entities; and lastly, (3) requiring strict compliance with Section 10 of the Agreement and expanding it to provide advance notice of operational expenses in excess of $25,000. Each of these proposals attempted to address the need for Brooktrails to verify that its ratepayers are not being overcharged, especially in the context of Brooktrails having discovered that the City had assigned many non-recoverable costs under the Agreement to Brooktrails and had utilized a variety of mechanisms to conceal the fact that it was taking the

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[1] In any event, Brooktrails will pay on an ongoing basis its share of payments to the USDA under the Fourth Amendment because those obligations relate to bond issuance. However, in making any such payments, Brooktrails will reserve recourse against the City for reimbursement for any general City overhead charged to the Sewer Project and reimbursed by USDA. Likewise, Brooktrails will pay on an ongoing basis its share of payments to the USDA for such amounts as governed by any Fifth Amendment which may subsequently negotiated and executed. At this point the Fifth Amendment document signed by Brooktrails and delivered to the City is deemed terminated by reason of the Council's rejection.

interpretations enabling such overcharges.

Brooktrails suggested the creation of a joint powers agency which would be administered by a four person board consisting of the respective managers and a policy appointee from each agency. This proposal would have resolved all potential issues because the JPA would prepare a separate budget for the sewer treatment plant operations and remove any possibility that charges for general city overhead and operation of the City sewer collection systems did not end up being allocated by the City as a Sewer Operation expense and passed on for payment to Brooktrails in violation of the Agreement. This proposal was never dignified by any response from the City. It should be noted that the JPA would accomplish the segregation of sewer treatment plant operations from sewer collection operations which is already mandated by the existing Agreement, but has been ignored by the City.

Brooktrails also demanded repeatedly in writing that the City comply with the Agreement and provide Brooktrails with an audit of the sewer treatment expenses by a time certain each year. Specifically, Brooktrails complained that City Staff began interpreting the requirement to provide an audit merely as being a requirement to provide a qualified balance sheet presentation upon which the auditor expressed no opinion and made clear that Brooktrails was not entitled to rely upon the document. Brooktrails was not only alarmed that the City unilaterally asserted a contractual interpretation for the audit requirement with which the District disagreed, but that the interpretation was also accompanied by a substantial increase in the City's allocation of expenses to sewer operations. Brooktrails' alarm was heightened by the fact that the City went for at least two consecutive years without providing any audited financial information in any form to Brooktrails, the public, its lenders, or its policy makers. This was not only a violation of the Agreement, but was also a serious, virtually unprecedented, violation of the City's financial reporting requirements under the law.

Lastly, in an effort to bring accountability to the situation, Brooktrails suggested that the City strictly comply with Section 10 of the Agreement requiring advance notice to Brooktrails for certain transactions.

Audit Requirements

A. Contractual Requirements for Financial Reporting.

The Agreement requires that the City cause an audit of the account relating to the sewer treatment plant:

"The City shall annually cause to be made an audit of its

> accounts for the previous fiscal year which shall separately treat therein the accounts relating to the City sewage treatment plant. On or before October 1 of each year, the City shall deliver to the District's Manager a copy to the parts thereof relating to its sewage treatment plant."

The Agreement also provides a standard for the City's accounting standards:

> "The City shall establish and maintain accurate accounts of all capital costs as to its sewage treatment plant, ***separate and distinct from all other accounts*** of the City, ***in conformance with good municipal accounting standards.***"
>
> . . .
>
> "The City shall establish and maintain books of account of all costs of administration, maintenance, operation and repair of the City treatment plant, separate and distinct from all other accounts of the City, and distinct from capital improvements thereto, ***in conformity with good municipal accounting practices.***"
>
> . . .
>
> "City shall budget and keep and maintain books of record and accounts which shall reflect, separately from its sewage collection system, records and accounts of its costs of administration, maintenance, operation and repair of its sewage treatment and disposal work and system, and of new construction, ***in sufficient detail and categories that the different categories and proofs of costs may be reasonably ascertained.***"

B. Attestation Audit Required.

As relevant here, there are two types of audits: (1) "Financial Statement Audits" designed to provide users of financial reports with assurance concerning their reliability; and (2) "Attestation Engagement Audits" designed to provide assurance on matters other than financial reports. The two types of audits are not mutually exclusive of each other and typically the same auditor produces an audit document complying with both audit requirements.

Financial Statement Audits are conducted in accordance with Generally Accepted Auditing Standards ("GAAS") which are established by the Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA). The requirements for Attestation Audits provide additional standards which are set forth in the U.S. General Accounting Office publication, "Government Auditing Standards" ("GAO"). The combination of GAAS standards with GAO standards are simply referred to as "Generally Accepted Government Auditing Standards," ("GAGAS"). For Attestation engagements the appropriate guidelines are set forth by the AICPA's Attestation Standards which are supplemented by the GAO published standards in what is commonly referenced as the "Yellow Book." The Agreement's reference to "good municipal accounting practices" incorporates these standards into the Agreement.

The Agreement contemplates that the audit will attest that the charges to Brooktrails are in conformity with the Agreement, hence, the requirement is for an Attestation Engagement Audit. There is no doubt that the audit requirement is stated in the Agreement so that Brooktrails will have assurance that the amount billed to it is proper and is supported by sufficient "proof" in the form of documentation, as is specifically required by the Agreement. The reference to an audit requirement certainly is not for the purpose of advising Brooktrails as to the status of City finances. Instead, the City has merely provided documents prepared by a CPA loosely referenced as an "audit" but which are merely a purported representation of the City Financial Statements, with disclaimers that effectively qualify the representations as not rising to the level of an audit upon which Brooktrails could rely.

In that the City has been the recipient of federal funds, it is likely that its audit will be required by the USDA and EPA to comply with the Single Audit requirements. For such an audit, your auditor would be required to report on their tests of internal controls over compliance with federal award programs describing both the scope of the testing and the results, and to express an opinion or disclaimer of an opinion on whether the City complied with laws regulations, and provisions of contracts or grant agreements that could have a material effect on the program. Auditors preparing a Single Audit are required to prepare a Schedule of Expenditures of Federal Awards and to express an opinion on whether the Schedule is fairly presented in all material respects in relation to the basic financial statements. This examination should be sufficient to reveal whether there has been a systematic effort to include non project costs in the accounting system for a federal project such as the City assignment of general overhead costs to the USDA Project and the Safe Streets Grant.

Stated another way, the City Council and its lenders may have an interest in the City's overall financial condition such as would be revealed by a Financial Statement

Audit, but the Agreement provides that Brooktrails be supplied with an Audit which assures it that the charges to it are properly supported by documentation and reflect supportable reimbursements. The City has treated the Agreement as an authorization for the City to periodically receive a blank check from Brooktrails whereupon the City fills in the amount of its choosing. The Agreement does not contemplate this.

The City's position as to financial accountability has concealed the City's systematic overstatement of its expenses for operating the sewer treatment plant. Perhaps the easiest way to illustrate this is that the most current information from City Staff for FY 2009-10 indicates that the administration expenses for operating the sewer plant are $356,785, when the cost of operations is $605,634. This translates to an alleged cost of administration as 59% of the operations being administered.

C. Indirect Administration Cost Assignment Requires Documentation.

As expenses for administration are reviewed, one has to differentiate between direct and indirect costs. It is one thing to invoice Brooktrails with direct administration costs. Some administration costs are so direct as to admit of no controversy. However, for one entity to charge another with incurred indirect costs, "***good municipal accounting practices***" would, at the very least, require the agency to have an Indirect Accounting Cost Recovery Plan in place to provide guidance to City staff for every day allocation decisions. Furthermore, an Attestation Audit would measure performance in accord with accounting standards under that plan ***and*** verify that indirect charges are supported by "proof" as required by the Agreement. The accounting measure of "proof" is documentation such as time cards and auditable criteria for allocations.

Instead all of the indirect costs by the City for the years that Brooktrails is demanding by this letter that an audit in conformity with the Agreement be provided, have been posted to the accounts arbitrarily by City Staff with no guidance other than the culture which the City Council has expressly condoned. That culture is best summarized as being, "load as many expenses into the sewer operating account as possible." Not only does your staff routinely post questionable "administration" expenses, but Brooktrails learned earlier this year that the City also, in addition, imposes an across-the-board "administration" fee which your Finance Director was unable to explain either the origin, or justification. She reported to us, "it has always been done that way."

It is submitted that such matters should have been apparent to your auditing firm and addressed by it. An example is found in the City's defense of billing Brooktrails for a share of the costs for refurnishing the Public Works Department with

elegant wood furniture as an administration expense for the sewer treatment plant. This illustrates the absurdity of the City's allocations to administration expenses.

Efforts by Brooktrails to bring the relationship into conformity with good municipal accounting practices has been met by a stone wall from past, ***and current*** City staff as well as the City Council. Recently your Finance Director advised Brooktrails that the City would engage its auditing firm in the same manner as prior years unless Brooktrails has an objection. This letter constitutes an objection.

It is submitted that the City's practice is not in the best interests of either the City ratepayers or District ratepayers. Furthermore, the Council's irresponsible position that "Brooktrails is just a customer" and the City Council's opposition to clarifying Section 10 of the Agreement to provide an alternative means for financial accountability leads Brooktrails to demand that the Agreement be strictly complied with, both as to Section 10 and to the Audit standard required by the Agreement. The Council's recent delegation to the City Manager of sole discretion over a million dollar change order to avoid the requirements of Section 10 is not only financially irresponsible, but in bad faith avoidance of existing Section 10 requirements.

D. Structural Problems of Purported Audit as Presented.

The use of the term "audit" in the Agreement contemplates that Brooktrails will receive assurance in the form of an audit that the charges to it are in compliance with the Agreement. Brooktrails asserts that for at least each of the past four years the City has not been in compliance with either the letter, or the spirit of the Agreement.

While the District is appreciative that the "audit of financial statements" presented for FY 2008-09 was timely for the first time in eighteen successive years, any resolve by the current city administrators to correct the City's failure to provide timely review of its financial performance, the document produced by R.J. Riccardi, Inc. fell far short of the requirements of the Agreement.

A *prima facie* failure of the purported audit begins with the June 16, 2009 "understanding" between the City Staff and the Ricciardi firm. In violation of the Agreement the "understanding" provides that the report to be produced by Ricciardi is not intended for the "information and use" of Brooktrails and that the resulting document was "not intended to be and should not be used" by Brooktrails. In furtherance of this "understanding," a letter was appended to the purported audit dated January 21, 2010 asserting that Brooktrails could not even use the "audit." There can be no more fundamental principle but that our Agreement contemplated that Brooktrails would be assured that the City's billing to it was accurate and that the

assurance would take the form of an "Audit" meeting certain standards and that it could "use" the audit to enjoy some measure of assurance that it was not being overcharged.

Had the purported audit not expressly excluded reliance by Brooktrails, the purported "audit" was so riddled with accounting double talk that is was essentially meaningless, even if use was permitted by Brooktrails. Examples of this double talk are:

- As to whether the City's financial statements were free of material misstatement as it related to compliance with contracts such as the Agreement with Brooktrails, your "auditor" stated that "providing an opinion in compliance with those provisions was not an objective of our audit and accordingly we do not express an opinion."

- As to the Statement of Revenues and Expenditures your "auditor" stated, "we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information."

- As to the consideration of the City's internal control over financial reporting your "auditor" referred to a document outside the "audit."

These qualifications are not confidence instilling. It is submitted that the City and the Ricciardi firm have gone out of their way to qualify the so-called "audit" so that it does not even approach the utility contemplated by our Agreement. The Agreement contemplated that Brooktrails would be assured that the charges to it which are presented to the City of Willits in summary format are consistent with the requirements of the Agreement. Instead, the arrangement between the Ricciardi firm and the City makes no effort whatsoever to even address the requirements of the Agreement as it relates to providing assurance to Brooktrails that it is not being cheated by the City.

To be clear, Brooktrails does not expect to be informed as to the financial condition of City balance sheets, but rather to have an outside auditor attest that the charges to Brooktrails are consistent with the Agreement and are supported by written documentation in accord with good municipal accounting practices.

E. The Audit Deficiencies Are Not Unintentional

Recently Brooktrails discovered the circumstances by which the Ricciardi firm was retained. The City's prior auditor, Odenberg, Ullakko, Muranishi & Co. withdrew

in the midst of an audit from its contract to provide auditing services to the City in 2005 for specific reasons well known to the Ricciardi firm and to the City. It is significant that the Ricciardi firm, knowing that Brooktrails has been billed for and had paid a percentage of substantial costs which had been questioned by a City employee as being fraudulent and illegal made no disclosure of such fact. By this letter Brooktrails notifies the Ricciardi firm that it will be held responsible for any overt acts to assist the City in systematically overcharging Brooktrails.

Brooktrails now understands that the Ricciardi firm accepted an engagement from the City knowing that hundreds of thousands of dollars of expenses allocated to Brooktrails had been questioned by the City's Finance Director. It is immaterial whether the allegations were deemed meritorious - these allegations should have been disclosed. They were not. Instead of disclosing this material fact in the "Audit," the City and the Ricciardi firm undertook a series of "audit" arrangements which not only failed to disclose this information, but concealed the failure to disclose through a guise of accounting double talk. This double talk when translated to understandable prose translates to "Brooktrails may not rely upon this 'Audit,' and by the way, this not really an audit."

We do know that an effort to conceal information from Brooktrails and the public was furthered by your City Manager's report to the Council regarding the withdrawal of the Odenberg, Ullakko, Muranishi & Co. as the City's auditor by the written misstatement, "it was determined that our current auditing firm Odenberg is unable to meet the City's needs for auditing services for fiscal year ending 2005." This statement was and is misleading in that it omitted material information and incorrectly implied that the City unilaterally terminated the relationship. The fact of the matter is that the audit firm withdrew in part due to allegations by your then current Finance Director that the City was breaking the law. This Finance Director later, at great cost to herself, resigned her position in protest.

The regimen of financial disclosure and accountability designed by the City with the cooperation of its "auditor" provides absolutely no assurance that the City's payment demands to Brooktrails are legitimate. Brooktrails concludes that the *status quo* is a desired result for the City. This conclusion is fortified by the City's summary rejection of the Brooktrails settlement proposal, its interpretation of Section 10 of the agreement so as to render it meaningless, its failure to provide an audit as that term is commonly understood in the context of this relationship, and the City's failure to even consider a clarification of Section 10 so as to substantially reduce the opportunity for disagreement.

F. Deficiencies Have Led to Substantial Overcharges for the Sewer Project.

We are being told that the sewer plant project is a $23.5 million project (although additional engineering expenses in excess of a million dollars is excluded from that total). As the Council is aware, the actual construction costs for Phase I, which undoubtedly includes some engineering expenses, was $3.7 million. The bid submitted by Overaa was $11.1 million for a total construction cost of $14.8 million. Therefore, the non-construction cost of this project is $8.7 million and those costs are primarily engineering expenses, or at least $9.9 million dollars taking into account other engineering costs which were charged to Brooktrails, but are not accounted for as "project costs" to the USDA.

Ponder that for a moment. The non-construction costs of this project represent 40% of the construction costs. In contrast, the City of Ukiah using a recognized engineering firm with experience in sewer plant construction recently completed its sewer plant project and its engineering expenses represented 21% of the construction costs.

The disparity in the ratio of engineering expenses to construction costs is in part because City Staff, in its zeal to apportion as much of its general overhead as possible to the sewer project, loaded non-project expenses into the sewer project to maximize its recovery from Brooktrails, USDA and EPA. This was to the detriment of Brooktrails which ends up paying 37.69% of non-recoverable costs, mostly paid to one local firm, and also abuses USDA and EPA, both of whom have provided project financing. It is one thing for the City Council to preside over the systematic misrepresentation of expenses to its neighbor, Brooktrails, but quite another for the City to apply federal funds awarded for a sewer project to non-sewer project expenses. The Council should inquire as to whether the City has been contacted by the Inspector General of the EPA and further what the potential consequences might be for any misapplication of federal grant funds.

Furthermore, the City Council should be aware that a substantial portion of the engineering expenses for the sewer project were incurred as a product of the City entering into a succession of no bid contracts with the firm which then served as its City Engineer. Your "City Engineer" who also served as "Project Manager" for substantial periods of the sewer plant project was a sole proprietorship whose principal was not a licensed engineer, but rather a surveyor. One only need look at the imbalance of the non-construction costs to projected actual construction costs of an unbuilt project to gain an appreciation as to exactly how lucrative it has been for this engineering firm, and the negative impact of the City entering into a succession of no-bid contracts.

Also compare the Ukiah experience where the non-construction costs totaled 21% of the construction costs, where Ukiah complied with the bidding requirements and utilized "experienced and recognized engineers" as required by our Agreement. In addition the City of Ukiah Plant is built and online while it remains to be seen whether the current design of the Plaint will ever be built, or if built, will meet the permit requirements.

It should also be noted that the accounting practices that lead to the overcharging of Brooktrails also overcharges City ratepayers. The attitude which is summarized as "Brooktrails is just a customer" demonstrates contempt not only for Brooktrails, but also for City ratepayers.

Demand for Separation of Accounts

The Agreement requires the City to maintain the sewage treatment plant account in a separate account distinct from all other accounts. While it is believed that the City likely does so, the most recent "audit" does not separate the accounts. See for example pages 18-20 of the 2009 audited Financial Statement which references a "Sewer Enterprise Fund" but without defining the discrete functions. This blending of the accounts with one "enterprise fund" leaves open the question whether administration costs for the City's sewer collection system, direct and indirect, are properly identified and segregated. This letter also demands correction of this in your development of a contract for audit services.

Correction of Default

Your correction of the deficiency as it applies to the audits contemplated by the Agreement should be made within thirty days of this letter. Absent correction as demanded Brooktrails will amend the pending lawsuit accordingly; and reserve all available options.

Yours very truly,

BROOKTRAILS TOWNSHIP COMMUNITY SERVICES DISTRICT

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September 16, 2010

Christopher Neary
BTCSD General Counsel
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Re: Response of the City Council of the City of Willits to the Brooktrails Township Community Services District "Demand for Audit in Compliance with Agreement"

Dear Mr. Neary,

The Willits City Council has carefully considered the arguments and the demands asserted on behalf of the Brooktrails Township Community Services District in your letter of August 16, 2010 addressed to Mayor Bruce Burton. The Council approves the following response and settlement proposal.

The demand for an attestation engagement audit appears to be a new twist to an old issue. For many years your client has expressed its displeasure with the conditions and disclaiming statements contained within the audit reports of the sewer treatment plant. Your letter of August 16, 2010, however, appears to be the first time in 35 years that Brooktrails has asserted its position that the reports contemplated by the parties' agreement must be attestation engagement audits subject to the standards and guidelines set forth by the American Institute of Certified Public Accountants (AICPA). As discussed herein, the parties' disputes are attributable to the uncertain language of Sections 14 and 16 of the agreement. Unless the agreement is amended the disputes will likely continue.

The Subject Agreement is not Amenable to an Attestation Audit

The parties' agreement, as you know, makes no specific reference whatsoever to attestation engagement audits or to the AICPA standards and guidelines that are specifically applicable to attestation audits. The agreement does not require that an auditor be engaged for the purpose of "attesting" to any fact or to state his or her conclusion to any issue. Instead, Section 14 requires that:

> "The City shall annually cause to be made an audit of it's Accounts for the previous year which shall separately treat therein the accounts relating to the City Sewage treatment

EXHIBIT E

> plant. On or before October 1 of each year, the City shall deliver to the District's Manager a copy of the parts thereof relating to its sewage treatment plant."

The foregoing language does not support the conclusion that the parties contemplated an attestation engagement audit when the agreement was drafted. Unfortunately, the language also does not clearly describe what exactly *is* required. The City's former auditor, Scott Miller of Odenberg, Ullakko, Muranishi & Co, made the following comments regarding Section 14 in his August 26, 2003 memo to the City:

> "This statement is unclear as to what is specifically required when it refers to "separately treat therein the accounts related to the City sewage treatment plant." Correspondingly, it is unclear as to what is meant by "deliver a copy of the parts thereof relating to the sewage treatment plant." It appears that this is open to interpretation."

This lack of clarity has unfortunately contributed to years of needless disagreement and frustration. As described below, the City Council proposes that the parties adopt a new, clear methodology and agreed upon auditing procedures to account for the direct and indirect sewer treatment plant expenses. Until acceptance of those agreed procedures, the agreement as presently written is not amenable to an attestation engagement audit and the applicable AICPA standards.

The AICPA Statements on Standards for Attestation Engagement (SSAEs) include the requirement that the attesting practitioner have reason to believe that the subject matter is capable of evaluation against criteria that are suitable and available to users. Criteria should permit reasonably consistent measurements, qualitative or quantitative, of the subject matter.

> " .29 In evaluating the measurability attribute as described in paragraph .24, the practitioner should consider whether the criteria are sufficiently precise to permit people having competence in and using the same measurement criteria to be able to ordinarily obtain materially similar measurements. Consequently, practitioners should not perform an engagement when the criteria are so subjective or vague that reasonably consistent measurements, qualitative or quantitative, of subject matter cannot ordinarily be obtained. However, practitioners will not always reach the same conclusion because such evaluations often require the exercise of considerable professional judgment."
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> *SSAE Attest Engagements, AT Section 101.29*

In addition to the uncertain language within Section 14, the agreement at Section 16 does not provide a precise definition of the term "costs of administration." Section 16 of the agreement requires that "all costs of administration" be apportioned annually. This means that both direct and indirect costs must be apportioned. As long as the City's rationale for allocating administrative costs to its enterprises is equitable and representative of actual administrative costs incurred, the agreement requires the District to pay its share. These costs are allocated during the budget preparation process.

The District, however, continues to take issue with the nature and amount of the administrative costs apportioned by the City. This difference of opinion is perhaps best illustrated by the position taken in your August 16, 2010 letter regarding the office furniture purchased for the Public Work Department. In that letter the City's allocation is ridiculed as an "absurdity" and the purchase is portrayed as a lavish waste. In the effort to make this claim the District, incredibly, describes this inexpensive, laminated pressboard furniture as "elegant wood furniture." [1]

Earlier this year another unfounded claim was made regarding the allocation of Council member salaries and health insurance. In a March, 2009 staff level meeting between the City and District it was strenuously, yet incorrectly, asserted that 100% of the Council member salaries and health insurance premiums were charged to the Sewer Fund during fiscal years 2001 and 2002. In actuality, the total costs of the City Council in FY 2001 were $69,461. The Krieg Report shows that only $1,504 of this amount was charged to the District. The total cost for the City Council in FY 2002 was $80,943. The Krieg Report shows that $1,822 was charged to the District.

The parties' agreement, as presently written, provides no definitions or other criteria to determine whether these or other expenses qualify, or fail to qualify, as legitimate costs of administration. Without that guidance, and given the parties' antithetical interpretations, any

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[1] A review of the City's expenditure ledgers of fiscal years 2002/03 through 2009/2010 reveals only two instances when furniture was charged to Brooktrails.

In fiscal year 2006/2007 $725 was spent on desks and chairs and charged to Sewer Engineering. Brooktrails' share of this purchase was 23.62% for a total of $171.36. In fiscal year 2007/2008 $1,938.58 was spent on furniture. Brooktrails' share of this was 23.62% for a total of $447.89. There was a $5,040 expense for furniture to set up the Engineering Department in fiscal year 2006/2007, but this was charged to the General Fund Engineering Department. No portion of this purchase was cost shared with Brooktrails either directly or indirectly.

Over the last seven years Brooktrails has paid a total of $630 on furniture for the Public Works and Sewer Engineering Departments.

auditor engaged by them will be unable to affirmatively attest, without qualification, to the validity of the administrative costs.

The "elegant wood furniture" issue and the Council member salary and insurance premium issue are two examples of gross exaggeration of the City's cost allocation practices. Such statements apparently fuel the misperception made in your August 16 letter that the Council has developed a culture to "load as many expenses into the sewer operating account as possible." That statement may serve a purpose of getting your client stirred up, but it simply isn't true, and it is counterproductive to the goal of settlement.

Given the parties' extreme, conflicting opinions and interpretations of Sections 14 and 16, it seems obvious that an attestation engagement audit, if conducted at this time, will not produce the result desired by the District. The parties' appear to have vastly different understandings and expectations regarding the shared costs of administration. If the parties are unable to agree on whether the cost of a cheap, laminated desk is an appropriate administrative cost under the terms of the agreement, or is instead a lavish and wasteful expense and an example of absurd cost allocation, how can the auditor make that call?

The lack of a precise definition of administrative costs and the uncertainly of the parties' intentions was noted within the 2004 Agreed upon Procedures Report *prepared by the District's own auditor*, Terry Kreig.

"The Second Amendment of the Agreement between the City and the District did not define explicitly the term "costs of administration" of the City Sewerage Treatment Plant." 2004 Terry Kreig Agreed Upon Procedures Report, P. 13

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"Based upon my experiences auditing California cities, my judgment is that cities are free to select their own methods of allocating costs to various funds.....I do not know what was intended to be included as administration costs of the treatment plant in the agreement between the City and the District." Kreig Report, supra,, *P.* 14

An attestation audit must be capable of evaluation against reasonable and measurable criteria. To meet this standard the agreement must be sufficiently precise and not subject to conflicting interpretations. The City and the District need to come to an agreement on the acceptable costs of administration and the criteria to determine whether the City is in compliance with the agreement. Both Brooktrails and the City agree that Section 14 of the agreement does not provide sufficient clarity for deriving the charges for treating Brooktrails' wastewater.

The Council believes it is in the parties' best interests to amend the agreement to stipulate to a specific methodology for how Brooktrails' charges will be derived in sufficient detail that will allow for an audit. Providing additional detail will not yield a methodology that

will be conducive to an attestation audit because the methodology will prescribe procedures requiring judgment outside the purview of accounting expertise. For example, the methodology will prescribe the classification and allocation of costs. In an attestation audit, the auditor can confirm the accuracy of the cost accounting by sampling the City's accounts. Indeed, the City's outside auditor does that every year. The problem lies in verifying the classification and allocation of costs, which rely on operational and engineering expertise. Hence, the auditor will have no recourse but to issue a qualified opinion, which will not advance us in addressing Brooktrails' concerns.

Background regarding Agreed Upon Procedures and Brooktrails' Approval

As noted earlier, the District has previously objected that past audit reports often included qualifying or disclaiming statements. The parties exchanged correspondence on this issue in the summer of 2003. At that time the City responded that disclaiming statements within audit reports are very common and that the agreement does not require that the City produce an unqualified audit report. The City noted that a possible solution could be an "agreed upon procedures" engagement that lays out specific procedures to perform related to the cost sharing arrangement between the City and the District. At that time, however, the City explained that it was unwilling to incur the additional expense of engaging an auditor to perform that service because it was not described nor contemplated by the existing agreement.

The City's unwillingness to participate in an agreed upon procedures engagement changed in 2009 following productive joint City and District staff level meetings held in your office. Specifically, on March 18, 2009 the City agreed to retain the services of R.J. Ricciardi, CPAs to conduct an agreed upon procedures engagement consisting of detailed testing and verification of the costs and calculations used to compute the sewage disposal billings presented to Brooktrails . The nature and scope of the engagement was discussed with District staff, and the specific, written proposed procedures were shared with Brooktrails in advance of the work performed. Brooktrails had the opportunity to comment on the procedures yet made no objection to the terms of the engagement or the procedures to be followed. Further, it is my recollection, and the recollection of the City Manager and City Finance Director, that both you and the District Manager appeared to be very pleased with the scope and description of the proposed report. It was a viewed as a welcome breakthrough after years of squabbling over the past audits.

The minutes of the Joint Sewer System Committee meeting of March 3, 2009 state that Mike Chapman reported that he and the District Counsel had reviewed the engagement letter from R. J. Ricciardi to prepare the Agreed Upon Procedures report and were comfortable with the language. The 2008 Agreed Upon Procedures report was thereafter provided to Brooktrails in June, 2009. Brooktrails made no objection at that time to the content or the procedures used to produce the report. Minutes of the July 28, 2009 Brooktrails board meeting include a report from the District's Counsel that Brooktrails continued to have successful meetings with the City of Willits staff on several sewer issues.

More than one year passed without any comment or objection from Brooktrails to the report procedures. On Page 7 of your August 16, 2010 letter you have objected to the continued use of the same AUP. You also wrote that the City's Finance Director "advised Brooktrails that the City would engage its auditing firm in the same manner as prior years unless Brooktrails has an objection." This comment refers to the email message which the City's Finance Director sent to Michael Chapman concerning the AUP. Your account did not fairly describe the comments of the City's Finance Director in that email message.

What you neglected to mention was that Ms. Cavallari also specifically invited Mr. Chapman to comment and participate upon the continued use of those procedures. She wrote,

"I invite your participation upon these procedures if you have any comments to offer. If I do not hear from you I will assume this meets with your approval."

It was appropriate and considerate of Ms. Cavallari to invite Mr. Chapman to comment and participate in the development of the procedures. Given Brooktrails' prior approval of the AUP, Ms. Cavallari's comment that she intended to utilize the same procedures, in the event Brooktrails declined her invitation to comment, was also entirely reasonable.

Proposed Amendment to Provide Compliance Audits

Rather than performing attestation audits, the City proposes an amendment to the agreement to provide "compliance audits" that will confirm that an agreed upon methodology for determining District charges is complied with. Compliance audits are used by other agencies (e.g., San Francisco Public Utilities Commission) for determining charges for providing contract utility services to neighboring agencies. The amended agreement would specify how the compliance audit will be conducted, including the procedure and schedule. The proposed compliance audit would be conducted by an independent party with the requisite expertise.

As to the methodology that would be the subject of the compliance audit, the proposed amended agreement will fully prescribe the procedure for deriving Brooktrails' charges. Those procedures would include the methodology to prescribe the following:

1. The level of accounting detail used for accounting for costs related to wastewater treatment.

2. Allowable direct costs of wastewater treatment, including operating and capital costs.

3. Allowable indirect costs related to wastewater treatment, including the procedure for allocating these costs to the wastewater treatment function.

4. Allowable administrative overhead, including the procedure for allocating these costs to the wastewater treatment function.

5. Derivation of the allocation factors used for allocating the costs attributable to the wastewater function between the City and Brooktrails, including the procedure for maintaining accurate flow data.

6. The analytical format reflecting the foregoing procedures, which will be followed in calculating Brooktrails' charges.

7. Derivation of the difference between the projected charge and the actual costs, with the variance credited or debited to a "balancing account".

8. Procedures for reviewing budgets and compliance audits.

The "balancing account" is a common mechanism in rate making that protects both parties from over- or under-estimated charges. The compliance audit will serve to determine the annual variance, which will be factored into determining each year's charge.

What the City is proposing will result in a method for deriving Brooktrails' charges following agreed-upon procedures and an audit process to ensure compliance with the procedures. Ultimately, it is the City's responsibility to set reasonable charges. This approach will lead to reasonable charges, which will address Brooktrails' demands.

Conclusion

As discussed above, the attestation audit procedure demanded in your letter of August 16, 2010 is not required by the terms of the agreement. Further, the agreement in its present form is not amenable to an attestation audit. Instead, the parties should meet and confer to negotiate an amendment to the agreement which will incorporate a new accounting methodology amenable to a compliance audit process as outlined above.

The Council desires to improve its relationship with Brooktrails and to put an end, once and for all, to the ongoing audit and administrative cost disputes. The Council is interested in prospective changes only, and is not willing to participate in new audits of plant operations of prior fiscal years. That demand to revisit past audits is not supported by the terms of the agreement. Finally, the Council does not agree that Brooktrails has the authority to impose a credit toward future plant expenses based upon any claimed failure of the City to follow the

audit requirements. In short, the problem is not with the City's compliance, but rather with the uncertain and problematic nature of the agreement as written.

If the settlement proposal outlined above is agreeable, in concept, the City will promptly engage a qualified consultant to assist in the development of a draft amendment for consideration by the District Board.

Yours very truly,

H. James Lance
Willits City Attorney

cc: Willits City Council
BTCSD Board of Directors
Paul Cayler, City Manager
Joanne Cavallari, City Finance Director
Michael Chapman, District Manager