

MUNICIPAL EFFLUENT OPTION AGREEMENT

This MUNICIPAL EFFLUENT OPTION AGREEMENT (“Agreement”) is entered between the City of Bisbee, a municipality of the State of Arizona (the “City”), and Cochise County, a political subdivision of the State of Arizona (the “County”). The City and County are collectively referred to herein as the “Parties.”

RECITALS

WHEREAS, the County intends to complete a large-scale recharge project focused upon maintaining the flows and supporting the riparian habitat of the San Pedro River (the “Bisbee Effluent Project”). The Bisbee Effluent Project requires a minimum of 200-acre feet of water annually to accomplish its intended purpose, so the County needs an assured source of water before it incurs additional expenses, including engineering and other analysis needed to complete the Bisbee Effluent Project;

WHEREAS, the City operates the San Jose Water Treatment Facility (the “Facility”), which currently discharges approximately 360-acre feet of treated wastewater (“Effluent”) annually;

WHEREAS, the City can assure minimum quantities of Effluent to the County for use in the Bisbee Effluent Project, thus ensuring beneficial use of a renewable water resource for watershed enhancement purposes while reducing demand for non-renewable water supplies;

WHEREAS, on April 17, 1989, in *Arizona Public Service Co. v. Long*, 160 Ariz. 429 (1989) (“*Long*”), the Supreme Court held, among other things, that municipal sewage effluent is neither surface water nor groundwater; it is water that loses its original character as surface water or groundwater, and does not reestablish its legal character until it is returned to the land as either surface water or groundwater, such that the municipalities creating it are free to contract for the disposition of said effluent;

WHEREAS, consistent with the holding in *Long*, the Arizona legislature subsequently amended Arizona water code to define “effluent” separately from surface or groundwater, and it is currently defined as “water that has been collected in a sanitary sewer for subsequent treatment in a facility that is regulated pursuant to title 49, chapter 2. Such water remains effluent until it acquires the characteristics of groundwater or surface water.” A.R.S. § 45-101(4).

WHEREAS, the option obtained by the County from the City in accordance with this Agreement, and any agreements the Parties will subsequently enter into to complete the transactions contemplated by this Agreement, is intended by the Parties to meet the legal standards set forth in *Long* and A.R.S. § 45-101(4) regarding the City’s contemplated disposition of the Effluent; and

WHEREAS, the Parties acknowledge that it is in each of their best interests to enter this Agreement to provide the County with the option, at a later date, to enter a longer-term agreement securing effluent from the City (the “Contemplated Effluent Agreement”).

AGREEMENT

NOW, THEREFORE, in consideration of the mutual promises, terms, and conditions contained in this Agreement, and other good and valuable consideration, the receipt and adequacy of which are hereby acknowledged by the Parties, the Parties agree as follows:

1. Incorporation of Recitals. The Recitals detailed above are accurate and incorporated herein.
2. Term and Termination Date of Agreement. This Agreement shall become effective on the date on which this Agreement has been approved by the governing bodies of the Parties and is signed by authorized representatives of the Parties (the “Effective Date”) and shall terminate five (5) years from the Effective Date (the “Termination Date”).
3. Option Payment. In consideration of the rights conveyed by this Agreement, the County shall pay the City the sum of \$35,000.00 (the “Option Payment”). The Option Payment shall be paid to the City in immediately available funds within thirty (30) days of the Effective Date of this Agreement. The Option Payment is non-refundable and earned by the City upon receipt.
4. Rights Conveyed and Exercise of Option. This Agreement conveys to the County the right, but not the obligation, to use a minimum of 200-acre feet of Effluent and ensures that the City will make such Effluent available to the County in the event the County, or its assignee, exercises such right. The rights conveyed to the County by this Agreement shall extinguish unless the County, or its assignee, commences construction on or before the Termination Date.
5. Liquidated Damages to the County: The City’s material breach of the Agreement or the Contemplated Agreement will result in damages to the County, including, but not limited to, costs incurred in permitting the Bisbee Effluent Project, securing easements or other land acquisitions related to the pipeline, engineering and design of pipeline, and costs for staff or independent contractors to perform ongoing Operation and Maintenance. The Parties agree that a reasonable estimate of the County’s damages in the event of a breach is difficult due to the variables detailed herein. Thus, the Parties agree that if the County expends funds in permitting the Bisbee Effluent Project, securing easements or other land acquisitions related to the pipeline, engineering and design of pipeline, or costs for staff or independent contractors to perform ongoing Operation and Maintenance in reasonable anticipation of and reliance upon the City’s performance of the Agreement or Contemplated Agreement, and the City is notified of such expenses and fails to advise of its intent not to comply with the Agreement or Contemplated Agreement, or materially breaches the Agreement or Contemplated Agreement, the County is entitled to liquidated damages in the amount of \$7,260,000 (“Full Damages”) The parties agree that the Full Damages amount shall be awarded for any breach by the City in the first ten years after construction of all improvements, which completion date shall be acknowledged by all parties in writing. (the “Full Damages Period”). Upon expiration of the Full Damages

Period, the Parties agree that the County shall only be entitled to compensatory damages for any breach by the City.

6. Liquidated Damages to the City: The County's material breach of the Contemplated Agreement will result in damages to the City, including, but not limited to, costs incurred in maintenance, instrumentation, and improvements to the Facility and monitoring instrumentation or equipment that the City may install to comply with its obligations under the Contemplated Agreement. The Parties agree that a reasonable estimate of the City's damages in the event of a breach of the Contemplated Agreement is difficult due to the variables detailed herein. Thus, the Parties agree that if the City expends funds in on its Facility, including, but not limited to, permitting, instrumentation, monitoring or other improvements in reasonable anticipation of and reliance upon County's performance under the Contemplated Agreement, and the County is notified of such expenses and fails to advise of intent not to exercise, the Parties agree that the City is entitled to liquidated damages in the amount of \$510,000 ("Full Damages"). The parties agree that the Full Damages amount shall be awarded for any breach by the County in the first ten years after construction of all improvements, which completion date shall be acknowledged by all parties in writing. (the "Full Damages Period"). Upon expiration of the Full Damages Period, the Parties agree that the City shall only be entitled to compensatory damages for any breach by the County.
7. The Parties agree that the City is not entitled to liquidated damages for breach of the Agreement, and that its exclusive damages in the event the County does not exercise its rights under the Agreement is to retain the Option Payment.
8. No Third-Party Beneficiaries. This Agreement is entered and enforceable between the Parties. No third-party beneficiaries are intended by this Agreement.
9. No Third-Party Contract Interference: This Agreement in no way restricts either Party from participating in similar activities with other public or private agencies, organizations, or individuals. Each party represents that the Agreement and Contemplated Agreement will not interfere with any existing or contemplated contract with any third party.
10. Notice. All written notices concerning this Agreement shall be delivered in person or sent by certified mail, return receipt requested, to the Parties as follows:
 - a. To the City:
City Manager
915 S. Tovreaville Rd.
Bisbee, Arizona 85604

b. To the County:
County Administrator
1415 Melody Lane, Building G
Bisbee, Arizona 85604

Any notice or communication required or necessitated by this Agreement shall be given or served, and shall not be deemed to have been duly given or served unless in writing and forwarded by certified or registered mail, return receipt requested, or by personal delivery (which may include public or private express delivery and overnight courier services) addressed to the Party Representative specified in this Paragraph. Either Party may change such address by written notice in the manner specified above for the giving of notices to the other; provided, however, neither Party may designate a foreign address or an address for delivery of notices which does not indicate a street address (i.e., building name or number and street identification), city, state and zip code. Notice shall be deemed received as of the date such notice is (i) delivered to the Party intended to receive such notice, (ii) delivered to the then designated address of the Party Representative to receive such notice, (iii) rejected or other refusal to accept at the then designated address of the Party Representative to receive such notice, (iv) undeliverable because of a changed address of which no notice was given, or (v) three (3) days following deposit in the United States mail, if served by certified or registered mail, return receipt requested. In no event shall notices be transmitted by facsimile or electronic mail.

11. Amendments and Assignment. The Parties acknowledge that the County may—and at this point in fact intends to—convey the rights secured by this Agreement to a third party to allow that third party to complete construction and other improvements related to the Contemplated Agreement. The Parties acknowledge that the City must consent to such assignment, and such consent shall not be unreasonably withheld. Amendments to this Agreement, including assignments or other transfers of rights or obligations under this Agreement by either party, shall be made in writing, signed and dated by the Parties, prior to any changes being effective.
12. Additional Documents. The Parties agree to cooperate fully and execute any and all supplementary documents and take all additional actions which may be necessary or appropriate to give full force and effect to the basic terms and intent of the Agreement. Nothing stated herein shall be construed as requiring any Party hereto or any representative of any Party to provide any evidence, document or testimony other than in response to legal process.
13. Records. In accordance with A.R.S. § 35-214, all books, accounts, reports, files, electronic data, and other records relating to this Agreement shall be subject at all reasonable times to inspection and audit by the State of Arizona for five (5) years after completion of this Agreement.

14. Termination. This Agreement is subject to termination by mutual agreement of the Parties signed and confirmed in writing, or pursuant to A.R.S § 38-511.
15. Entire Agreement. This Agreement constitutes the entire agreement between the Parties pertaining to the subject matter herein and accurately sets forth the rights, duties, and obligations of the County and the City. All prior or contemporaneous agreements and understandings, oral or written, are hereby superseded and merged herein.
16. Invalid Provisions. In the event that any provision of this Agreement or portion thereof is held invalid, illegal, or unenforceable, such provision or portion thereof shall be severed from this Agreement and shall have no effect on the remaining provisions of this Agreement, which shall remain in full force and effect.
17. Taxes. All payments received by the City pursuant to this Agreement may be subject to federal and local income tax. Any questions regarding the tax status of payments should be directed to the City's tax accountant.
18. Choice of Law and Venue. This Agreement is governed by the laws of the State of Arizona. Any lawsuit related to this Agreement shall be brought in Cochise County, Arizona.
19. Counterparts. This Agreement may be executed in counterparts and if so executed, shall have the same force and effect as if the documents had been executed in a single part.
20. Titles, Headings and Captions. Titles or captions contained in this Settlement Agreement are inserted only as a matter of convenience and for reference and in no way define, limit, extend or proscribe the scope of this Agreement or the intent of any provisions hereof.

MATERIAL TERMS OF THE CONTEMPLATED EFFLUENT AGREEMENT

Subject to alteration via mutual written, signed agreement of both Parties, and without limiting inclusion of additional or alternative material terms in the event the Parties do enter the Contemplated Effluent Agreement, the Parties agree to that the Contemplated Effluent Agreement will include the following material terms:

21. Contingency Acknowledgement. The Parties acknowledge that the Contemplated Effluent Agreement is entirely contingent upon the County securing third party funding for all phases of design and construction of the improvements required to convey the effluent to the project site, as well as securing third party funding to make the payments to the City for its effluent as provided herein.
22. Form of Agreement. The Contemplated Effluent Agreement will be in the form of a license granted from the City to the County guaranteeing a minimum available quantity of 200-acre feet of Effluent discharged from the City's Facility annually.

23. Payment Terms. The County shall pay the City \$150,000.00 upon the effective date, as such term will be further defined in the Contemplated Effluent Agreement. Additionally, the County shall pay the City, on an annual basis, \$60.00 per acre foot of Effluent actually delivered to the County for the first 200 acre feet of Effluent. At the City's discretion, and provided the County is notified of and agrees in writing to the additional delivery, the City may deliver more than 200 acre feet to the County annually. The County will pay the City \$90.00 per acre foot for each acre foot of Effluent in excess of 200 acre feet in any given year. The Parties will evaluate the market every five (5) years and adjust the per acre foot payment to reflect current market conditions for payments for Effluent that the City may deliver to the County in excess of the 200 acre foot minimum. The City is responsible for invoicing the County for all amounts due and payable.
24. Term. The term of the Contemplated Effluent Agreement will be 25 years from the effective date, as such term will be further defined in the Contemplated Effluent Agreement.
25. Volume of Effluent: A minimum of 200-acre feet of Effluent from the City's Facility will be made available to the County on an annual basis. Measurement and quantification of the volume delivered in any year will be determined by the instrumentation and monitoring equipment in place at the City's Facility. The City shall be solely responsible for maintaining its instrumentation and monitoring equipment to ensure accuracy of the quantification. The County may, however, request an independent examination of the instrumentation and monitoring equipment of the Facility in the event it believes the quantification is inaccurate.
26. Maintenance of the Facility: The City warrants and represents upkeep and maintenance of its Facility and continued compliance with and satisfaction of all statutes, laws and other regulatory or permitting standards regarding the Facility and the Effluent discharged therefrom.
27. Force Majeure. A "Force Majeure" is defined as any event beyond the control of the Parties that prevents the Parties from complying with obligations under the Contemplated Effluent Agreement, including but not limited to: act of God (such as, but not limited to, fires, explosions, earthquakes, drought, tidal waves and floods); war, hostilities (whether war be declared or not), invasion, act of foreign enemies, or embargo; rebellion, revolution, insurrection, or military or usurped power, or civil war; contamination by radio-activity from any nuclear fuel, or from any nuclear waste from the combustion of nuclear fuel, radio-active toxic explosive, or other hazardous properties of any explosive nuclear assembly or nuclear component of such assembly; riot, commotion, strikes, go slows, lock outs or disorder, unless solely restricted to employees of the Supplier or of his Subcontractors; or acts or threats of terrorism. Neither the City nor the County shall be considered in breach of the Contemplated Effluent Agreement to the extent that performance of their respective obligations (excluding payment obligations) is prevented by an event of Force Majeure that arises after the Effective Date. The Party prevented from

carrying out its obligations hereunder (the “Affected Party”) shall give notice to the other Party of an event of Force Majeure upon it being foreseen by, or becoming known to, the Affected Party. If and to the extent that the City is prevented from executing the Services by the Event of Force Majeure, while the City is so prevented it shall be relieved of its obligations to make Effluent available but shall endeavor to continue to perform its obligations under the Contemplated Effluent Agreement so far as reasonably practicable. If an event of Force Majeure results in a loss or damage to the Facility, then the City shall rectify such loss or damage to the extent required by the County, provided that any Cost of rectification (less any insurance proceeds received by the City for the loss or damage) is borne by the County after the City takes reasonable steps to mitigate losses. During a period of Force Majeure, the City is not entitled to any payments pursuant to the Contemplated Effluent Agreement, and the term of the Contemplated Effluent Agreement shall be extended by a period of time equal to the period of interruption of access to available Effluent caused by the event of Force Majeure.

28. Stay or Termination. Irrespective of any extension of time, if an event of Force Majeure occurs and its effect continues for a period of 180 days, the Contemplated Effluent Agreement shall be stayed unless either the City or County gives the other a notice of termination. In the event either party delivers a notice of termination, it shall take effect 45 days after the giving of the notice. If, at the end of the 45-day period, the effect of the Force Majeure continues, the Contemplated Effluent Agreement shall terminate.
29. Insurance. The Parties shall each procure and maintain until all of their obligations have been discharged (including any warranty periods under this Agreement are satisfied), insurance against claims for injury to persons or damage to property which may arise from or in connection with the performance of the work hereunder by the Parties or their agents, representatives, employees or contractors. The types and amounts of such insurance will be further negotiated in the Contemplated Effluent Agreement, but in no event shall such insurance be insufficient to address foreseeable losses of the Parties.

IN WITNESS WHEREOF, the Parties hereto have executed this Agreement with an effective date as of the last signature date below, and each person signing this Agreement warrants that he/she has the capacity and authority to execute this Agreement.

APPROVED:

City Council, City of Bisbee, Arizona

David Smith, Mayor

DATE

APPROVED:

Board of Supervisors of Cochise County, Arizona

Peggy Judd, Chairperson

DATE