

b. a dispute as to whether capital improvements have increased a Party's entitlements or obligations under this Contract, and if so the extent of such increased entitlements or obligations, or

c. a dispute as to whether a Party's usage of water is exceeding its share of capacity of facilities, and if so the extent of such excess, or

d. a dispute as to the design of capital improvements proposed to be constructed by a Party or as to the portion of capital improvements, if any, to be paid by a Party, or

e. any other dispute arising out of or relating to this Contract or any other relationship between the Parties concerning a matter as to which the exercise of engineering experience and judgment is necessary for resolution of the dispute, or

f. any other dispute that the Parties at the time agree to submit to the dispute resolution procedure of this section.*

2. "The Neutral" means a civil engineer selected by the agreement of the two Parties or, in the absence of agreement, a civil engineer appointed pursuant to subsection C below.

B. Agreement to Arbitrate. In the event a dispute concerning engineering issues arises, and the Parties have not resolved the dispute by agreement, then the Parties agree to submit the dispute to the Neutral for binding arbitration.

C. Selection of the Neutral.

1. In the event the Parties do not promptly select the Neutral by agreement within 30 days following the request of either Party, then the Parties agree to cooperate promptly and reasonably, and without ex parte communications, in seeking and obtaining the appointment of a civil engineer by the Dean of the College of Engineering of Texas A & M University, or, if such Dean declines to appoint the Neutral, a civil engineer appointed by the presiding district judge of the 27th District Court of the State of Texas.

2. The Parties agree that such Dean, such district judge and the Neutral shall have no liability whatsoever to either of the Parties and shall be deemed by the Parties to enjoy judicial immunity for any role in this dispute resolution process.

D. Procedures and Related Matters.

1. The arbitration shall be held in Lampasas, Texas, or at such other place as may be selected by mutual agreement.

2. Promptly upon billing by the Neutral, the Parties shall each pay one-half of the deposits, fees and expenses charged by the Neutral, subject to such allocation for reimbursement as the Neutral may award as part of the Neutral's decision.

3. The arbitration shall be conducted by such procedure as the Neutral shall determine, with or without reference to available models such as the Commercial Arbitration Rules of the American Arbitration Association.

4. Judgment upon the award rendered by the arbitrator may be entered in any court having jurisdiction thereof.

5. Nothing contained herein shall prohibit a Party from seeking injunctive or other ancillary relief from any judicial authority, before, during or after the pendency of any arbitration proceeding; provided, however, that no relief so granted may operate to reduce or impair the authority of the Neutral as set forth in Article 4.4.

6. The provisions of this arbitration clause shall survive the termination or expiration of this Agreement.

7. In making any determination regarding any dispute concerning engineering issues, the Neutral may consider (i) original design parameters and (ii) that the delivery capacity of the system between the CWTSC Water Treatment Plant and the Points of Delivery to the City is dependent upon hydraulic conditions of the system as a whole, including but not limited to initial pump available head, friction loss, water velocity, pipe diameter, ground elevation along the transmission route, water elevations in storage tanks, and other factors.

8. As to any calculations in which the Neutral is required to use a friction coefficient: KWSC represents, and the City has no basis to dispute, that the KWSC Existing System was designed with the use of a friction coefficient of 140. The Parties agree

a. that the Neutral should use a presumption that the friction coefficient is 140 in the KWSC Existing System unless the Neutral is persuaded based upon empirical evidence that a different friction coefficient is more accurate and reliable as to one or more components of the KWSC Existing System,

b. that the Parties will cooperate in good faith to allow prompt measurement of the friction coefficient in any component of the KWSC System upon either Party's request, and

c. that no presumption shall exist as to the friction coefficient as to any portion of the KWSC Existing System if the Neutral is persuaded based upon empirical evidence that a different friction coefficient is more accurate and reliable as to one or more components of the KWSC Existing System; and in such circumstance, the Neutral's use of any

parameters to be used in any calculations should be based upon the Neutral's judgment, experience and conclusions from any evidence presented by the Parties.

4.5 Records

Upon written notice and during normal business hours, the City shall have the right to inspect, and/or have its independent auditor evaluate, the records of KWSC to the extent necessary to verify the accuracy of any statement, charge or computation made pursuant to any provisions of this Contract. Upon written notice and during normal business hours, KWSC shall have the right to inspect, and/or have its independent auditor evaluate, the records of the City to the extent necessary to verify the accuracy of any statement, charge or computation made pursuant to any provisions of this Contract. Upon request, a Party shall provide the other Party with its audited financial statements.

4.6 Concurrence by USDA-RD

KWSC and the City agree to use their best efforts to obtain the concurrence of USDA-RD and to cooperate in all reasonable ways to amend this Contract consistently with its current substance to the extent, if at all, needed to obtain such concurrence. Following the Effective Date, the City agrees to cooperate with KWSC in seeking the closing of the TWDB Loans.

4.7 Enforcement of CTWSC Wholesale Contract

The Parties acknowledge that KWSC's ability to perform some obligations under this Contract are subject to CTWSC's performance of the CTWSC Wholesale Contract. KWSC shall use its best efforts to insure that each covenant and representation made by CTWSC in the CTWSC Wholesale Contract is performed; such best efforts shall include without limitation KWSC's enforcement of its legal and equitable remedies, including specific performance, in the event CTWSC fails to perform timely these covenants and representations. Upon request the Parties shall meet to discuss KWSC's efforts and CTWSC's response. Without modifying in any way the foregoing, the Parties further acknowledge that the City's agreement to pay the agreed escalator on the \$0.08 per 1000 Gallons is expressly conditioned on KWSC's agreement to use its best efforts to enforce the following:

A. CTWSC shall maintain the current rated capacity of the CTWSC Water Treatment Plant Capacity at no less than 14.35 MGD;

B. CTWSC shall require that all other members and/or customers of CTWSC contribute to the Capital Investment Account according to the Capital Contribution Schedule applicable to KWSC;

C. Funds contributed to the Capital Investment Account by KWSC and by members and customers of CTWSC shall be accumulated in the Capital Investment Account to pay for capital improvements, as the Board may, in its discretion, from time to time deem necessary pursuant to its Capital Policy. CTWSC may also use the Capital Investment Account to (i)

acquire leases, licenses, easements, rights-of-way, and interests in fee simple to extend rights in the Water Treatment Plant site from the Corps of Engineers, Department of U.S. Army from May 10, 2029 to the expiration of the Term of this Contract, (ii) acquire leases, licenses, easements, rights-of-way, and interests in fee simple to extend rights in pipeline easements from the Fort Hood Military Reservation from January 22, 2035 to the expiration of the Term of this Contract, and (iii) obtain renewals and extensions of contracts with BRA.

D. In considering expenditures for capital improvements, CTWSC agrees to keep facilities in good condition to deliver contractual quantities to the respective points of delivery.

E. Payments from the Capital Investment Account will be made only with prior approval of specific item(s) by the Board of CTWSC given after due notice and action by the Board at a regular meeting on items regarding the expenditure of these funds.

4.8 Reserve Accounts and Use of Reserve Fund Earnings

"Joint Use Facilities Base Reserve Account" and "Joint Use Facilities System Account." The Parties have paid into reserve accounts required by certain loans for "Joint Use Facilities" as defined herein. The Parties desire to cooperate to accumulate and make available the interest on reserve amounts and other monies to provide an ongoing source of funding for the purposes set forth herein. KWSC agrees, as a condition precedent to operation of this Section 4.8, that it shall maintain as fully funded its reserve accounts for all indebtedness to USDA-RD.

1. "Joint Use Facilities." The proceeds from KWSC USDA-RD Loans 91-06 and 91-07 and CTWSC USDA-RD Loan 91-06 were used to construct facilities for the water storage and transmission system benefiting both the City and KWSC. KWSC anticipates using proceeds of the TWDB Loans to prepay KWSC USDA-RD Loan 91-07 and CTWSC USDA-RD Loan 91-06, as well as to fund the purchase and construction of certain CTWSC facilities which currently serve both KWSC and the City. Those facilities financed by KWSC with funds from KWSC USDA-RD Loans 91-06 and 91-07 and the facilities and purposes referenced above for which the proposed TWDB Loans will be used by KWSC (including those purchased from CTWSC) are referred to as the "Joint Use Facilities."

The proceeds from KWSC USDA-RD Loans 91-01 and 91-02 were used to construct facilities for the sole benefit of KWSC. Additionally, KWSC expects to use proceeds of TWDB Loan 2 to finance the construction of KWSC New Facilities for the sole benefit of KWSC. The facilities constructed with the proceeds of KWSC USDA-RD Loans 91-01 and 91-02, and the proposed KWSC New Facilities to be constructed by KWSC with TWDB Loan 2 as described in this paragraph, shall not be considered Joint Use Facilities.

2. "Joint Use Facilities Base Reserve Account" and "Joint Use Facilities Base Reserve Amount." Existing USDA-RD loan documents require reserve accounts for each USDA-RD loan and it is anticipated future TWDB loan documents will also require the establishment of a reserve account. The Parties agree it is prudent and necessary for KWSC to segregate and keep separate the reserve accounts for the Joint Use Facilities in an account to be

called the "Joint Use Facilities Base Reserve Account." At the present time, the Joint Use Facilities Base Reserve Account shall include the following reserve amounts, which together are called the "Joint Use Facilities Base Reserve Amount."

a. Reserve amounts for KWSC USDA-RD Loans 91-06 and 91-07. Under existing USDA-RD loan documents, the Base Amount for KWSC USDA-RD Loan 91-06 is approximately \$329,784.00 and for KWSC USDA-RD Loan 91-07 is approximately \$211,200.00, for an approximate total of \$540,984.00, which amount is fully funded.

b. Reserve amount for CTWSC USDA-RD Loan 91-06, as refinanced. It is anticipated that KWSC will prepay and retire CTWSC USDA-RD Loan 91-06 with TWDB Loan 1 and CTWSC will transfer the funds in its reserve account in the amount of \$297,650.00 to KWSC. In lieu of distributing this amount pro rata to the City and to KWSC based on their payments under the 2000 Contract and 2001 Contract, KWSC will deposit the total amount into the Joint Use Facilities Base Reserve Account.

c. Future loans. In the event that the Parties mutually agree in future to other loan(s) for purpose of improvements to Joint Use Facilities, the reserve amount for such loan (s) shall be added to the Joint Use Facilities Base Reserve Account.

d. Retention of reserve amounts. It is the Parties' intent that, when KWSC USDA-RD Loan 91-07 is prepaid and retired, the reserve amount attributable to Loan 91-07 in the amount of approximately \$211,200.00 will remain in the Joint Use Facilities Base Reserve Account to satisfy requirements of TWDB loan documents for loans related to the Joint Use Facilities. It is also the Parties' intent that the same procedure shall apply in the event KWSC USDA-RD Loan 91-06 is prepaid or the Parties mutually agree to establish other loans for the Joint Use Facilities as set forth in c above and to prepay such other loans. Upon retirement of a loan, provided KWSC's reserve accounts for all indebtedness to USDA-RD are fully funded, the Joint Use Facilities Base Reserve Fund Amount shall be adjusted under the provisions of the existing loan documents and any funds in excess of the Base Reserve Fund Amount shall be transferred to the Joint Use Facilities System Account as defined below, except as follows: if at the time of the proposed funds transfer the balance in the Joint Use Facilities System Account exceeds \$1,000,000.00, or the proposed funds transfer will result in a balance exceeding \$1,000,000.00, then the Parties shall disburse the portion of such funds which if added to the Joint Use Facilities System Account would result in a balance in excess of \$1,000,000.00 to the Parties, 63% to the City and 37% to KWSC.

e. Use of Base Reserve Fund Amount. The Base Reserve Fund Amount may only be used for the purpose of paying the cost of repairing or replacing any damage to the KWSC System which may be caused by any unforeseen circumstance, subject to agreement of the Parties to the contrary. Prior to any such expenditure of the Base Reserve Fund Amount, the Parties shall mutually agree to a timeframe for replacement of such funds in the Base Reserve Fund Amount.

3. Joint Use Facilities System Account. The Parties intend for the Joint Use Facilities Base Reserve Account to accumulate interest to be used as provided herein. Interest earned on the funds in the Joint Use Facilities Base Reserve Account shall be transferred quarterly to the "Joint Use Facilities System Account" which shall be created and administered by KWSC. Upon recommendation by KWSC's auditor, the Parties shall mutually agree on the type of account, including permissible investments and recordkeeping, for the Joint Use Facilities System Account. The funds in the Joint Use Facilities System Account shall be used exclusively for purposes benefiting the Joint Use Facilities as mutually agreed by the Parties, and may include funding of improvements to or maintenance of the Joint Use Facilities and funding of reserves in the event the Parties agree to undertake further loan(s) with respect to the Joint Use Facilities. Such uses may include improvements primarily benefiting one Party or the other Party. The Parties will discuss proposed fund uses at their annual meeting, or more frequently if necessary. Both Parties shall approve in writing any proposal for the expenditure of any funds in the Joint Use Facilities System Account prior to obligating the Parties to any proposed project or use.

4. Account Statements. KWSC shall provide copies to the City of the statements from the Joint Use Facilities Base Reserve Account and Joint Use Facilities System Account.

5. Disbursement of Excess. At such time as the Joint Use Facilities System Account exceeds \$1,000,000.00, then KWSC shall cause the excess to be disbursed to KWSC and to the City. Earned interest in excess of \$1,000,000 in the Maintenance Reserve Account shall be disbursed quarterly to the City and KWSC as follows: (i) 63% to the City and (ii) 37% to KWSC. While the Parties intend that the anticipated use of the proceeds so disbursed shall be discussed at the annual meeting of the Parties, either Party may use the proceeds so disbursed to it as it sees fit.

6. Expiration. At the expiration of the Term of this Contract, any amounts remaining in the Joint Use Facilities System Account and the Joint Use Facilities Base Reserve Account shall be disbursed 63% to the City and 37% to KWSC; unless at such time a Party has no remaining amounts following an expenditure of its portion of such remaining amounts in a mutually agreed project for that Party's exclusive benefit.

4.9 Effective Date Adjustments

A. Escrow Amount. Upon the Effective Date of the 2006 Contract, the City shall cause to be paid to CTWSC the funds deposited by the City into, and currently held in, the escrow account, together with any interest thereon, currently maintained by the Parties to provide for and pay the difference between the amount paid by the Parties to CTWSC pursuant to the Water Sale and Purchase Contract executed by CTWSC and KWSC on or about July 22, 1985 (as may have been amended by agreement or subsequent judgment) and the amount which would have been paid by the Parties to CTWSC under the provision of the 2000 and 2001 Contracts from January 1, 2004 to the effective date of the 2005 Contract.

B. Billing Adjustment. Upon the Effective Date of the 2006 Contract, the Parties shall "true up" the bills to the City from KWSC for CTWSC Operation & Maintenance Expenses for months subsequent to the effective date of the 2005 Contract, so that CTWSC O&M Expenses for months subsequent to the effective date of the 2005 Contract are calculated based upon the "City Percentage" calculated pursuant to Section 3.5.C.1 of the 2006 Contract. In the event any such adjustment results from the "true-up," the Parties agree that the amount of such adjustment, whether a credit or debit, shall be prorated in twelve equal amounts and shall be reflected as adjustments in the next twelve monthly billings. The Parties further agree that bills to the City for months following January 2006 shall be subject to the Annual True-Up as provided in Section 3.11.

ARTICLE V. MISCELLANEOUS

5.1 Force Majeure

If by reason of Force Majeure KWSC or the City shall be rendered unable wholly or in part to carry out its obligations under this Contract, other than the obligation of the City to make the payments required by this Contract, then if such Party shall give notice and full particulars of such Force Majeure in writing to the other Party, as appropriate, within a reasonable time after occurrence of the event or cause relied on, the obligation of such Party, so far as it is affected by such Force Majeure, shall be suspended during the continuance of the inability then claimed, but for no longer period, and such Party shall endeavor to remove or overcome such inability with all reasonable dispatch. The term "Force Majeure" as employed herein shall mean acts of God, strikes, lockouts or other industrial disturbances, acts of public enemy, orders of any kind of the Government of the United States or the State of Texas, or any civil or military authority, insurrection, riots, epidemics, landslides, lightning, earthquake, fires, hurricanes, storms, floods, washouts, droughts, or other catastrophes, arrests, restraint of government and people, civil disturbances, explosions, breakage or accidents to machinery, pipelines or canals, power failure, partial or entire failure of water supply, or on account of any other causes not reasonably within the control of the Party claiming such inability. Notwithstanding the foregoing, this provision shall not be construed to apply to the delivery and pressure obligations set forth in Section 3.9.A, or to supplant Section 3.9.C or the specific remedies for Intrusion provided therein.

5.2 Default

A. No Party shall be deemed to be in default hereunder until the passage of thirty (30) days after receipt by such Party of notice of default from the other Party. Upon the passage of thirty (30) days without cure of the default, such Party shall be deemed to have defaulted for purposes of this Contract. Notwithstanding the foregoing, this provision shall not be construed to apply to the delivery and pressure obligations set forth in Section 3.9.A, or to supplant Section 3.9.C or the specific remedies for Intrusion provided therein.

B. Recognizing that each Party's undertakings under this Contract are obligations, failure in the performance of which cannot be adequately compensated in money damages alone,

each Party agrees, in the event of any default on its part, that the other Party shall have available to it the equitable remedy of specific performance in addition to any other legal or equitable remedies which may also be available.

5.3 Conservation

KWSC and the City agree to provide to the maximum extent practicable for the conservation of water, and each agrees that it will operate and maintain its facilities in a reasonable manner that will prevent waste of water. KWSC and the City further agree to implement water conservation and drought management plans as required by state regulations.

5.4 Term of Contract

This Contract shall be effective on and from the Effective Date, and shall continue in force and effect until July 22, 2084; provided, however, that the reservation of capacity to the City in the KWSC System, in the event of any new or amended contract negotiated by and between the Parties and subject to the terms thereof, shall not terminate at the end of the Contract.

5.5 Approval and Consent

Unless otherwise provided herein, any approval or consent required by the provisions of this Contract by KWSC or the City shall be evidenced by a written resolution adopted by the governing body of the Party giving such approval or consent. Upon receipt of such written resolution duly certified by the appropriate Party, KWSC or the City can conclusively act on the matter requiring such approval.

5.6 Modification and Amendment

This Contract may be amended upon the written consent of the respective Board of KWSC and the Council of the City, subject to the concurrence (to the extent required) of USDA-RD; provided, however, no amendment to this Contract shall affect the unconditional obligations of such Parties to pay the amounts due to USDA-RD under CTWSC USDA-RD Loans 91-01 and 91-06 and KWSC USDA-RD Loans 91-06 and 91-07.

5.7 Notice Relating to CTWSC Contracts

In the event that KWSC contemplates any amendment or modification of any contract KWSC has with CTWSC pertaining to the supply of water, then KWSC shall give notice to the City of the specific contemplated amendment or modification at least 30 business days prior to making the same, with express reference to this Section 5.7. Within 20 business days of the City's receipt from KWSC of any such notice of contemplated amendment or modification, the City shall provide KWSC with its written consent, which shall not be unreasonably withheld, to such contemplated amendment or modification and/or written objection to all or such portion(s) of such contemplated amendment or modification to which it objects, setting out with

particularity the basis for each such objection. Should the City not provide timely, written notice to KWSC of its specific objection(s), the City shall be deemed to have consented to the same; however, notwithstanding the foregoing, (i) failure on the part of the City to object to any amendment or modification of any contract KWSC has with CTWSC shall not constitute or be deemed to constitute waiver or modification of any provision or requirement of this Contract or compliance therewith, and (ii) this Section is not intended to supplant or modify Section 5.6, Modification and Amendment, or to permit any amendment or modification of this Contract without compliance with Section 5.6. KWSC agrees that it shall not amend or modify its contractual relationship with CTWSC with respect to any provision (i) for which the City has timely provided written objection in accordance with this Section (ii) in such manner that has a material adverse impact on the rights of the City under this Contract. City consent is not required for any amendment or modification of KWSC contracts with CTWSC provided such amendment or modification does not impact this Contract. KWSC shall give the City 5 business days' notice of its determination to go forward with any proposed amendment or modification to which the City has provided written objection.

5.8 Addresses and Notice

Unless otherwise provided herein, any notice, communication, request, reply, or advice (herein severally and collectively, for convenience, called "Notice") herein provided or permitted to be given, made or accepted by any Party to any other Party must be in writing and may be given or be served by depositing the same in the United States mail postpaid, certified and addressed to the Party to be notified, with return receipt requested, or by hand delivering the same to an officer of such Party. Notice deposited in the mail in the manner hereinabove described shall be conclusively deemed to be effective, unless otherwise stated herein, from and after the expiration of three (3) days after it is so deposited. Notice given in any other manner shall be effective only if and when received by the Party to be notified. For the purposes of notice, the addresses of the Parties hereto shall, until changed as hereinafter provided, be as follows:

- | | | |
|----|---------------------|--|
| A. | If to KWSC, to: | Office of the General Manager
Kempner Water Supply Corporation
Post Office Box 103
Kempner, Texas 76539
Telephone: (512) 932-3701
Fax: (512) 932-2546 |
| | | |
| B. | If to the City, to: | Office of the City Manager
City of Lampasas
312 East Third
Lampasas, Texas 76550
Telephone: (512) 556-6831
Fax: (512) 556-7937 |

The Parties hereto shall have the right from time to time and at any time to change their respective addresses and each shall have the right to specify as its address any other or additional address by at least 15 days written notice to the other Parties hereto.

5.9 State or Federal Laws, Rules, Orders, or Regulations

This Contract is subject to all applicable federal and state laws and any applicable permits, ordinances, rules, orders, and regulations of any local, state, or federal governmental authority having or asserting jurisdiction, but nothing contained herein shall be construed as a waiver of any right to question or contest any such law, ordinance, order, rule, or regulation in any forum having jurisdiction.

5.10 Venue

All amounts due under this Contract, including, but not limited to, payments due under this Contract, shall be paid and be due in Lampasas County, Texas, the County in which the principal administrative offices of KWSC and the City are located. The Parties specifically agree that Lampasas County, Texas, is the place of performance of this Contract.

5.11 Assignment

This Contract may be assigned to USDA-RD as security for KWSC's indebtedness. Otherwise, neither KWSC or the City may assign any interest it may have under this Contract without the prior written consent of the other Party.

5.12 Entire Agreement

This Contract and the contemporaneous Settlement Agreement constitute the entire agreement among the Parties with respect to the sale of treated water by KWSC to the City.

5.13 Applicable Law

This Contract shall be governed by and construed in accordance with the laws of the State of Texas, and the obligations, rights, and remedies of the Parties hereunder shall be determined in accordance with such laws without reference to the laws of any other state or jurisdiction, except for applicable federal laws, rules, and regulations.

5.14 No Third Party Beneficiary

The Parties hereto are entering into this Contract solely for the benefit of themselves and agree that nothing herein shall be construed to confer any right, privilege or benefit on any person or entity other than the Parties.

5.15 Counterparts

This Contract may be executed in several identical counterparts, each of which shall be an original and all of which shall constitute but one and the same instrument.

5.16 Conforming Documents

The Parties shall cooperate in conforming and maintaining accurate exhibits and attachments to this Contract, and in assuring correct references, including exhibits and attachments and references arising from or related to any prepayment of USDA-RD CTWSC Loan 91-06 and/or USDA-RD KWSC Loan 91-07, or closing of the Agreement for Sale.

5.17 Signed on the date executed by both Parties.

KEMPNER WATER SUPPLY CORPORATION:

By: 

President

Attest: 

Secretary

Date: August 28, 2006

CITY OF LAMPASAS, TEXAS:

By: 

Jack Calvert, Mayor

Attest: 

Stacy Brack, City Secretary

Date: August 28, 2006

UNITED STATES OF AMERICA

By: _____

Name: _____

Title: _____

Date: _____

Rural Development, acting on behalf
of the Rural Utilities Service, State of
Texas, United States Department
of Agriculture

ATTACHMENT 1
USDA-RD Concurrence



United States Department of Agriculture
Rural Development
Texas State Office

AUG 22 2006

The Honorable Jack Calvert
City of Lampasas
312 East Third Street
Lampasas, Texas 76550

Mr. Robert Bikoski, President
Kempner Water Supply Corporation
P.O. Box 103
Kempner, TX 76539

RE: 2006 Wholesale Water Supply Contract

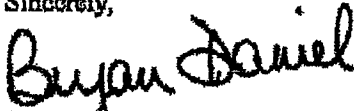
Dear Sirs:

The Agency concurs in the 2006 Wholesale Water Supply Contract, as amended, submitted to this office on July 26, 2006, between Kempner Water Supply Corporation (WSC) and the City of Lampasas, with such concurrence being conditioned upon Kempner WSC paying off USDA Rural Development's notes 91-06 and 91-07.

Notwithstanding positions taken by either party in pending litigation, the parties to this Contract have advised the Agency that neither party asserts an ownership interest in assets of the other contracting party. Certain amendments were made to the Contract to clarify this point. The parties, by accepting this concurrence, agree that the United States has not waived its regulatory or statutory rights, including the right to assert the protections of 7 U.S.C. Sec. 1926(b), notwithstanding any provision contained in the Contract or incorporated therein by reference or appended thereto.

If you have any questions or need additional information, please contact Paco Valentin, Community Programs Director, at (254) 742-9789.

Sincerely,


BRYAN DANIEL
State Director

101 South Main • Federal Building, Suite 102 • Temple, TX 76781
Phone: (254) 742-9789 • Fax: (254) 742-9748 • TDD: (254) 742-9742 • Web: <http://www.rurdev.usda.gov>

Committed to the future of rural communities

"USDA is an equal opportunity provider, employer and lender."
To file a complaint of discrimination write USDA, Director, Office of Civil Rights, Room 328-W, Whitten Building 14th and Independence Avenue, SW Washington, DC 20250-8410 or call (202) 720-6984 (voice or TDD).



United States Department of Agriculture • Rural Development
101 South Main • Suite 102 • Temple, TX 76701

Phone: (254) 742-9759 • Fax: (254) 742-9749 • TDD: (254) 742-9712 • Web: <http://www.rurdev.usda.gov>

FAX COVER SHEET

DATE: AUGUST 22, 2006

TO: ROBERT BIKOSKI, PRESIDENT

FROM: Connie Petru, Community Programs
Texas State Office

FAX NUMBER: 512-932-2546

TELEPHONE NUMBER: (254) 742-9793

PHONE NUMBER:

FAX NUMBER: (254) 742-9749

SUBJECT: Water Supply Contract

NO. OF PAGES INCLUDING COVER: 2

message:

CC: CITY OF LAMPASAS

Committed to the future of rural communities.

"USDA is an equal opportunity provider, employer and lender."
To file a complaint of discrimination with USDA, Director, Office of Civil Rights, Room 320-W, Whitten Building, 14th and
Independence Avenue, SW, Washington, DC 20250-0410 or call (800) 720-6888 (voice or TDD).

PAGE 3/3 * RCVD AT 8/23/2006 7:15:52 AM [Central Daylight Time] * SVC: HIS-FAX01/1 * DNIS: 1 * CSID: 512 932 2546 * DURATION (mm-ss): 01-22 * 6E19T 5022-22-20



EXHIBIT A
System Map

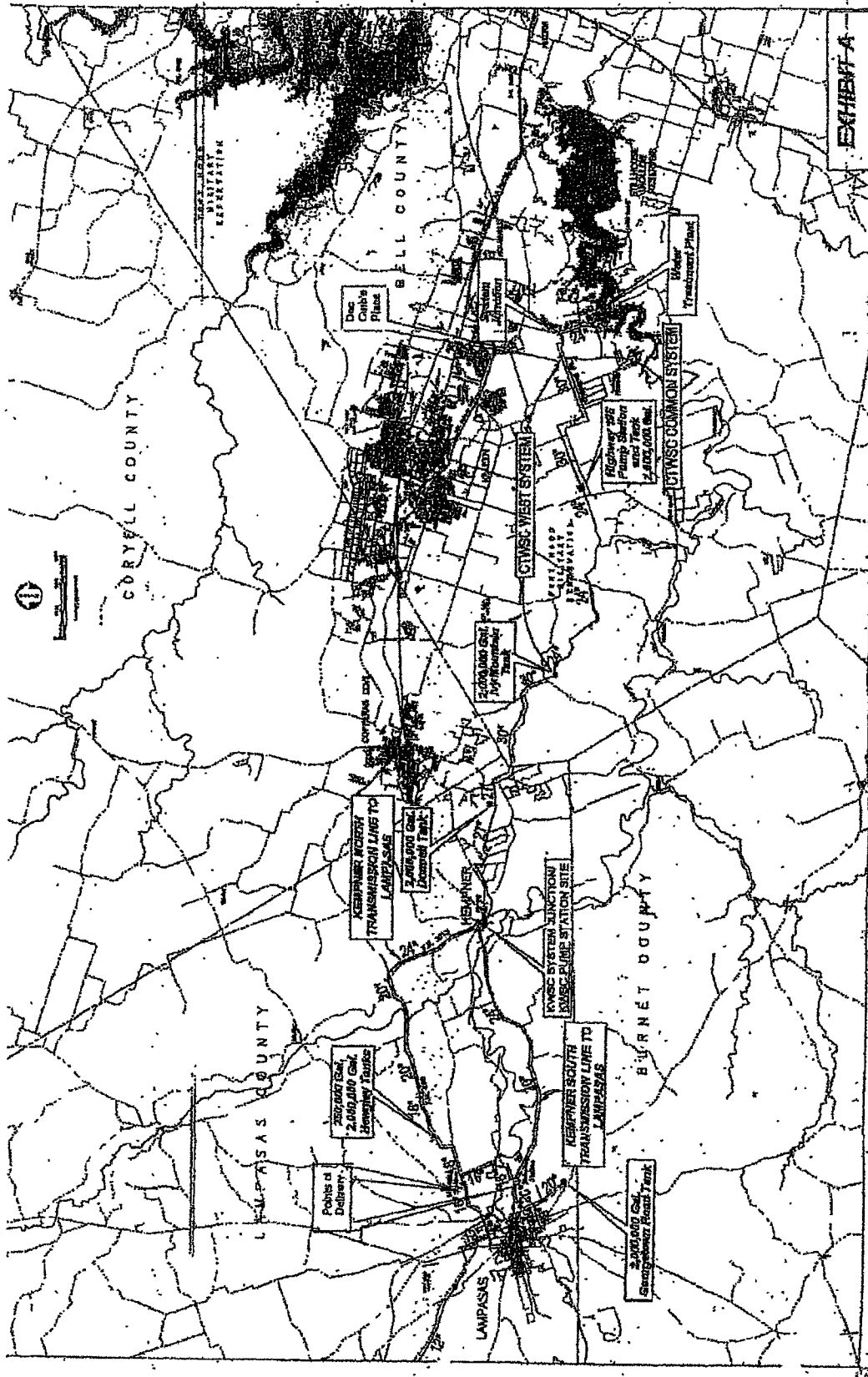


EXHIBIT B
Kallman Estimate

PROJECT COST ESTIMATE

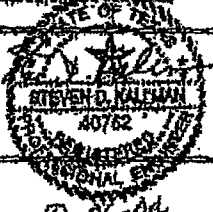
Page 1 of 2

☐ Conceptual ☒ Preliminary ☐ Final

Prepared by: Steven D. Kallman, P.E., R.P.L.S.

Date: October 6, 2004

PROJECT: Contract Mediation with Kempner WSC
 LOCATION: Harker Heights, Bell County, Texas
 TYPE OF IMPROVEMENTS: Water Distribution System
 CLIENT NAME: Central Texas WSC
 CLIENT ADDRESS: 4928 Lakewood Drive, Harker Heights, Texas 76548-8607
 CLIENT PHONE: (254) 898-2778
 CLIENT FAX: (254) 898-4105

1.	200,000 Gallon Ground Storage Tank, 980 Foot Overflow on 0.442 Acre Tract Adjacent to Hwy. 195 Pump Station Site	\$ 175,000.00
2.	Booster Pump Station on Same Site Above, Water Line and Gravel Access Road to Same Site Above Purchase 4,823' x 30' Strip of Land Adjacent to and East of Hwy. 195 Pump Station Site from Chaparral Road to Pump Station Site	\$ 1,167,077.00
3.	18" Water Line Paralleling Existing 24" Water Line along West Side of Stillhouse Lake Road in Private Basements yet to be Acquired	\$ 500,000.00
4.	2 - 2000 GPM, 300 HP High Service Pumps, Starters, Piping, Valves and Related Items at Existing Water Treatment Plant site to increase firm Pumping Capacity from 2,050 GPM (14.03 MGD) to Minimum 11,582 GPM (16.17 MGD)	\$ 312,600.00
5.	Relocate 2 West Bell Meters from Hwy. 195 Pump Station Site to 0.442 Acre Site	\$ 25,000.00
6.	Remove West Bell Meter and Plug Water Line at Fort Hood Site; Replace 1,400 L.F. of 8" Water Line	\$ 50,000.00
7.	Relocate Kempner WSC Meter from Ivy Mountain Tank Site to Hwy. 195 Pump Station Site at Inlet to Tank	\$ 25,000.00
TOTAL		\$ 2,264,677.00
Notes: 1. Item Nos. 1, 2, 4, 5, 6 and 7 include 10% Construction Contingency, 10% Engineering and 5% for Special Items such as Surveying, Geotechnical and Environmental Services. 2. Item No. 2 includes 10% Contingency and \$22,500. Engineering to Complete Project. No Costs are included in Item No. 3 to Purchase Easements or for Legal Fees to Prepare Easement Documents.		
<p style="text-align: center;">S.D. KALLMAN, L.P. ENGINEERS AND ENVIRONMENTAL CONSULTANTS 1108 South Mays, Suite 100 Round Rock, Texas 76684 Phone: (512) 218-4404 Fax: (512) 218-1400</p> <div style="text-align: right;">  10-06-04 </div>		

PROJECT COST ESTIMATE

Page 2 of 2

Conceptual ☐ Preliminary ☒ Final ☐

Prepared by: Steven D. Kallman, P.E., R.P.L.S.

Date: October 6, 2004

PROJECT: Chaparral Pump Station to replace Hwy. 195 Pump Station
 LOCATION: Adjacent to and north of Hwy. 195 Pump Station on 0.442
 Acre Site
 TYPE OF IMPROVEMENTS: High Service Pump Station, Water Line and Access Road
 CLIENT NAME: Central Texas WSG
 CLIENT ADDRESS: 4020 Lakewood Drive, Harker Heights, Texas 78640-3607
 CLIENT PHONE: (261) 698-2778
 CLIENT FAX: (261) 698-4109

Item	Description	Unit	Quantity	Unit Price	Total Price
1	Bond and Mobilization	L.S.	1	\$ 20,000.00	\$ 20,000.00
2	Excavation	L.S.	1	\$ 28,000.00	\$ 28,000.00
3	Concrete	L.S.	1	\$ 42,000.00	\$ 42,000.00
4	Piping, Valves, Meters and Meter Vaults	L.S.	1	\$ 366,000.00	\$ 366,000.00
5	Vault Covers and Grating	L.S.	1	\$ 27,000.00	\$ 27,000.00
6	1600 Square Foot Building	L.S.	1	\$ 80,000.00	\$ 80,000.00
7	1600 GPM, 150 HP High Service Pump and Can	EA.	2	\$ 35,000.00	\$ 70,000.00
8	Electrical	L.S.	1	\$ 150,000.00	\$ 150,000.00
9	Trench Safety	L.S.	1	\$ 1,000.00	\$ 1,000.00
10	Chain Link Cross Fence; Access Road Fence; Three Gates	L.S.	1	\$ 3,800.00	\$ 3,800.00
11	30" x 18" Tapping Sleeves and Valve	L.S.	1	\$ 7,800.00	\$ 7,800.00
12	16" PVC, C-905-CL, 150 Water Line	L.F.	350	\$ 40.00	\$ 14,000.00
13	SR Fence	L.F.	840	\$ 2.00	\$ 1,680.00
14	Restoration and Revegetation	S.Y.	3,360	\$ 1.00	\$ 3,360.00
15	All Weather Access Road and Parking	S.Y.	910	\$ 8.00	\$ 7,280.00
16	18" CGMP Driveway Culvert	L.F.	32	\$ 34.00	\$ 1,122.00
17	Headwalls for Culvert	EA.	2	\$ 1,500.00	\$ 3,000.00
18	12" Modulating Valve and Vault Feeding 200,000 Gallon Ground Storage Tank	L.S.	1	\$ 15,000.00	\$ 15,000.00
19	350 KW Emergency Generator	EA.	1	\$ 93,500.00	\$ 93,500.00
PRELIMINARY ESTIMATED CONSTRUCTION COST					\$ 933,682.00
10% CONTINGENCY					\$ 93,368.20
10% ENGINEERING					\$ 93,368.20
0% FOR SITE ACQUISITION FOR 30 FOOT WIDE ACCESS TO SITE AND SURVEYING GEOTECHNICAL AND ENVIRONMENTAL SERVICES					\$ 46,663.90
ESTIMATED TOTAL PROJECT COST					\$1,167,077.90

EXHIBIT C
Amortization Schedules

EXHIBIT D
CTWSC O&M Calculation Examples

CTWSC O&M EXAMPLES – Section 3.5

Definitions for purposes of the examples:

“City Percentage” is the percentage calculated as set forth in Section 3.5.C.1 (metered flow of treated water into the City at City Points of Delivery by metered pump discharge flow from State Highway 195 Pump Station, including any flow from KWSC New Facilities; or City Use divided by City Use + KWSC Use + KWSC New).

“City Use” means water delivered to City Points of Delivery.

“KWSC Take” means all water delivered to KWSC from CTWSC.

“KWSC Volume Percentage” means KWSC Take divided by Total CTWSC Sales.

“KWSC Use” means KWSC Take, less City Use

“KWSC New” means water From KWSC New Facilities.

“Total CTWSC Sales” means all water delivered to CTWSC customers.

“Volume Bill” means the amount CTWSC bills to KWSC monthly for O&M, absent application of a “floor.” The Volume Bill is calculated by multiplying the CTWSC O&M on the Existing System (“CTWSC O&M”) by the percentage calculated by dividing the volume of treated water delivered to KWSC by the total volume of treated water delivered to all customers of CTWSC and multiplying by 100 (KWSC Take divided by Total CTWSC Sales x 100).

“Floor Bill” means the amount CTWSC bills to KWSC monthly for O&M in the event that a floor applies. The Floor Bill is calculated by multiplying CTWSC O&M by the floor calculated pursuant to Section 3.5.B.1.

1. As information, City Use, KWSC Use, and Total CWSC Sales figures are from the December 2005 CTWSC bill.
City Use 31,718,000
KWSC Use 53,106,000
KWSC Take = 84,824,000.
KWSC New = 0.
KWSC Volume Percentage = 53%.
City Percentage = 31,718,000 divided by 84,824,000 = 37%.
CTWSC Total Sales = 159,848,746
Assume CTWSC O&M = \$100,000

Volume Bill = \$100,000 x [KWSC Volume Percentage, i.e., KWSC Take
84,824,000 divided by Total CTWSC Sales 159,848,746 x 100 = 53%] = \$53,000
No floor applies (53% exceeds 42%).

CALCULATION:

City Bill = CTWSC O&M x KWSC Volume Percentage x City Percentage =
\$100,000 x 53% x 37% = \$19,610.

KWSC Bill = \$33,390.

2. Same assumptions as 1, but KWSC Use is 25,000,000 and KWSC New is 28,106,000.
City Percentage remains 37%. (City Use-31,718,000, divided by 84,824,000, or
City Use + KWSC Use 25,000,000 + KWSC New 28,106,000).
Assume CTWSC Total Sales = 131,742,746 (decreased by lost sales of KWSC
New of 28,106,000).
KWSC Take (City Use 31,718,000 + KWSC Use 25,000,000 = 56,718,000)
divided by CTWSC Total (131,742,746) = 43.052%, KWSC Volume Percentage.
No floor applies (43.052% exceeds 42%).
Assume CTWSC Total O&M = \$100,000.
Volume Bill = \$43,052.
City Percentage = 37%. City pays \$15,929.24, KWSC pays \$27,122.76.
3. Same assumptions as 1, but KWSC Use is 0 and KWSC New is 53,106,000.
City Percentage remains 37% (City Use divided by City Use + KWSC Use plus
KWSC New is same percentage as in Example 2).
Assume CTWSC Total = 106,742,746 (decreased by lost sales of KWSC New of
53,106,000).
KWSC Take (City Use 31,718,000 + KWSC Use 0) = 31,718,000, divided by
CTWSC Total 106,742,746 = 29.7%, KWSC Volume Percentage.
Floor applies (29.7% is less than 42%).
Assume CTWSC Total O&M = \$100,000.
Volume Bill without floor would be \$29,700.
City Bill without floor would be 37% x \$29,700 = \$10,989, and KWSC would pay
\$18,711.
Floor Bill = \$42,000, for an increment of an additional \$12,300.

a. Assume KWSC is still using 1.06 MGD of City water treatment capacity so
that City:KWSC capacity ratio is 49:51, not 63:37, for purpose of "floor
increment" calculation.

Applying this 49:51 ratio to the "floor increment," City would pay 49% of
\$12,300, or an additional \$6027. KWSC would pay 51% of \$12,300, or an
additional \$6273.

Total City Bill: $\$10,989 + \$6027 = \$17,016$.

Total KWSC Bill: $\$18,711 + \$6273 = \$24,984$.

b. Same assumptions as in 3.a., but KWSC has restored the 1.06 MGD to the City and now the City:KWSC capacity ratio is 63:37.

Applying this 63:37 capacity ratio to this "floor increment," City would pay 63% of \$12,300 ; or an additional \$7749. KWSC would pay 37% of the increment, or an additional \$4551.

Total City Bill: $\$10,989 + 7749 = \$18,738$.

Total KWSC Bill: $\$18,711 + \$4551 = \$23,262$.

4. Same assumptions as 3, but assume KWSC reduces its share of CTWSC WTP capacity by 10% without the City acquiring that capacity, resulting in a floor of 37.8% under the CTWSC Wholesale Contract.

City Percentage remains 37% (City Use + KWSC Use plus KWSC New is same as in Example 2 and 3).

Assume CTWSC Total = 106,742,746 (decreased by KWSC New of 53,106,000).

KWSC Take (City Use 31,718,000 + KWSC Use 0) = 31,718,000, divided by

CTWSC Total 106,742,746 = 29.7%.

Floor applies (29.7% is less than 37.8%).

Assume CTWSC Total O&M = \$100,000.

Volume Bill without floor would be \$29,700.

City Bill without floor would be $37\% \times \$29,700 = \$10,989$, and KWSC would pay \$18,711.

Floor Bill would be $37.8\% \times \$100,000 = \$37,800$, for an additional increment of \$8100. Applying the 63:37 capacity ratio to the increment (since the City did not acquire KWSC's capacity, the ratio remains unchanged), the City would pay 63% x \$8100 or an additional \$5103. KWSC would pay 37% x \$8100 or an additional \$2997.

Total City Bill: $\$10,989 \text{ plus } \$5103 = \$16,092$.

Total KWSC Bill: $\$18,711 + \$2997 = \$21,708$.

5. Assume KWSC reduces its capacity completely, the floor becomes 26.5%.

City does not acquire KWSC capacity. Assume City use drops to 18,000,000.

Otherwise same assumptions as in 4.

City Percentage = $18,000,000 \text{ divided by } 18,000,000 = 53,106,000 + 0 =$

$18,000,000 \text{ divided by } 71,106,000 = 25.31\%$.

Assume CTWSC Total Sales = 100,000,000..

KWSC Take (City Use 18,000,000 + KWSC Use 0) = 18,000,000, divided by

CTWSC Total 100,000,000 = 18%, KWSC Volume Percentage.

Floor applies (18% is less than 26.5%).

Assume CTWSC Total O&M = \$100,000.

Volume Bill would be \$18,000 (18% x 100,000).

City Bill without floor would be 25.31% x \$18,000 = \$4555.80, and KWSC would pay \$13,444.20.

Floor Bill would be \$26,500 (26.5% x 100,000),

With floor of 26.5%, KWSC Bill = \$26,500, for an additional increment of \$8500.

Applying 63:37 ratio: City would pay an additional \$5355 and KWSC would pay an additional \$3145.

Total City Bill: \$4555.80 + \$5355 = \$9910.80.

Total KWSC Bill: \$13,444.20 + \$3145 = \$16,589.20.6. Under Section

3.1.B, City has right to acquire up to 2.06 MGD of additional capacity, on a volume-only O&M basis. Floor does not apply to and City will not pay floor on CTWSC O&M on this amount of additional capacity.

7. Same assumptions as 5, but (i) City has acquired relinquished KWSC capacity (i.e., in addition to or other than the volume-only 2.06 MGD referenced in Section 3.1.B) so that floor remains 42%, and (ii) despite KWSC Use being 0, CTWSC Total Sales have increased to 180,000,000.

City Percentage remains 25.31%.

KWSC Take = (18,000,000 + KWSC Use 0 = 18,000,000, divided by CTWSC

Total Sales 180,000,00 = 10%, KWSC Volume Percentage.

Floor applies (10% is less than 42%).

Assume CTWSC O&M = \$100,000.

Volume Bill would be \$10,000 (10% x \$100,000).

City bill without floor would be 25.31% x \$10,000 = \$2531, and KWSC would pay \$7469.

Floor Bill would be 42% x \$100,000 or \$42,000, for an additional increment of \$32,000.

If City has acquired 100% of KWSC relinquished CTWSC WTP capacity (leaving City with 7.68 MGD), then City would pay \$2531 + 32,000 = \$34,531. KWSC would pay \$7469.

EXHIBIT E
Tank Assessment

KEMPNER WATER SUPPLY CORPORATION AND CITY OF LAMPASAS CAPITAL POLICY

This capital policy has been developed and adopted for the purpose of clarifying when a repair constitutes a capital improvement, as opposed to a non-capital repair, and which clearly delineates between KWSC O&M Cost and capital improvements to the system, permitting proper KWSC O&M Cost allocations in accordance with accepted principles and policies of the American Water Works Association, as required by the 2006 Wholesale Water Supply Contract between Kempner Water Supply Corporation (KWSC) and the City of Lampasas (City) (2006 Contract). Refer to Section 3.5C of the 2006 Contract. From time to time, KWSC and the City may be called upon to determine whether a particular expenditure should be treated as a "repair" or "capital improvement". In order to promote uniformity in the decision making, the following guidelines for delineating between repair expenditures and capital expenditures are adopted by KWSC and the City. These guidelines are intended to aid and assist in the decision making process and in no way alter or take precedence over what is set out and established in the 2006 Contract.

Definitions

The following terms and expressions as used in this Policy, unless the context clearly shows otherwise, shall have the following meanings:

"Repair" means that an asset is restored and fully functional by replacing a part, and by putting together that which is torn or broken. A repair consists of any work that restores or extends the useful life of an existing asset and which is not part of general maintenance and operations (i.e. repairing a break in a line, periodic lubrication of moving parts).

"Capital improvement" means the replacement and upgrade, expansion, development, or rehabilitation of capital water system assets that either extends the useful life or reliability of the asset, system or system component or adds new capabilities to enhance the asset, system or system component's performance. A capital improvement consists of replacements, upgrades or provides for extension of service of an existing asset and that is not used for the general operation or maintenance of the system.

Examples of Capital Improvement

Repair (capital) – Adding a new pump in an existing expansion slot of a pumping facility to increase the facility's pumping capacity to its design maximum limit (an expansion upgrade).

Replacement of one or more constant speed pumps with a new constant speed longer-life pump (higher quality upgrade), thereby permitting the facility to be used for an additional 10 years.

Replacement of a constant speed pump with a same capacity variable speed pump (capability enhancement upgrade) permitting more flexible operation of the facility.

In the event that further assistance is required in determining whether the expenditure is a repair or capital improvement, the attached Exhibit A chart is intended to provide further guidance. The chart includes simplified examples and is not intended to be all inclusive.

Operations and Maintenance Costs

Operation and maintenance cost allocations are established in the 2006 Contract Section 3.5 and should be referred to when determining cost allocations and expenditures. If questions arise regarding whether or not an expense should be classified as an Operations and Maintenance expense, a repair or a capital improvement reference should be first taken from the 2006 Contract and then from the attached Exhibit A and from definitions provided by the American Water Works Association.

Allocation of Repair or Capital Improvement Costs

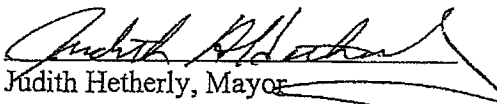
Allocations of such costs shall be in compliance with the 2006 Contract Section 3.5 C.1. Capital expenditures need to be signed off on by both parties prior to expenditure of any funds, unless an emergency situation exists. KWSC should provide the City with a written explanation for the capital expenditure with a section for the City to sign off on or provide written notice back to KWSC as to why the City may oppose the expenditure or dispute it as a capital expenditure.

Dispute Resolution

In the event a dispute arises between KWSC and the City regarding whether or not a particular KWSC expense should be treated as a repair expense or a capital expense, *within 15 days from written notification of either party to the other party that such dispute cannot be remedied*, such dispute shall be reviewed by a committee of four, two from KWSC and two from the City chosen by the president of KWSC Board of Directors and the Mayor of the City. The committee shall make every effort to help the two parties come to terms. If the parties cannot come to terms with the help of the committee, *within 30 days from the appointment of the committee*, it shall then be submitted to a mutually agreed upon independent Professional Engineer and Certified Public Accountant. In the event such independent Professional Engineer and Certified Public Accountant makes a determination as to how the disputed expense should be characterized, the characterization shall be final and binding upon KWSC and the City. The parties to any such dispute shall bear their own respective professional fees and expenses incurred therein, except that the disputing parties shall split the charges and expenses of the independent engineer and accountant, one-half to be borne by KWSC and the remaining one-half to be borne by the City.

In the event that there is a dispute regarding engineering issues regarding any repair or capital matter, KWSC and the City shall refer to the 2006 Contract Section 4.4 regarding "Dispute Resolution Concerning Engineering Issues".

PASSED and APPROVED by the City Council of the City of Lampasas on the 11th
 , day of August, 2008.


Judith Hetherly, Mayor

PASSED and APPROVED by the Kempner Water Supply Corporation Board of
Directors on the 20th, day of August, 2008.

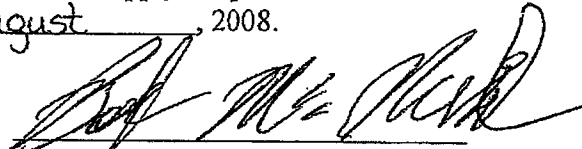

Bob McDonald, President

EXHIBIT A

Repair Expenses		Capital Improvements Expenses	
1.	Accounting. Relatively low cost per unit and recur on a frequent or regular basis -- one or more times per budget year. Examples: Pipeline leak repair or monthly sampling. Expenditure is expensed.	1.	Accounting. Relatively high cost per unit, infrequent-less than annually. Examples Planned, engineered project -- water treatment plant expansion or transmission pipeline upsizing in high growth area. Expenditure is capitalized.
2.	Expected Useful Life. Items having a useful life of less than two years. Examples: Computer and software.	2.	Expected Useful Life. Items having a useful life of two years or more. Examples: Filter media replacement or ground storage tank.
3.	Purpose. Consumable items used to operate storage, transmission, metering, and remote monitoring of the system. Examples: Contract repairs, or repair inventory items such as coupling or pipe joints.	3.	Purpose. Items that increase holdings in property or increase or replace such things as capacity, water supply services, treatment, storage, transmission, metering, and remote monitoring of the system. Example: Construction of new treatment facilities or transmission lines.
4.	Consultation Application. Consultation incidental to normal or annual support requirements.	4.	Consultation Application. Engineering and legal fees for projects. Examples: Strategic planning, system upgrade and/or capacity expansion; legal for property acquisition, easements.
5.	Maintenance. Repairs of System. Examples: Pipeline leak repair or SCADA RTU repair.	5.	Maintenance. Replacement or rehabilitation of facilities; replacement of dilapidated facilities or items that have exceeded useful life. Example: major reconstruction of storage tank due to obsolescence.
6.	Construction. Correction. Example: Rerouting a pipeline improperly placed in easement.	6.	Construction. New construction. Example: Building a new storage tank.
7.	Labor. Labor incidental to day to day operations. Examples: Employee wages, salaries and benefits.	7.	Labor. Labor used for In-house capital projects. Example: In-house sub-contract (pro-rate share of total compensation).

CAUSE NO. 19005

CITY OF LAMPASAS, TEXAS) IN THE DISTRICT COURT
)
Plaintiff(s),)
)
VS.) 27TH JUDICIAL DISTRICT
)
KEMPNER WATER SUPPLY CORP.,)
)
Defendant(s).) LAMPASAS COUNTY, TEXAS

ORAL DEPOSITION OF
FINLEY deGRAFFENRIED
AS A CORPORATE REPRESENTATIVE FOR CITY OF LAMAPASAS
NOVEMBER 17, 2014

ORAL DEPOSITION OF FINLEY deGRAFFENRIED, produced as
a witness at the instance of the Plaintiff, and duly
sworn, was taken in the above-styled and numbered cause
on the 17th day of November, 2014, from 10:13 a.m. to
5:46 p.m., before Shannon H. DeLay, CSR in and for the

State of Texas, reported by method of machine

shorthand, at Graves, Dougherty, Hearon & Moody, P.C.,

401 Congress Ave., Suite 2200, Austin, Texas, pursuant

to the Texas Rules of Civil Procedure and the

provisions stated on the record or attached hereto.

Oral Deposition of Finley deGraffenried

Page 2

1 APPEARANCES

2

3 FOR THE PLAINTIFF(S):

4 Mr. David P. Lein
5 Ms. Helen Currie Foster
6 GRAVES, DOUGHERTY, HEARON & MOODY, P.C.
7 401 Congress Ave.
8 Suite 2200
9 Austin, Texas 78701

10 FOR THE DEFENDANT(S):

11 Ms. Lea A. Ream
12 Mr. William A. Faulk, III
13 DAVIDSON, TROILO, REAM & GARZA, P.C.
14 7550 West IH-10
15 Suite 800
16 San Antonio, Texas 78229-5815

17 ALSO PRESENT:

18 Delores Goode

19

20

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Oral Deposition of Finley deGraffenried

Page 3

1	INDEX	
2		PAGE
3	Appearances	2
4	Stipulations (Attached hereto)	N/A
5	FINLEY deGRAFFENRIED	
6	Examination by Ms. Ream	4, 189
7	Examination by Mr. Lein	184
8	Signature and Changes	196
9	Reporter's Certificate	198

EXHIBITS

10	NO.	DESCRIPTION	PAGE
11	1.	Summary Response to Topics	
12		Corporate Representative Deposition ...	52
13	2.	2006 Wholesale Water Supply Contract ..	61
14	3.	Draft	
15		First Amendment to 2006 Wholesale Water	
16		Supply Contract Between Kempner Water	
17		Supply Corporation and the City of	
18		Lampasas	143
19	4.	Letter	148
20	5.	Topic Notebook Index	189
21			
22			
23			
24			
25			

Oral Deposition of Finley deGraffenried

Page 4

1 FINLEY deGRAFFENRIED,
2 having been first duly sworn, testified as follows:

3 EXAMINATION

4 BY MS. REAM:

5 Q. Good morning, Mr. DeGraffenried. Would you
6 state your full name for the record.

7 A. Finley deGraffenried.

8 Q. Mr. DeGraffenried, you're here on behalf of
9 the City of Lampasas; is that correct?

10 A. Yes.

11 Q. You have been designated as their corporate
12 representative for the deposition today?

13 A. Yes, I have.

14 Q. Okay. Have you had your deposition taken
15 before?

16 A. I have not.

17 Q. So, for purposes of our communication, I'm
18 going to ask, sort of, a couple of things, and that is
19 that you allow me to finish my question before you
20 answer. Would you agree to do that?

21 A. Certainly.

22 Q. And then also that we try to -- that you try
23 to communicate with an oral answer, as opposed to a
24 nod. Would you agree to do that?

25 A. Certainly.

1 Plant burned down on a given day, do you view -- does
2 the City view that Kempner is excused from delivering
3 treated water to the City?

4 A. Are you talking about a force majeure event,
5 or a natural disaster?

6 Q. The example I gave you is that the Plant
7 burned down.

8 A. Okay. You're talking about a fairly rare and
9 unpredictable event. It would be -- Kempner is never
10 excused from this delivery. However, I think it would
11 be reasonable under a plant burning down or under a
12 force majeure, that the Parties would get together and
13 to see if there's any sort of equitable compensation --

14 Q. What --

15 A. -- that -- under those types of circumstance.

16 Q. And in the meantime before some equitable
17 discussion is had, what does the City expect Kempner to
18 do?

19 A. Well, I think Kempner certainly has
20 obligations with Central Texas via their contract. We
21 would expect that they would enforce their contract
22 with Central Texas. And, again, we're talking
23 hypothetical natural disasters, unplanned events. But
24 I think -- I think the Parties, in trying to work
25 together, would look at, you know, are there equitable

Oral Deposition of Finley deGraffenried

Page 78

1 remedies for Kempner to get from Central Texas,
2 perhaps, to pay for that water, is there something
3 equitable that Lampasas and Kempner could do.

4 Q. Okay. And --

5 A. So, it's -- it's a very hypothetical. I don't
6 think the contract specifically addresses the -- the --
7 the remedies. You know, it does not say, for example,
8 that Kempner can charge us under these circumstances,
9 if that's what you're asking.

10 Q. Okay. So, my question to you is you've
11 described that -- that the Parties would work together
12 to figure out an equitable solution. That's what
13 you've described, correct?

14 A. I think under those very --

15 MR. LEIN: Objection, form.

16 A. I think under those very rare and unusual
17 circumstances, yes.

18 Q. (BY MS. REAM) Okay. So, what -- what
19 should -- the example I've given you is that the
20 Central Texas Plant has burned down. So, they're not
21 able to treat your water.

22 A. Uh-huh.

23 Q. What water should -- should Kempner deliver to
24 you in that situation?

25 A. I think they would -- they would have to not

1 only enforce their contract with Central Texas, but I
2 think they would have to use their, you know, their
3 best efforts to deliver us treated water at those --

4 Q. And where would they provide that water to you
5 from?

6 A. They could provide it to us from your Points
7 of Delivery. I don't know. That's a hypothetical.

8 Q. What would be the natural solution to that
9 problem?

10 A. The -- the answer to that would be, yes, that
11 would be an option, receiving it from Kempner's Plant.

12 Q. Okay. So, isn't that actually what the City
13 would expect Kempner to do in the event that the?
14 plant -- Central Texas Plant burn down? I mean, I
15 understand your suggestion that we're supposed to
16 enforce our rights with regard to Central Texas, but
17 that obviously doesn't occur overnight, correct?

18 MR. LEIN: Objection, form.

19 A. Enforcing our rights with Central Texas?

20 Q. (BY MS. REAM) Kempner enforcing its rights
21 with regard to Central Texas --

22 A. Certainly.

23 Q. -- rebuilding a plant, for example, isn't
24 going to occur overnight, correct?

25 A. That's correct.

Oral Deposition of Finley deGraffenried

Page 80

1 Q. And the citizens of Lampasas wake up in the
2 morning and want to take a shower, right?

3 A. Right.

4 MR. LEIN: Objection, form.

5 Q. (BY MS. REAM) Want water to come out of the
6 spigot, correct?

7 A. Correct.

8 Q. And what would the City of Lampasas expect
9 Kempner to do under that situation?

10 A. I think the expectation is that the Parties
11 would sit down and figure out how to come up with a way
12 that was equitable to compensate Kempner --

13 Q. Okay. What --

14 A. -- under those circumstances.

15 Q. For Kempner delivered water?

16 A. Under those circumstances, that certainly
17 could be an option.

18 Q. Okay. What other options would you like
19 Kempner to pursue?

20 A. Are there remedies within the Central Texas
21 System, are there remedies -- I don't know.

22 Q. So, just to be clear --

23 MR. LEIN: Let him finish his answer.

24 MS. REAM: All right.

25 A. The problem I have with that question is --

1 I'm making a statement. I apologize. But the issue
2 you're talking about is a -- obviously, something
3 catastrophic happening, a Plant burning down. Under
4 those situations, the contract doesn't -- doesn't
5 address how the Parties are to respond, specifically.

6 I think we can go back to the preamble and
7 say, hey, we're going to work as neighbors. You know,
8 we certainly want to come to the aid of our -- our
9 friends & our business associates. But what -- so, it
10 doesn't address that. But the contract also does not
11 allow, you know, a new interpretation outside of some
12 sort of catastrophic event like that.

13 Q. (BY MS. REAM) All right. So, you've told me
14 that the contract doesn't contemplate what Kempner is
15 supposed to do in the event of a catastrophic event,
16 correct?

17 A. It doesn't contemplate the remedy, certainly.

18 THE REPORTER: I need to switch my plug.

19 MS. REAM: Okay.

20 (Recess from 1:59 p.m. to 2:01 p.m.)

21 Q. (BY MS. REAM) So, I understand your testimony
22 before we broke for lunch to be that Kempner can
23 deliver whatever kind of water it wants to the City,
24 but it can only charge the City for water that it takes
25 from Central Texas; is that correct?

Oral Deposition of Finley deGraffenried

Page 82

1 MR. LEIN: Objection, form.

2 A. That is the structure of the contract, yes.

3 Q. (BY MS. REAM) Okay. So, under the structure
4 of this Agreement as the City contends, in the event
5 that Central Texas Plant burned down and Kempner
6 provided water from its plant, is it your contention
7 that the agreement does not allow it to recover for
8 that water?

9 MR. LEIN: Objection, form.

10 A. I think I've already answered that question.
11 There's no provision in the contract dealing with that
12 specific remedy.

13 Q. (BY MS. REAM) All right. As the City
14 interprets the Agreement, correct?

15 A. I believe it's hard to interpret otherwise,
16 yes.

17 Q. When the City and Kempner entered into this
18 Agreement, the City was fully aware of Kempner's
19 intention to build its own plant to treat water,
20 correct?

21 A. Correct.

22 Q. Is there any clause in the Agreement that says
23 that Kempner is prohibited from delivering water it has
24 treated to -- to the City?

25 A. I would -- if Kempner is prohibited from? No.

Oral Deposition of Finley deGraffenried

Page 110

1 etcetera, that require the Parties to concur. There,
2 perhaps, may be. My recollection is, perhaps, under
3 Capital Improvements for Increased Capacity, there may
4 be some suggestion of a concurrence in another part.
5 But certainly in 3.1, it does not say that.

6 Q. And it doesn't any anywhere in 3.5 in terms of
7 treated water cost, that the Parties should discuss and
8 meet regarding some agreement on treated water cost,
9 does it?

10 A. It's not necessary in 3.5.

11 Q. All right. But it -- it doesn't say that in
12 3.5, does it?

13 A. No, it does not.

14 Q. All right. What -- what does the City contend
15 that Kempner should do in the event that water
16 delivered by Central Texas fails to meet the TCEQ
17 standards?

18 A. Not having the precise section at my
19 fingertips, but I believe the contract generally calls
20 for Kempner to enforce water quality issues. Kempner
21 also has an agreement with Central Texas regarding
22 acceptance of their -- there is some mention in the
23 contract regarding communication with the City, as well
24 as supplying them with the information related to what
25 the violation was, what -- what Kempner did, what

1 Central Texas did.

2 Q. What kind of what water should Kempner deliver
3 to the City in the meantime while those things are
4 being pursued?

5 A. Kempner has a responsibility to deliver water
6 under certain pressure and certain volumes per 3.9, at
7 its -- to the best of its ability. Obviously, it would
8 be reasonable to think that Kempner would deliver water
9 from its Plant.

10 Q. In that situation?

11 A. Certainly.

12 Q. All right.

13 A. That could be an option.

14 Q. And at that point and time, if -- if Kempner
15 did that, is Kempner entitled to bill the City for it,
16 the water its delivered?

17 A. There is no provision in this contract for the
18 City to compensate Kempner. Kempner has the obligation
19 to deliver, but there's no provision in the contract,
20 which is one reason that David Sneed requested
21 negotiations on an amendment be made.

22 Q. Well, let's go back to the situation in which
23 Kempner has delivered water because Central Texas water
24 doesn't meet TCEQ standards. If Kempner delivers a
25 bill to the City for the water that it delivered to the

Oral Deposition of Finley deGraffenried

Page 112

1 City from its Plant at the Central Texas rate, would
2 the City refuse to pay it?

3 A. I think the City would suggest to Kempner that
4 it has recourse with Central Texas, as opposed to the
5 City.

6 Q. Okay. Well, let's talk about what happens
7 when Kempner delivers water to the City's Points of
8 Delivery. The City --

9 A. Under this --

10 Q. -- has --

11 A. -- circumstance? I didn't mean to interrupt
12 you.

13 Q. I'm sorry. Just, period.

14 A. Okay.

15 Q. After it's delivered to the City's Points of
16 Delivery, the City distributes it to its citizens,
17 correct?

18 A. It goes into our distribution system, yes.

19 Q. Right. And it's delivered to the -- to the
20 rate payors of -- of your system, correct?

21 A. Correct.

22 Q. All right. And you don't not bill your --
23 your citizens because of the source of the water from
24 Kempner, do you?

25 A. That's correct. We bill all our citizens.

1 Q. All right. So, you collect from the citizens
2 for the water that's been delivered, correct?

3 A. That's correct.

4 Q. And that's based on the Central Texas Rate
5 Scheme? Is that what your rates are based on, the --
6 the cost for treated water from Central Texas?

7 A. No. That's an oversimplification of what it
8 takes to --

9 Q. Fair enough.

10 A. -- bill.

11 Q. That's a component of it?

12 A. Absolutely --

13 Q. Okay.

14 A. -- the cost of water is.

15 Q. The cost of water at Central Texas rates,
16 correct?

17 A. The cost of water that -- that we pay for
18 that, that is -- is due from Central Texas, yes.

19 Q. Okay. So -- so, you're billing the citizens
20 of Lampasas based, in part, on the rate structure from
21 Central Texas. But, yet, in this instance, if Kempner
22 delivered its water, you wouldn't pay Kempner?

23 A. There's no provision in this contract for us
24 to pay Kempner.

25 Q. I understand that's your contention. I guess

Oral Deposition of Finley deGraffenried

Page 114

1 my question to you is you do see the lack of fairness
2 of that situation, don't you?

3 MR. LEIN: Objection, form.

4 A. I think if there was an objection, it would be
5 because there's so many cost components that go into
6 what the citizens pay for. You know, the cost of water
7 may be actually a smaller slice. So, I -- is it unfair
8 for us to receive revenue from water we don't pay for?
9 I think that's a gross oversimplification of it.

10 Q. (BY MS. REAM) Well, what is the water that
11 Kempner delivered to you? Is it a gift?

12 A. You know, in 2011, David Sneed asked for an
13 amendment.

14 Q. Okay. I'm going to --

15 A. And -- and, certainly, this could have been
16 addressed. What I'm saying and in answer to your
17 question, is that there's not a provision in this
18 contract for us to pay for Kempner treated water.

19 MS. REAM: Object to that as
20 nonresponsive.

21 Q. (BY MS. REAM) My question to you, sir, is if
22 Kempner delivers its treated water to the City's Points
23 of Delivery, is it a gift to the City? Is that the
24 City's contention?

25 MR. LEIN: Objection, form.

1 A. We pay for all the water according to the
2 contract. Whether Kempner chooses to abide by the
3 obligations and responsibilities is not the
4 responsibility of the City of Lampasas.

5 Q. (BY MS. REAM) Well, let's be clear about that
6 because we've just come up with a couple of situations
7 in which Kempner is permitted by this Agreement,
8 according to you, to deliver water, its water from its
9 treatment plant, to the City at its Points of Delivery,
10 correct?

11 A. Under very specified conditions within the
12 contract, yes.

13 Q. Okay. And my question to you is a simple one.
14 You believe that's -- the City contends that that's a
15 gift from Kempner --

16 A. No.

17 Q. -- to --

18 A. The City --

19 Q. -- the City?

20 MR. LEIN: Objection, form.

21 A. -- does not contend that it's a gift.

22 Q. (BY MS. REAM) Well, what is it?

23 A. It's Kempner not meeting the obligations and
24 responsibilities of the contract.

25 Q. You've just told me that it's obligated under

Oral Deposition of Finley deGraffenried

Page 116

1 certain situations to provide water to the City.

2 A. It's obligated to deliver our water from
3 Central Texas.

4 Q. Really? Can you -- where is that?

5 MR. LEIN: Objection, form.

6 A. Ms. Ream, I'd cite 2.2 on Page 11. After the
7 semicolon, the City has full power and authority to
8 purchase treated water from Kempner Water Supply Corp
9 in accordance with the terms of this Contract; the City
10 has rights to stored water in Stillhouse in a
11 sufficient amount to supply the treated water that the
12 City requires to meets its needs.

13 The other thing I would look at, getting
14 back to your quality of water delivered by Central
15 Texas to Kempner -- I'm sorry, 3.7 Page 30 -- water
16 delivered by Central Texas to Kempner is contractually
17 required to be treated water of a quality sufficient to
18 meet the requirements. Central Texas has to deliver
19 the water to Kempner. Kempner has to deliver it to the
20 City.

21 Q. (BY MS. REAM) Are the citizens of Lampasas
22 aware that when the City decides not to pay Kempner for
23 water, that the citizens are still being billed for it?

24 MR. LEIN: Objection, form.

25 A. I think the citizens of Lampasas understand

1 that there is a dispute related to the contract between
2 Lampasas and Kempner.

3 Q. (BY MS. REAM) What are they aware of?

4 MR. LEIN: Objection --

5 Q. (BY MS. REAM) What have you made them aware
6 of?

7 MR. LEIN: Objection, form.

8 A. I think the City has only been noted once or
9 twice. I believe once in the Killeen Daily Herald,
10 and, perhaps, once in the Lampasas Dispatch, that there
11 were contract -- conflicts with the contract.

12 Q. (BY MS. REAM) Has that noted that you've
13 refused to pay for water that Kempner has delivered to
14 the City?

15 A. Without having it in front of me, I couldn't
16 tell you if that's what it said.

17 Q. Has the City distributed any kind of notice
18 to -- in its billing statements to the citizens of
19 Lampasas that -- that its not paying for water that's
20 been delivered by Kempner?

21 MR. LEIN: Objection, form.

22 A. No. We have not put any bill stuffers or
23 anything like that.

24 Q. (BY MS. REAM) Which months did Kempner provide
25 water to the City from its plant in 2013, if you know?

EXHIBIT 3

MICHAEL H. TALBOT
December 15, 2014

Page 1

CAUSE NO. 19005

CITY OF LAMPASAS, TEXAS)	IN THE DISTRICT COURT
)	
Plaintiff)	
)	
)	
vs.)	27TH JUDICIAL DISTRICT
)	
KEMPNER WATER SUPPLY)	
CORP.)	
)	
Defendant)	LAMPASAS COUNTY, TEXAS

ORAL DEPOSITION

MICHAEL H. TALBOT

DECEMBER 15, 2014

ORAL DEPOSITION OF MICHAEL H. TALBOT, produced as a witness at the instance of the Defendant and duly sworn, was taken in the above-styled and numbered cause on December 15, 2014, from 10:14 a.m. to 2:55 p.m., before Elena Maloney, Certified Shorthand Reporter in and for the State of Texas, reported by computerized stenotype machine at the offices of Graves Dougherty Hearon & Woody, 401 Congress Avenue, Suite 2200, Austin, Travis County, Texas 78701, pursuant to the Texas Rules of Civil Procedure and the provisions stated on the record or attached hereto.