CONFIDENTIAL MEMORANDUM

TO: Frank Robinson
Dennis Cron

FROM: J. Jeffery Kinsell
Janees Williams
Pamela Newcomb

RE: Apple Valley Ranchos Water Company – Follow-Up

Thank you again for meeting with us last week in Monterey. The discussion concerning the Town's acquisition of the Company was helpful and enlightening for us.

We understand you have a meeting tomorrow, Thursday, to discuss with your attorneys and consultants the possibility of the Town bidding for the Company. This consideration is a response to the proposed acquisition of the Company by an investment fund.

We thought it might be helpful to you to reiterate our thoughts and opinions for your deliberations. If the Town decides to pursue the acquisition, our comments are as follows:

1) KND assumes that the Town's first preference is a negotiated purchase, with a tax exempt financing to provide the purchase monies;

   a) the Town (the water enterprise) assumes the financial risk related to such acquisition; and

   b) the Town would establish a new enterprise or operational division to operate and maintain the system.

2) the financing arrangements can be developed concurrently with other acquisition negotiations;

3) such transaction requirements probably do not allow for the luxury of a Town driven time schedule;

4) another option is to shift the financial and operational risk to the private sector in a concession type methodology;

   a) the Town acquires all assets of the system;

   b) the Town becomes the rate making authority; and

c) the Town leases the assets for a 30-35 year period to a financial and operational entity for this concession period before "returning" the risks and operations back to the Town.

Because of the nature of the transaction and the need for decisive and timely actions, the concession concept may deserve appropriate consideration. Absent a tax-exempt, Town driven acquisition, we understand the current proposal calls for the enterprise to be operated by the private sector with rate making and operational issues outside the Town's control. With a concession arrangement, the acquisition could be completed in a timely fashion, making the "private sector" the Town's partner providing the Town with rate making choices, as well as the system ownership from the closing forward.

We introduced the concession concept as our response to our understanding of the desire of the Town to better control its own destiny by owning the water enterprise, yet shifting the risk to the private sector through the concession period.

In its truest sense, the Town's constituents pay the bills. In a concession arrangement, the Town will have the benefits of the private sector financial risk assumption and operation by a private sector partner, rather than the current proposal of a private sector third party operator whose regulatory control is at the PUC level rather than the Town Council. Answers to operational issue questions can range from an entirely new private operator, the development of a new public department, or assumption of the current Company employees.

We believe the concession concept can be employed at least as efficiently as a traditional Town acquisition, financing and operation structure. We have worked with several California cities utilizing the provisions of relatively new legislation, Section 5956. This new law allows for private/public partnerships and grants relief from a stringent public bidding procurement process for financial/operational partners needed as described herein. If followed, we do not believe the concession arrangement described will be a detriment to the timing constraints inherent in the proposed acquisition. (See the attached summary of this new law.)

As always, we are prepared to employ any resources the Town requests to study or implement an acquisition strategy. Please do not hesitate to contact us with any questions or comments.

Competitive Negotiation Process

Assuming that the project qualifies as a "fee-producing infrastructure project or facility" under the statute and that the fee-paying entity will not be the California state government (this would disqualify the project from the statutes applicability), the City would not need to enter into a PPP agreement through a bidding process. Instead, the City would need to use a "competitive negotiation process" to contract with the private entity. Section 5956.5. The statute's provisions involving process mostly focus on transparency and anti-corruption requirements. Given that Public Contract Code or the Government Code that relates to public procurements other than those related to providing security for the construction and completion of the facility, the agency's procedural limitations to enter into PPP agreements are few. Below you will find the general competitive negotiation process requirements or powers broken out into three topical paragraphs.

<u>1. Proposal Methods</u>

Municipalities have broad discretion to enter into PPP agreements. They do not even have to receive competitive bids, nor do the projects need to be initially proposed by the local agency. If the private entity proposes the project, it is within the governmental agency's discretion to accept the proposal. Projects may be proposed and selected individually or as part of a related or larger project.

<u>2. Anti-corruption Protections</u>

To enter into PPP agreements with a California municipality, two general anti-corruption requirements must be met. The agency's competitive negotiation process must (a) specifically prohibit practices that may result in unlawful activity including, but not limited to, rebates, kickbacks, or other unlawful consideration, and (b) specifically prohibit governmental agency employees from participating in the selection process when those employees have a legally restricted relationship with a person or business entity seeking a contract.

<u>3. Selection Criteria</u>

The primary selection criteria of potential project partners under this statute is that the chosen private party demonstrate competence and qualifications for the studying, planning, design, developing, financing, construction, maintenance, rebuilding, improvement, repair, or operation, or any combination thereof, of the facility, and the selection criteria shall also ensure that the facility be operated at fair and reasonable prices to the user of the infrastructure facility services.