



1231 Eleventh St.
P.O. Box 4060
Modesto, CA 95352
(209) 526-7373

July 9, 2012

Mr. Greg Nyhoff
City Manager
1010 Tenth Street
P.O. Box 642
Modesto, CA 95353

Dear Mr. Nyhoff:

The Modesto Irrigation District (MID) would like to take this opportunity to provide you with updated information regarding the MID's proposed sale of water to the City and County of San Francisco.

MID has provided your office and City Council members with the latest version of the proposed contract for the sale of 2,240 acre feet [equal to approximately 2 million gallons per day (mgd)] of water. We would like to direct your attention to Section IH which we believe addresses the City's concern that MID may be in breach of the Amended and Restated Treatment and Delivery Agreement (ARTDA). This section reads: "MID has determined that it has 2 mgd of water available for transfer which is surplus to its requirements for water supply. MID has determined that it has sufficient water available to meet its contractual obligations to the City of Modesto pursuant to the ARTDA and to provide 2 mgd of transfer water to the SFPUC."

The MID Board of Directors is appreciative of our long partnership with the City of Modesto. It is not MID's intention, either through commission or omission, to undermine or weaken those ties. Our legal counsel believes the language change in the contract should resolve any City of Modesto concerns as they relate to the potential water sale. However, I want you and the City Council to know that MID will take those steps necessary to fully comply with the provisions of the ARTDA.

It may be helpful for you to understand the long and successful history that MID has had with water transfers. From 2000 to 2011, MID sold 11,000 acre feet annually for environmental purposes under the Vernalis Adaptive Management Plan (VAMP). That water is now available to MID for its use. Additionally, from 1996, MID has been selling 10,000 acre feet annually to the City and County of San Francisco to help San Francisco meet its obligations to the Federal Energy

Mr. Greg Nyhoff
July 9, 2012
Page 2

Regulatory Commission. This transfer ends in 2016 and that water will then become available to MID.

The 2,240 acre foot water transfer contract is currently set for consideration by the MID Board of Directors at the Tuesday, July 24, 2012 MID Board meeting. I hope this information is helpful to you and the Council as you discuss this matter. As always, if you have any additional questions or concerns, please do not hesitate to contact me.

Sincerely,



Allen Short
General Manager

C: Mayor and City Council
MID Board of Directors



July 6, 2012

Greg Dias
Project Manager
Modesto Irrigation District
P. O. Box 4060
Modesto, CA 95352

Re: Modesto Regional Water Treatment Plant Phase Two Expansion Project-Project Funding

Dear Mr. Dias:

Thank you for your letter of June 29, 2012, regarding project funding for the Phase Two Expansion Project. Your letter correctly points out that the Policy Committee may submit an alternative to the proposed budget for MID Board consideration. However, your letter incorrectly states that no alternative funding methods have been proposed by the City at this point. In fact, the City has proposed a solution that would have led to a funding method for all the project funding shortfalls for the project. The terms of our proposed solution was rejected in total in Allen Short's letter of June 18, 2012, without any attempt whatsoever to discuss or negotiate the terms of the proposed solution.

As I stated in my July 2, 2012, letter to Allen Short, it is abundantly clear, based on all available information, there are insufficient bond proceeds to repair the damage done to the Expansion Project by the negligence of MID's contractors. The shortfall is not due to an error in the estimation of the cost of the construction of the Project; rather, it is due to the negligence of MID's contractors in the construction of the Project.

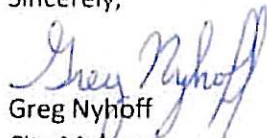
The City has all along taken the position that we are indemnified from all costs attributable to the negligence of MID's contractors. The only alternative the City could propose would be to assign those costs to other funding sources, thus excluding them from the MRWTP budget. Given the outcome of the recent Policy Committee action on this item, there is no reason to expect anything other than another split vote on this alternative proposal if it were to be presented to the Policy Committee.

Greg Dias, Project Manager
Modesto Irrigation District
July 6, 2012
Page 2

The City firmly believes that it is indemnified from costs attributable to the negligence of MID's contractors. Should an amended budget be approved by the MID Board, no payment shall be forthcoming from the City ratepayers to pay for costs that are a result of those negligent acts.

Should MID be willing to participate in meaningful discussions regarding the City's previous proposal, the City is certainly willing to restart those discussions.

Sincerely,


Greg Nyhoff
City Manager

cc: Allen Short, General Manager
Mayor and Council
Susana Alcala Wood, City Attorney
Roland Stevens, Assistant City Attorney
Richard Ulm, Director of Utility Planning and Projects



City Manager's Office

July 2, 2012

Allen Short, General Manager
Modesto Irrigation District
P. O. Box 4060
Modesto, CA 95352

Re: Overpayment for Domestic Water for Prior Domestic Water Year

Dear Mr. Short:

Thank you for your letter of June 21, 2012 responding to the City of Modesto's claim for overpayment. As is abundantly clear, based on all available information, there are insufficient bond proceeds to repair the damage done to the Expansion Project by the negligence of MID's contractors. I was very surprised by your comments that you expected the City would be willing to forfeit additional money to MID to pay for the repair of these damages, considering the fact that, in many meetings between the City's representatives and Board members Von Groningen and Warda, the City was repeatedly advised by them that the water rate-base would not be asked to pay for such negligence. So far, MID has spent ratepayers' money, but none of its own, on the expansion, and that is a situation which is no longer tenable.

The City understands that in this situation MID would like the ratepayers to pay for the Project a second time. But, as you know, the ratepayers have already given MID approximately \$65 Million (the full amount MID requested) to complete the Project, which money MID has spent. In addition, the City's rate-base has paid almost \$9 Million in debt service on an expansion that has not only not been delivered or produced any water in 2 ½ years, but also may not for years to come due to the negligence of MID's contractors. In addition, the City's Water Fund has about \$20 Million committed as collateral on the Project bonds. Accordingly, as the fund fiduciaries, the City is required to act prudently. The shortfall is not due to an error in the estimation of the cost of the construction of the Project; rather, it is due to the negligence of MID's contractors in the construction of the Project.

While the City sympathizes with MID's predicament, the City must insist upon adherence to the terms of the ARTDA, under which MID retains control and responsibility for the actions of its contractors. Hence, the City has no obligation, in contract or in equity, to bridge a shortfall that was created by the negligence of MID's contractors.

MID has acknowledged that it remains committed to the fulfillment of its responsibilities under the ARTDA. Among those obligations is MID's obligation to deliver a properly built and operational Project. So, it is not out of the ordinary for the City's statements to be consistent with this contractual obligation of MID. Likewise, under the ARTDA the City has no obligation to pay for costs and expenses arising from the negligence of MID's contractors.

Regarding the Policy Committee's approval of the repair to the west wall of the membrane building, the City acknowledges that MID's Policy Committee approved this repair. However, to the extent MID interprets the Policy Committee's approval as the City's own approval, MID's interpretation is in error. MID has the responsibility to decide the proper construction means and methods required for MID to deliver a properly built and operational Project. As such, the City takes no independent position concerning the appropriateness of that repair.

Moreover, it is incorrect for MID to assume that the City's allowing MID to exercise its obligation to determine the proper scope of repairs recommended by MID's consultants somehow constitutes the City's agreement to defray the costs for those repairs. While the City agrees that repairs are needed to allow for the completion of the Project, the City disagrees that it is the entity responsible for the costs of repairs. Section 19.2.4 of the ARTDA clearly assigns responsibility to MID for the costs or expenses from the negligence of MID's contractors.

MID's statement that the City has "reversed" its position regarding construction costs is not true. The City does not and never has agreed to incur the additional costs of construction made necessary by the negligence of MID's contractors. The City always has and remains willing to abide by the terms of the ARTDA, funding the construction of the Project as provided by the terms of the ARTDA.

It is true that the best interest of all concerned, including our ratepayers, is served by timely and competent completion of the Project. We both know that the true situation here is that MID has reserved inadequate funds to meet its moral and legal obligations to the City under the ARTDA. This is why MID has taken unfounded positions in communications with the City, such as in your letter of June 21. That is why the City proposed to MID an agreed modification of the ARTDA which would permit and fund completion of the Project and relieve MID from a predicament created at the hands of MID and its contractors – a proposal MID wholly rejected without engaging in any discussions with the City regarding any of the terms.

The City views MID's attempts at budget inflation and manipulation as an attempt to bail MID out of a predicament it created and for which it is responsible by asking the ratepayers to pay again, in full, for MID's contractors' negligence. MID has improperly and unilaterally taken the end of year true-up money for the O&M of the existing plant.

Your staff's email dated June 6, 2012, sent by Jill DeJong, advised the City that the true-up was complete and indicated that the District overcharged the City by \$885,472. In accordance with ARTDA Section 15, the overpayment for the year shall be paid by the District immediately following the completion of the accounting. Instead, the City was advised that the overpayment amount would be transferred to the Reserve and Contingency Fund. This action was never discussed or approved by the City and does not comply with Section 15 of the ARTDA. In response to your action, the July 1st payment for O&M has been reduced to reflect the amount owed to the City. Please find attached a statement of remaining funds due to the City for overpayment which totals \$248,081. The City intends to reduce the August 1st O&M invoice by this amount if the balance is not remitted to the City prior to July 30, 2012.

I must, therefore, respectfully decline MID's proposal to have the ratepayers pay for the negligence of MID's contractors by taking the true-up. The City simply cannot reconcile any possible variation from the City's obligation to its water customers by requiring them to pay for what they are not obligated to pay under the terms of the ARTDA. If MID is making a maximum effort to see that the expansion facilities are completed, then it needs to pay what it is contractually obligated to pay to ensure that result. If MID has no funds and cannot raise funds to meet this obligation, then the City would suggest that MID reconsider negotiating with the City in good faith so that we may act in the best interests of our ratepayer constituents.

Sincerely,



Greg Nyhoff
City Manager

Attachment: Statement of Balance Due

cc: Mayor and Council
Susana Alcala Wood, City Attorney
Roland Stevens, Assistant City Attorney
Richard Ulm, Director of Utility Planning and Projects
Gloriette Genereux, Director of Finance
Morey Davidovitz, Attorney
Greg Dias, Project Manager, MID
MID Board Members

1010 Tenth Street
Modesto, CA 95353
209 577-5394

July 2, 2012

Modesto Irrigation District Domestic Water Billing True-up for 2011 Dated 06/06/12 indicates the City was over charged by \$885,472.

1231 Eleventh Street
Modesto, CA 95352
209 526-7373

REMITTANCE	
Statement #	1
Date	
Amount Due	\$248,081.00
Amount Enclosed	

THANK YOU FOR YOUR BUSINESS!



Modesto
Irrigation
District

June 29, 2012

TO: Greg Nyhoff, City Manager

FROM: Greg Dias, Project Manager

SUBJECT: Modesto Regional Water Treatment Plant Phase Two Expansion Project –
Project Funding

Gentlemen,

As you know the bond funds available to pay for the Phase Two Expansion Project are insufficient to fund the work that both the City of Modesto and MID believe necessary. Consequently, the Modesto Irrigation District is proposing an \$8.3M amendment to the Project budget, as described in the attachments.

A split vote on this matter occurred during the April 13, 2012 Technical Committee and the June 29, 2012 Policy Committee meetings. The City of Modesto objected to this budget amendment. At this point, no comprehensive alternative funding methods have been proposed by City staff. Therefore, consistent with the Policy Committee's on-going directive to keep the project moving and the provisions within the Amended and Restated Treatment and Delivery Agreement ("ARTDA"), MID staff is bringing this same budget amendment for consideration by the MID Board of Directors on July 10, 2012.

This letter is notice pursuant to ARTDA Section 18.7.2.F. that the Policy Committee may submit an alternative to the objectionable budget item for the MID Board of Directors to be considered along with the proposed amended budget submitted by the District.

Please let me know if you have any concerns in connection with this matter.

Thanks,

Greg Dias
Project Manager

cc: Allen Short, Modesto Irrigation District

HAND DELIVERED
RECEIVED

JUN 29 2012

CITY MANAGERS OFFICE

1231 Eleventh St.
P.O. Box 4060
Modesto, CA 95352
(209) 526-7373



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P.O. Box 4060
Modesto, CA 95352
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June 29, 2012

TO: Policy Committee Members

FROM: Greg Dias, Project Manager

SUBJECT: Modesto Regional Water Treatment Plant Phase Two Expansion Project – Project Funding

Gentlemen,

As you know the bond funds available to pay for the Phase Two Expansion Project are insufficient to fund the work that both the City of Modesto and MID believe necessary. Consequently, the Modesto Irrigation District is proposing an \$8.3M amendment to the Project budget, as described in the attachments.

A split vote on this matter occurred during the April 13th Technical Committee meeting since the City of Modesto objected to this budget amendment. At this point, no alternative funding methods have been proposed by City staff. Therefore, consistent with the Policy Committee's directive to keep the project moving and the provisions within the ARTDA, MID is bringing this same budget for consideration by the Policy Committee on June 29, and to the MID Board of Directors on July 10.

Please let me know if you have any concerns in connection with this matter.

Thanks,

Greg Dias
Project Manager

2012 MRWTP Expansion Budget

Project	Task Number	Description	Cost Code	Budget Amount
312475	01.02	Construction Litigation		
		MID Labor	101	\$250,100
		Consultants	401	\$904,200
		Outside Legal Support	412	\$3,251,700
		Sub-total		\$4,406,000
	01.03	Construction		
		MID Labor	101	\$50,000
		Consultants	401	\$107,600
		Contract	402	\$1,526,000
		Outside Legal Support	412	\$750,400
		Engineering/CM	425	\$1,471,000
		Sub-total		\$3,905,000
		Total		\$8,311,000



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June 21, 2012

Mr. Greg Nyhoff
City Manager
City of Modesto
1010 Tenth St., Suite 4600
Modesto, CA 95353

Re: City of Modesto's Claim of Overpayment for Domestic Water for the Prior Domestic Water Year

Dear Mr. Nyhoff:

I am writing you in response to your letter of June 14, 2012, in further explanation of the Modesto Irrigation District's ("MID") position regarding unspent funds budgeted for the Domestic Water Year that ended on April 30, 2012. Since your letter of June 14, 2012, does not reflect the current status of the Phase Two Expansion Project, and the context in which both the City of Modesto and MID are working, I am obliged to briefly summarize the situation:

1. There are insufficient bond proceeds to complete the Project;
2. On April 12, 2011, the Policy Committee approved the repair of the lower west wall of the membrane basin building, based upon a specific cost estimate provided to the City in closed session. Although Western Summit Constructors, Inc. ("WSCCI") was directed to perform that work during the last Domestic Water Year, consistent with the Policy Committee's approval, WSCCI has failed to proceed and continues to fail to proceed in a timely fashion with that work. As a result, as Modesto is aware, MID is seeking a replacement contractor to perform the repair work which the Policy Committee approved and committed to have performed; and
3. Modesto has both publicly and privately expressed its desire for MID to proceed with the completion of the Project, rather than suspend it for lack of funding, on several occasions. By way of example, I would direct you to the following public actions and statements by City officials:

March 10, 2011 – Repair of Membrane Tank Structure

The Policy Committee, including Mayor Ridenour and Council Member Hawn, approved proceeding with the reconstruction of all walls and the bottom slabs of the membrane tank structure.

April 12, 2011 - Lower West Wall

The Policy Committee, including Mayor Ridenour and Council Member Hawn, approved the construction to strengthen the Membrane Building lower west wall and to authorize MID staff to negotiate and execute a change order for the work. Chairman Hawn voiced further support:

"This fix actually enhances the serviceability of the building — it could have been designed this way originally - it's not like it's a fix we have to live with - this is not a compromise at all and a good approach for the project."

June 5, 2012 – City Council Presentation (on slide show and orally)

Rich Ulm, on his slide show and during his presentation noted: *"MID and City agree it is in rate payers' best interest to complete project as soon as possible"*.

Consistent with the foregoing, MID has been attempting to put in place funding for the completion of the Project, including the lower west wall repairs.

MID, consistent with the Amended and Restated Treatment and Delivery Agreement ("ARTDA"), has been very transparent in its dealings with Modesto. In seeking an increase in the current Domestic Water Year's budget, to fund the continued construction of the Project, MID has sought \$6.3M additional funds, against an anticipated need of \$8.3M through year's end. MID has, as part of the budget increase process, advised Modesto's representatives that the amount of the increase is based upon the availability of unexpended funds to be utilized for use as part of the completion of the Project during the current Domestic Water Year.

Placed in context, Modesto's position regarding the unexpended funds left over from the last Domestic Water Year, is completely inconsistent with Modesto's avowed desire to see the Project completed, not suspended. MID cannot responsibly enter into contracts for additional work and services in connection with the Project for which no identifiable funding source is available. If Modesto and MID were to agree that the funds in question should be refunded under the ARTDA, the result would only be to delay the progress of the Project and to require that additional funding be secured by other means provided for in the ARTDA.

Given Modesto's position, MID is left with a very limited range of options. In order to fund the Project, MID can seek an additional increase in the current Domestic Water Year's budget, to offset the funds which Modesto now proposes to withdraw from the available Project funds. In doing so, and in light of Modesto's current position, MID would require reasonable assurances that, in fact, Modesto would reimburse MID for the additional budgeted expenses as called for under the terms of the ARTDA. In the alternative, MID can treat your letter as a reversal in Modesto's position regarding completion of the Project and proceed with its suspension for lack of funding in an orderly fashion.

Please let me know at your earliest convenience how Modesto would prefer to have MID respond to this situation.

Sincerely,



Allen Short
General Manager
Modesto Irrigation District

C: Mayor and Modesto City Council
Susana Alcala Wood, City Attorney
Roland Stevens, Assistant City Attorney
Richard Ulm, Director of Utility Planning and Projects
MID Board
Tim O'Laughlin



1231 Eleventh St.
P.O. Box 4060
Modesto, CA 95352
(209) 526-7373

June 18, 2012

Mr. Greg Nyhoff
City Manager
City of Modesto
1010 Tenth Street, Suite 4600
Modesto, CA 95353

Re: Modesto Regional Water Treatment Plant Phase Two Expansion Project

Dear Mr. Nyhoff:

The Board and staff of the Modesto Irrigation District ("MID") has devoted substantial time and effort to the consideration of and the evaluation of the term sheet which you forwarded on May 4, 2012. Multiple attempts have been made to develop a response to the various deal points. However, in the end, MID was unable to reconcile any possible variation on the terms offered, with the best interest of its rate payers. I have therefore been asked to respectfully decline all of the City of Modesto's proposed terms, including the sale of the Modesto Regional Water Treatment Plant facilities.

MID remains committed to the fulfillment of its responsibilities under the Amended and Restated Water Treatment Delivery Agreement ("ARTDA") as I am sure the City of Modesto is also. MID is making a maximum effort to see that the expansion facilities are completed, in conjunction with the City of Modesto's anticipated assistance and cooperation.

If the City of Modesto has any suggestions as to how to better manage and to achieve our mutual goal of bringing the expansion facilities on line, please feel free to provide them.

Very truly yours,

Allen Short
General Manager
Modesto Irrigation District



MODESTO

CALIFORNIA

City Manager's Office

June 14, 2012

Allen Short, General Manager
Modesto Irrigation District
P. O. Box 4060
Modesto, CA 95352

Re: City of Modesto Overpayment for Domestic Water for Year Ending April 30, 2012

Dear Mr. Short:

As you are aware, the Amended and Restated Treatment and Delivery Agreement (ARTDA) sets forth the terms and conditions regarding how the City of Modesto (City) is to make payments to the Modesto Irrigation District (MID) for water supplied to the City's water customers. More specifically, the terms for calculating the City's monthly payments are contained in Section 15.3 "Calculation of Monthly Payments" of the ARTDA. This section indicates that underpayment or overpayment by the City for any given Domestic Water Year will be reflected in the first invoice for the Domestic Water Year immediately following the accounting.

It has recently come to my attention that MID has indicated that it does not intend to abide by the terms of the ARTDA in regards to the City's overpayment of \$885,472 during the Domestic Water Year ending April 30, 2012. After inquiring about the annual "true up" that has in the past been reflected in the May invoice, City staff was informed that the overpayment had been transferred to the Reserve and Contingency (R & C) fund.

Section 15.3 of the ARTDA states, in relevant part, that City payments shall be increased to include payments in addition to Debt Service for the First Expansion Facilities *after* the Commercial Operation Date. ARTDA Section 14.3 is clear that such payments would include Operation and Maintenance costs. MID has neither provided documentation of valid withdrawals from the R & C fund pursuant to Section 12.1.2 of the ARTDA, nor a facility meeting Commercial Operation standards after more than two and one-half years of delay.

Allen Short, General Manager
Modesto Irrigation District
June 14, 2012
Page Two

Accordingly, please be advised that unless a revised, corrected invoice from MID is received by June 25, 2012, the City will be asserting a credit in the amount of \$885,472 and will be deducting the amount of \$885,472 from any amount asserted by MID due July 1, 2012, or thereafter, until the City receives the benefit of the full amount of that credit. Further, the City reserves all of its rights under the ARTDA and under law to remedy MID's violation of the ARTDA.

If you would like to discuss this further, please contact me at 577-5404.

Sincerely,



Greg Nyhoff
City Manager

cc: Mayor and Council
Susana Alcala Wood, City Attorney
Roland Stevens, Assistant City Attorney
Richard Ulm, Director of Utility Planning and Projects



ATTORNEYS AT LAW
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Conal Riday-White

Of Counsel
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Kristen L. Walter
Robert C. Diemer
James L. English

May 18, 2012

Via hand-delivery

Mr. Allen Short
General Manager
Modesto Irrigation District
1231 11th Street
P.O. Box 4060
Modesto, CA 95352

Re: Proposed Agreement Between Modesto Irrigation District And San Francisco Public
Utilities Commission For A Firm Long Term Transfer of 2MGD Of Water Supply

Dear Mr. Short,

This firm is counsel for the City of Modesto with regard to the propriety of the proposed agreement between the Modesto Irrigation District (MID) and the City of San Francisco's Public Utilities Commission (SFPUC) for a long term commitment to transfer water relegated to MID pursuant to MID's pre-1914 appropriative rights and MID's Raker Act entitlements. For this purpose we have reviewed the Draft Agreement between MID and SFPUC, MID's Amended Restated Treatment and Delivery Agreement with the City of Modesto (ARTDA), the materials provided by MID in support of the proposed Draft Agreement, and the applicable law. Our office's review and analysis has revealed a number of concerns by the City of Modesto regarding the propriety of the proposed transfer of water or water rights to SFPUC.

The Draft Agreement provides that commencing on July 1, 2012 MID will divert to SFPUC at the SFPUC Hetch Hetchy facility 2240 acre foot per year or 2 million gallons per day of water available to MID under its pre-1914 appropriative water rights. Water transferred under the agreement will be accounted for by a reduction to the amount of Tuolumne River water that SFPUC is required to release at the Hetch Hetchy facility for the benefit of MID and as a corresponding decrease of MID's Raker Act entitlements. The Agreement is for a period of ten years and provides it will automatically be renewed for two successive terms of twenty years. Although both MID and SFPUC have openly contemplated an increase in the amount of water transferred to 25,000 acre foot per year, the Draft Agreement is silent on that subject.

The Draft Agreement is also silent on the rights of the City of Modesto under the Amended Restated Treatment and Delivery Agreement with MID. Under Section 17.1 of that agreement, MID is required to provide a minimum of 33,602.1 acre feet per year and 30 million gallons per day to the City until completion of the First Expansion Facilities, at which time the commitment increases to 67,204.2 acre feet per year and 60 million gallons per day. That section also provides that MID shall meet its commitments to its agricultural customers and the City of Modesto before any subsequent water transfers outside of MID's boundaries.

It is our opinion that MID's planned commitment to SFPUC would conflict with MID's contractual obligation to the City of Modesto under the ARTDA. More specifically the Draft Agreement may be interpreted such that SFPUC's rights to the stated volume of water shall take priority over the City of Modesto's contractual rights under the ARTDA. See Draft Agreement, paragraphs II. C. 1 and 2 (transfer water shall not be subject to shortage or reduction for any reason other than force majeure event and resulting decrease in MID's water entitlements shall not exceed amount allocated in Raker Act.) In our opinion the implementation of the Draft Agreement with these provisions will not only constitute an anticipatory breach by MID of the ARTDA, but also will be in violation of Water Code Section 1014 which essentially provides that the transfer of water shall not be the basis of a forfeiture, abandonment or modification of any contractual right to the use of that water.

In addition, it is doubtful that the Draft Agreement for a long term transfer of water (50 years) constitutes a sale of "surplus water" as that term is defined by Section 383 of the Water Code. As MID is of course aware, the City of Modesto and other users within MID's District have not agreed to forego use of that water for the period of time specified in the Draft Agreement, and we believe that MID will not be able to establish that the transfer of water for fifty years will only be water that the City of Modesto and other users within MID's District will not take for their own use.

In a letter dated November 10, 2011, the City of Modesto's City Manager requested that both MID and SFPUC address in their negotiation of their agreement the issue of priority with respect to the City's in-District water needs and rights. The letter extended the City's offer to assist the parties in fulfilling that goal. Obviously the most effective way of addressing that issue would have been to express the City of Modesto's priority in the Draft Agreement. Unfortunately MID and SFPUC have chosen not to do so, and as a result have placed the City of Modesto's contractual and statutory rights in jeopardy.

The City of Modesto still wishes to work with MID and the SFPUC to amicably resolve this problem. It seems that if MID does not wish to impair the priority rights of the City of Modesto, then that result could readily be accomplished by a modification of the terms of the Draft Agreement. The City of Modesto is ready to meet with the parties to assist them in drafting an appropriate provision in their agreement which would not abrogate the City of

Mr. Allen Short
May 18, 2012
Page 3

drafting an appropriate provision in their agreement which would not abrogate the City of Modesto's contractual and statutory rights.

Very Truly Yours,

DAVIDOVITZ & BENNETT LLP

A handwritten signature in dark ink, appearing to be 'Moris Davidovitz', written over the printed name.

MORIS DAVIDOVITZ

MD/

cc: Mr. Steven Ritchie
Assistant General Manager
Public Utilities Commission
1155 Market Street
San Francisco, CA. 94103

(Via hand-delivery)