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Alex Garcia

Partner

February 5, 2010

VIA EMAIL AND REGULAR MAIL

Mr. Mike Page

Schwartz, Page & Harding, LLP

1300 Post Oak Blvd., Suite 1400

Houston, TX 77056

Re: San Jacinto River Authority ("SJRA") Draft Groundwater Reduction Plan Contract ("SJRA Draft")

Dear Mike:

Thank you for your December 21, 2009, letter regarding the SJRA Draft. As previously mentioned, we are concerned by the model proposed by SJRA to satisfy the Lone Star Groundwater Conservation District ("Lone Star") fresh groundwater reduction requirements. We agree that significant efficiencies and economies of scale result from groundwater reduction plans ("GRP") having a large number of participants. However, we also believe that local governance is a critical facet of any GRP.

Brief History (commencing fall 2009)

SJRA entered into a contract with the City of Houston ("Houston") effective October 16, 2009, whereby SJRA, in addition to its one-third ownership in Lake Conroe ("Lake"), reserved for SJRA the water from Houston's two-thirds ownership in the Lake. As we understand it, SJRA's one-third represents approximately 30 million gallons per day ("MGD") and Houston's two-thirds represents approximately 60 MGD, for a total of 90 MGD in the Lake. SJRA also obtained in the contract, Houston's agreement not to "sell, commit, or otherwise provide" to entities subject to Lone Star's groundwater reduction mandate (*i.e.*, large volume groundwater users in Montgomery County) any water out of the Lake, regardless of whether SJRA needs the water, unless SJRA gives permission.

On November 10, 2009, Lone Star adopted its Regulatory Plan Phase II(B) requiring large volume groundwater users ("LVGUs") to: (i) declare the GRP in which the LVGU will participate by June 1, 2010; (ii) submit a GRP to Lone Star by January 1, 2011; and (iii) implement conversion to alternative water by the year 2016.

Also effective November 10, 2009, SJRA entered into an agreement ("Woodlands Agreement") with Montgomery County Municipal Utility District No. 6 ("MUD 6"), one of the Woodlands MUDs (and presumably entered into similar agreements with other Woodlands MUDs), whereby SJRA will provide GRP service/compliance for such district.

On November 23, 2009, we met with SJRA and expressed concerns about the SJRA Draft, including the lack of local governance regarding these momentous water infrastructure decisions impacting Montgomery County. SJRA was asked if it would be willing to sell City of Conroe ("Conroe") raw water from the Lake so that Conroe could implement its own GRP to comply with Lone Star's rules if SJRA and Conroe are unable to come to mutually agreeable terms on the SJRA Draft. The response was "no." We expressed serious concern over this response as an attempt to force entities into a contract with SJRA though the SJRA Draft is viewed as unreasonable. In addition, we were surprised by this position because, prior to this date, Mayor Webb Melder was under the impression from SJRA that Conroe would be able to purchase raw water from SJRA.

Shortly thereafter, we communicated with you regarding many additional comments on the SJRA Draft. In mid-December 2009, you indicated that if SJRA and Conroe are unable to come to mutually agreeable terms, that SJRA *would be* willing to sell raw water to Conroe, but only on an interruptible basis. We again expressed our concern regarding that position because, of course, interruptible water is not a long-term viable water supply option. On December 21, 2009, you provided the current version of the SJRA Draft.

Threshold Concerns

We have a number of concerns about the SJRA Draft, including our threshold concern that the GRP model proposed by SJRA lacks the fundamental aspect of local governance. As previously discussed with SJRA, it is unprecedented in neighboring counties converting to alternative water to have a GRP provider lacking in local governance to function as the sole GRP provider for the entire county. Generally, regional water authorities, as GRP providers, have very broad powers, including the power to decide: (i) how much entities remaining on groundwater are required to pay for pumping their water wells; (ii) which entities convert to surface water and when they convert; (iii) how much surface water the entity is required to take; (iv) how much

the entity is required to pay for the surface water it is required to take; and (v) what facilities the entity will be required to construct to enable it to take the required amount of surface water.

These broad regional water authority powers are, however, controlled by the checks and balances of local accountability. Specifically, three out of the four regional water authorities implementing surface water conversion in Harris and Fort Bend Counties are jointly appointed by the governing bodies of the water-using local governments within their boundaries who, in turn, are popularly elected. (The board of directors of the other authority is popularly elected.) We believe that, unless GRP powers are tempered by local governance, the risk of disconnect between those governing and those governed is too great. This is especially true in the context of GRPs, which by necessity will be in effect for many decades.

SJRA, in its model, seeks regional water authority powers but avoids the accountability of local governance that is inherent in regional water authorities. We believe that it would be unprecedented for a river authority to obtain the breadth of powers SJRA is seeking over the water systems of approximately 200 governmental and non-governmental water well owners.

The regional water authority model of linking GRP powers to local governance is a success story. Collectively, the above-referenced regional water authorities: (i) have issued nearly \$900,000,000 in bonds; (ii) have constructed over 120 miles of water pipelines; (iii) include over 1,000,000 people within their service areas; and (iv) are estimated to have converted by mid-2010 over 200,000 people from groundwater to surface water usage.

As we discussed in mid-December 2009, we are concerned about language in the SJRA Draft that would allow SJRA to avoid accountability for its actions. The following provisions best exemplify the lack of accountability that results from inadequate local governance:

- Section 1.03(c): This provision provides that SJRA would have an absolute defense for its breach of contract, willful misconduct, gross negligence, and negligence if SJRA had "any good faith application or interpretation" of a provision in the contract or if it relied "in good faith on the advice or opinion(s)" of an experienced attorney. The immunity that SJRA seeks to obtain by this provision is much broader than any immunity granted to governmental entities by state law and surpasses the powers of a regional water authority. (In addition, can you explain why SJRA did not include this provision in the Woodlands Agreement?)

- Section 6.03(a): This provision allows SJRA to require the GRP participants to pay for SJRA's "failure to perform under this [GRP] Contract, except in an instance of gross negligence or willful misconduct [by SJRA]." (See also Section 6.04(d)(3).) Accordingly, if SJRA fails to convert an adequate number of participants to surface water and thereby causes some or all participants to be fined by Lone Star, there are no consequences for SJRA. Even if participants were able to somehow pierce SJRA's immunity under Section 1.03(c), above, the participants would be required to pay for SJRA's breach. Since SJRA has no retail customers, it would be able to pass on to others all of the costs for its breach. The regional water authority structure at least allows political recourse in the event of such a failure to perform. (In addition, can you explain why SJRA did not include these provisions in the Woodlands Agreement?)
- Section 2.11: This provision provides that the recommendations of the Review Committee, which partially consists of individuals appointed by local governments in Montgomery County, "are advisory only and shall not be binding upon the GRP Administrator or [SJRA]." Accordingly, SJRA can entirely reject the recommendations of the Review Committee. The Committee does not provide a meaningful substitute for local governance. The GRP project proposed by SJRA is the most expensive public works project ever undertaken in Montgomery County; it is estimated to cost ratepayers billions of dollars. Significant construction and disturbance of communities and streets will occur because of the GRP project. We believe that it is unreasonable to implement a project of this magnitude without local governance.

We have a significant number of additional comments to the SJRA Draft, but we would like to address these fundamental, threshold concerns prior to proceeding with other comments.

Request for Documents

Conroe's City Council ("Council"), of course, is answerable to its residents for proper management and expenditure of Conroe's public funds. To date, we have not received sufficient data from SJRA regarding studies/reports for Council to be able to adequately evaluate SJRA's proposal. Current estimates indicate that compliance with Lone Star rules will at least double the water rates paid by Conroe's residents. Council owes it to the residents to be certain that it is making a prudent decision on their behalf. To assist Council in this regard, and pursuant to the Texas Public Information Act, please provide me or Marcus Winberry a copy of:

1. Studies or reports performed after 2001 regarding the impact of water sales or withdrawals on lake levels in the Lake in connection with compliance with Lone Star rules;

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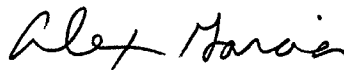
2. Studies or reports performed after 2001 regarding the ability of SJRA to utilize the Lake as a water supply source to provide compliance with Lone Star rules;
3. Studies or reports performed after 2001 regarding brackish groundwater in Montgomery County;
4. Studies or reports performed after 2001 regarding cost-analyses or feasibility analyses for SJRA's provision of GRP services, including analyses showing the \$1.80 to \$2.00 per 1,000 gallon pumpage fee presented by SJRA at its January 14, 2010, Stakeholder Meeting;
5. Studies or reports performed after 2001 showing cost and feasibility analyses of construction, operation or financing of an SJRA surface water treatment plant and/or surface water lines;
6. A copy of at least five contracts executed after 1980 wherein SJRA is a seller of raw surface water; and
7. A copy of all agreements between or among SJRA and: (i) any municipal utility districts in Montgomery County (including any that are members of the Woodlands Joint Powers Agency ("Agency")); and/or (ii) the Agency. This request specifically includes the Contract for Financing, Construction and Operation of Water Supply and Waste Disposal Facilities, dated June 20, 1975, between SJRA and MUD 6, and any amendments and supplements thereto.

Please advise regarding copying costs so that we can make arrangements for payment of same.

Finally, as discussed on page one of this letter, SJRA has indicated orally that if Conroe and SJRA are unable to come to mutually agreeable terms on the SJRA Draft, SJRA will not sell Conroe "firm" raw water from the Lake and that Conroe will only be allowed to purchase interruptible raw water. Please confirm this SJRA position in writing and provide it to us within seven days of the date of this letter.

Thank you for your continued efforts. Please advise when we can meet again to further discuss resolution of these matters.

Sincerely,



Alex Garcia

cc: Honorable City of Conroe City Council
Honorable Mayor Webb Melder
Mr. Jerry McGuire, City Administrator
Mr. Marcus Winberry, City Attorney