

# FULBRIGHT & JAWORSKI L.L.P.

A REGISTERED LIMITED LIABILITY PARTNERSHIP

FULBRIGHT TOWER  
1301 MCKINNEY, SUITE 5100  
HOUSTON, TEXAS 77010-3095  
WWW.FULBRIGHT.COM

NEIL THOMAS  
PARTNER  
NTHOMAS@FULBRIGHT.COM

DIRECT DIAL: (713) 651-3613  
TELEPHONE: (713) 651-5151  
FACSIMILE: (713) 651-5246

February 26, 2010

**BY E-MAIL MPAGE@SPHLLP.COM**

San Jacinto River Authority  
c/o Mr. Michael G. Page  
1300 Post Oak Boulevard  
Suite 1400  
Houston, TX 77056-3078

Re: San Jacinto River Authority GRP Contract

To the Board of Directors:

We are attorneys for Montgomery County Municipal Utility District No. 3. The following comments to the draft GRP contract circulated by the San Jacinto River Authority on December 22, 2010 are offered on behalf of our client.

At the outset, we raise two general concerns. First, it is the goal of the Authority for the contract to charge uniform costs to ratepayers. In fact, over time, the costs are not uniform. Early users will pay a larger share of facility capital costs than subsequent users, so that a developed area in the Woodlands or Conroe will pay a greater portion of the capital costs of the facility than an area developed in the future. While our client understands that this model has advantages—it is easy to administer and it places the fewest obstacles in the path of future development—it is not completely equitable. Other models, notably drainage costs in Harris County Flood Control, would recover some portion of the present capital costs from future users, which would at least allow the current developed areas to recover some portion of the initial capital investment. Some effort at recovering capital costs for current users is appropriate.

Second, the contract makes some effort at representation among users through the Review Committee, but the the committee has no authority and no guarantee as to the Authority's future responsiveness. We would recommend that the Committee have approval authority over the GRP, amendments to the GRP, general plan of facilities, approval of new GRP contracts, legislative action, annual budget, rate order provisions and amendments, and penalties, rates and fees. We would also suggest that the contract provide for payment of independent consultant and legal costs for the committee.

The following comments questions are offered by Section reference:

*Table of Contents.* This is a long contract, and a table of contents, including a list of Exhibits, would be helpful for future navigation.

*Section 1.01.* As a general matter, the contract has an odd habit of defining some but not all terms in both the singular and the plural. Section 1.03(b) would seem to make the double definitions unnecessary.

*Section 1.01(a).* If bonds are outstanding, the Applicable Interest Rate results in double payment of the bond interest rate for the period. Also, the 20-Bond Index is based on 20-year or longer bonds with relatively high interest rates. Unless the purpose of the provision is to be punitive, the rate should be a reasonable investment rate for the Authority. TexPool's rate would be a more realistic measure of possible investment for the period.

*Section 1.03(c).* The determination of contractual breach or whether a particular action constitutes negligence, gross negligence, or willful misconduct is a question of fact, and fact is usually an inappropriate subject for a lawyer's determination. This section is inappropriate, and it certainly inappropriate where the counsel reviewing the act is not otherwise independent.

*Section 1.03(d).* The provision is inappropriate and should be removed. There are strong reasons that ambiguous provisions are determined against the drafting party, and the convention can help avoid future litigation.

*Section 3.02(b).* How are the projections to be used?

*Section 3.03.* The right of ownership of Wells should also include ownership of withdrawn water.

*Section 3.04.* This provision is not clear to us. What is the difference between credits earned under the first sentence and credits under the second sentence?

*Section 4.03.* The easement provisions give the authority greater and overriding rights of use over a Participant's use or planned use of its own easements, and which must also be subject to the terms of the easements themselves. The provision needs to protect the rights of use of the Participants and also be subject to the terms of the easements.

*Section 4.06.* The provision assumes that no equipment is in place. Is that always the case? Why is Monitoring Equipment needed under Clause (2)?

*Section 4.07(b).* Approval of On-Site Facilities should not be unreasonably withheld.

*Section 4.08.* Reimbursement of On-Site Facilities should be offset if the Participant would otherwise be incurring additional groundwater costs that are no longer required, either directly or indirectly.

*Section 4.09.* What is the purpose of the limitation on groundwater requirements in the proviso in the second sentence?

*Section 4.11.* As a general matter, recovery, mandamus, and waivers of sovereign immunity need to run both ways. The Participants should be authorized to recover damages from the Authority for damages assessed against the Participants for the Authority's breach, negligence, or willful acts or omissions.

*Section 4.12.* There seems to be no purpose for the limitations against re-use, and the provisions generally make re-use difficult and limit its value to the Participants. Effectively, the provisions seem to transfer rights of re-use to the Authority. The right to and value of re-used water, whether direct or indirect and whether or not within a Participant's boundary, should remain in the control of the Participant. At a minimum, control of re-use should be controlled by the advisory committee.

*Section 5.02.* Is annual testing common, and is it an appropriate engineering and operations practice? I would assume it will be expensive.

*Section 8.04.* The provisions needs to provide that unless there are amendments to 15c2-12, no participant will be an obligated person if less than 15% of Authority pledged revenues are received from that person.

*Section 11.03.* The Contract should provide for termination if a Participant provides for defeasance of its pro-rata share of outstanding indebtedness.

Please call if you have any questions concerning this contract.

Very truly yours,

Neil Thomas

cc: Mr. Ken Conatser  
Mr. Marcus L. Winberry  
Mr. Joe B. Allen  
Mr. Ron Young  
Mr. Alex Garcia  
Mr. Clark Lord

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