



May 15, 2015

City of Cleveland Heights
Tanisha R. Briley
City Manager
40 Severance Circle
Cleveland Heights, Ohio 44118

Re: Public Private Partnership (P3) Proposal For the Water System of the City of Cleveland Heights

Dear Ms. Briley:

Aqua Ohio, Inc., ("Aqua") is pleased to submit this Letter of Intent ("LOI") setting forth the terms and conditions under which Aqua proposes to proceed with a Public Private Partnership ("P3") with the City of Cleveland Heights ("City") related to Aqua's proposal to operate the water system of the City. The proposal is intended to cover all the assets owned and maintained by the City, recognizing that certain portions of the water system are owned by the City of Cleveland, or otherwise maintained by the City of Cleveland pursuant to certain agreements between the City and the City of Cleveland.

This letter is not intended to be binding, nor is it intended to contain all of the detailed terms and conditions of the Proposed P3. Consummation of the Proposed P3 is subject to a mutually acceptable Definitive Agreement ("Agreement") with negotiated final terms, including final financial terms, closing conditions as well as legal and similar due diligence with results satisfactory to both Parties at their discretion.

A. Aqua Services. Under the proposed transaction, Aqua acknowledges that the City's water system is in "as is" condition and would assume responsibility for the operations of the City's water system over the term of contract. Such operation would include:

- a. Daily operation of the City's water system as described in the final agreement.
- b. In the operation of the water system, Aqua will work to comply with all related federal, state and local laws, ordinances and regulations.
- c. Work with the City in its efforts to comply with the Water Service Agreement between the City and the City of Cleveland.
- d. Billing and customer service, including phone center support, billing (water, sewer, trash), remittance processing, and collections.
- e. Replacement of capital assets other than developer contributed property installed after the date of the Agreement.
- f. System maintenance.

- g. Overall regulatory compliance / implementation, including environmental regulations, as well as enforcement of cross connection.
- h. Management of employees.
- i. Insurance of and handling and responsibility for claims related to the water system.
- j. Responsibility for safety/OSHA requirements.

B. Payments.

- a. Aqua proposes to pay an up-front payment estimated at up to \$3,700,000 ("Initial Payment") upon execution of the Agreement. In addition thereto:
 - i. Upon Aqua attaining at least a threshold of 30% unaccounted for water and an acceptable cumulative rate of return on its invested capital, as derived in the latest PUCO litigated rate case and not less than 7.75%, Aqua shall make annual payments to the City equal to an amount mutually negotiated for that particular rate plan period (see Section F.).
- b. **Purchased Water Payments.** Upon receipt of a monthly invoice for water purchased under the Water Service Agreement between the City and the City of Cleveland, Aqua will reimburse the City generally within two weeks.
- c. **Employees.** Upon receipt of a monthly invoice from the City Aqua will reimburse the City generally within two weeks for the costs associated with the lease of existing water employees of the City, as discussed in paragraph H.g., up to the full time equivalents from the City's 2015 water fund budget.
- d. **Building Lease or License.** Aqua will be granted the right to use the current buildings via lease or license of the water system for both administrative and operational purposes without payment of additional rent, or at an agreed to nominal lease amount, during the initial rate period. Thereafter, any applicable rents would be negotiated as a part of the rate plan for that period of time.

C. Capital Improvements and Asset Ownership. The existing system capital assets as of Agreement date owned by City shall remain under City ownership. Aqua shall provide and own all new or replacement capital investment assets, including developer contributed property, except as provided in sub-paragraph c hereunder.

- a. Aqua shall present to the City at the time of the Agreement an agreed to preliminary five year capital plan for the water system. Aqua will review the capital plan annually with the City and specifically address changes identified as system specific data becomes available, recognizing the need to develop a more accurate list of system assets and their functionality. Aqua shall have the responsibility for and discretion as to implementation of any capital improvement projects consistent with all regulatory obligations and obligations under the Agreement.
- b. Aqua shall be subject to at least the same level of spending proposed in the agreed to preliminary five year capital plan that is a part of an overall rate plan unless modified

under paragraph F.b. The timing and projects to be addressed by the preliminary five year capital plan shall be subject to modification by Aqua to address areas of specific concern or need, including but not limited to issues of service, reliability, unaccounted for water management, or regulatory compliance. Aqua shall notify the City of any such changes in the preliminary five year capital plan.

- c. In the event the City should desire to participate in improvements through grants or other funding sources, such participation is subject to the mutual agreement of Aqua and the City and shall be at the sole discretion of each party. Any portion of the improvements so implemented or facilitated shall be:
 - i. Owned by the City for the portion (or proportion thereof) financed either by such grant or other funding source, or otherwise financed by the City;
 - ii. Owned by Aqua for the portion (or proportion thereof) financed by Aqua.

Any improvements financed by any grants, other funding source, the City or otherwise added to the water system and not owned by Aqua shall be added to the originally leased facilities with no additional lease payment from Aqua.

D. Term. The initial term of the Agreement shall be 20 years. Thereafter, the Agreement will automatically renew in 10 year increments unless either party sends notice of its intent not to renew at least one year prior to the then applicable expiration date.

- a. Upon the end of the initial term or renewal term as applicable, or upon termination of the agreement during the initial term for any reason, the City shall purchase from Aqua all new or replacement capital investment assets owned, paid for or otherwise financed by Aqua. The price for such assets shall be determined on the basis of replacement cost new less depreciation, measured as of the time of Agreement termination.
 - i. The determination of the replacement cost new less depreciation hereunder shall be determined by an appraiser (or firm) with utility valuation experience hired by Aqua. Should the City disagree with any such valuation, they will be afforded an opportunity to conduct an independent appraisal of such value by an appraiser (or firm) with utility valuation experience and the parties shall attempt to mutually agree as to the value. Should the parties still be unable to agree on a valuation, the parties shall mutually agree on an independent third appraiser (or firm) with utility valuation experience and such appraiser's valuation shall be determinative of the replacement cost new less depreciation value hereunder.
- b. Such final agreement shall include Termination provision(s) related to the bankruptcy, insolvency, involuntary receivership, unresolved material breach for both parties.
- c. If the agreement is terminated during the initial term for any reason other than an uncured material breach by Aqua, the City shall pay to Aqua:

- i. The price determined by replacement cost new less depreciation delineated in paragraph D.a. hereof; plus
- ii. an amount equal to unamortized balance of the total upfront lease payment remaining over the initial term of the Agreement; plus
- iii. an amount sufficient to make Aqua whole for any difference in under achieved earnings between an acceptable cumulative rate of return on its invested capital, as derived in the latest PUCO litigated rate case and not less than 7.75% (adjusted for income tax), and the actual earnings recorded through the time of termination.

E. Customers. All customers of the water system shall become customers of Aqua. Aqua shall have the sole right to charge the customers for water service and use of the City's water system assets. The City will not charge or assess to customers of the water system any fees based on the provision of water or use of the assets.

F. Rates. The determination of rates will be locally negotiated for a specific time period, generally five years each, based on the anticipated level of revenue, expenses and capital investment, and targeted return on rate base (cumulative capital less depreciation), subject to an annual rate increase cap.

- a. The parties would annually review progress on such rate plan for the above determinants.
- b. During the term of the agreement, the City and Aqua will cooperate in the evaluation of any new or unforeseen changes to the rate plan expenses or capital investments in order to ensure that they are addressed through customer rates or the capital investment plan in a timely manner.
- c. As a part of that annual review of the rate plan parameters, the City and Aqua will review and potentially modify the five-year capital investment plan in order to address any changes to items in the capital plan or priorities.
- d. The parties will agree on miscellaneous processes and charges allowed, such as shut-off and connection charges.
- e. The Agreement would provide for recourse to the PUCO for rate determination, as generally described in Section 4909 of the Ohio Revised Code, in the event the parties cannot mutually agree on rates or to the applicable rules and regulations in the event of a failure to agree on processes and charges.
- f. During the term of the Agreement, as part of its annual review of rates Aqua shall provide the City Aqua's cumulative investment of capital in the System and book value of the system assets.

G. Regulatory Approval. Aqua Ohio is a regulated public utility. The Agreement and Aqua's operation of the water system shall be subject to all applicable statutes, rules and regulation of the Ohio Public Utility Commission and any other agency as applicable.

H. Additional Terms. The Agreement shall incorporate and be subject to the following additional terms.

- a. Any sale of the system by the City to a third party will include the Agreement and Aqua will be granted a right of first refusal to purchase the water system with the exception of the prior provision in the purchased water agreement between the City and the City of Cleveland. Any sale of the water system assets owned by Aqua shall include the Agreement and the City will be granted a right of first refusal to purchase such assets.
- b. The Agreement will not be assigned without the written consent of the parties.
- c. The City and Aqua will establish terms to transfer certain designated machinery, vehicles, supplies, inventories, furniture, software systems, and other assets to Aqua related to the water system. The parties will agree on certain property to be excluded from such transfer.
- d. The City will transfer to Aqua all files, records, data related to the water system, including customer records.
- e. The City will grant Aqua a license, grantee rights, or otherwise permit Aqua to utilize all easements, use of right of ways or other rights held by the City necessary for the operation, maintenance, repair and modification of the water system.
- f. The parties will agree on specific areas for use of and any reimbursement for City services, when use of such services provides the better alternative, including but not limited to street and road paving and maintenance.
- g. Aqua proposes to provide its own management and to initially lease existing water system employees of the City up to the full time equivalents from the City's 2015 water fund budget. Aqua acknowledges that the "leased" employees from the City are subject to a collective bargaining agreement. Aqua intends to implement its work rules within the context of the existing agreement and will work with the City to negotiate any modifications or subsequent collective bargaining agreements as they occur during the term of this agreement. The parties shall agree on issues of employee insurance, workers compensation, pension, staffing levels, phasing to Aqua Ohio workforce over time. Within the first eighteen months of the initial contract term, Aqua will assess the appropriate size and configuration of the water system-related workforce. Therein, Aqua and the City will work on the elements of the workforce transition including, but not limited to, the use of retention, attrition, retirements, transfers and/or other actions.
- h. The City shall remain in control of the acquisition and supply of the purchased water from the City of Cleveland to both resident and non-resident water customers. Therefore, the purchased water contract with Cleveland Water shall remain with the City and the Agreement shall provide for all water purchase charges including any increases to the City to be a "pass through" charge for Aqua to water system customers.

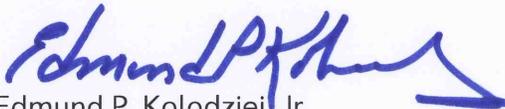
- i. The Parties shall work with each other for transitional billing and other services and transition of customer accounts to Aqua. Such shall include use of the City's computer systems for billing and maintenance of customer accounts.
 - j. The City of Cleveland Heights shall coordinate interaction between Aqua and the City of Cleveland when necessary to impact needed improvements to the City of Cleveland Heights water system, recognizing the City of Cleveland Heights is party to the Water Service Agreement with the City of Cleveland.
- I. Consummation of the Proposed Agreement is subject to the preparation, authorization, execution and delivery of a definitive Agreement and other related documents by and between the City and Aqua which are acceptable to both Parties as well as any due diligence the parties may wish to undertake. Upon the acceptance of this Letter of Intent by the parties, the City and Aqua will promptly undertake negotiations of the terms of the Agreement. The Agreement will be in a form customary for transactions of similar scope and significance to the Parties and will include, in addition to those matters specifically set forth in this letter, customary representations, warranties, covenants, and other customary matters. The Parties intend to proceed toward consummation of the Agreement in good faith.
- J. The Agreement shall also provide for the following:
- a. **Standards for Service.** The City and Aqua will work to identify and establish desired standards for water service. City Council will then consider and formally establish these desired service standards with the intent of establishing relevant operating metrics.
 - b. **General Conditions Precedent.** The Agreement will be subject to the following general conditions precedent prior to the parties closing the transaction contemplated by this letter of intent:
 - i. Approval by the Board of Directors of Aqua and Aqua America Inc.;
 - ii. Approval of the Agreement by the City Council;
 - iii. Receipt of all material, non-governmental third party consents;
 - iv. Any other state agency approvals necessary or advisable to consummate the Agreement;
 - v. Compliance with all local and state laws necessary to consummate the Agreement;
 - vi. The City shall have good and marketable title to all assets, including any real estate that may be transferred, free and clear necessary for Aqua to lease and operate the water system, and that no bond obligations, covenants, license or agreements shall prohibit the contemplated transaction;
 - vii. The water system will be run in the ordinary course until the time Aqua assumes operations;

- viii. Neither the City nor Aqua shall be subject to any injunction, preliminary restraining order or other similar decree of a court of competent jurisdiction prohibiting the consummation of the transaction contemplated by this letter of intent;
- ix. Customary legal opinions, closing instruments, certificates and other documentation shall have been executed and delivered; and
- x. Aqua and the City shall have completed their business, financial, legal, regulatory and similar due diligence to the parties satisfaction as of the execution of the Agreement. As of the Agreement's effective date, Aqua and the City shall have discovered no facts or conditions which constitute, or could reasonably be expected to result in, a material adverse change in the properties, assets, liabilities, operations, condition (financial or otherwise) or results of operations of the water system.
- xi. Aqua recognizes that the City is and Aqua possibly may be subject to provisions of state and local open records laws as applicable.

K. Effect; Termination. The Parties intend to negotiate the terms and conditions of the Agreement. The Parties agree that this letter is not intended to be a binding agreement between the Parties but merely an expression of their intent with regard to the transactions described herein, and each Party covenants never to contend to the contrary. This letter will expire if a definitive final Agreement concerning the matter is not authorized on or before August 31, 2015. Either party may terminate this LOI at its sole discretion at any time.

L. Cost and Fees. Each Party shall pay its own expenses, including without limitation any counsel and/or advisor fees, incidental to this LOI and the Agreement, whether or not the transactions contemplated herein are consummated.

Sincerely,



Edmund P. Kolodziej, Jr.
President & COO
Aqua Ohio

Accepted:

City of Cleveland Heights

Date: _____