

Term sheet
NCMWC-Conservancy groundwater well
Preliminary and non-binding
December 23, 2014

CONTENTS: Overview, *p. 1*
Purpose, *p. 1*
Proposed structure, *p. 1*
Benefits to NCMWC, *p. 2*
Benefits to the Conservancy, *p. 3*
Conclusion, *p. 3*
Footnotes, p. 3

Overview

The Natomas Central Mutual Water Company (NCMWC) wishes to install a groundwater well it could use to help manage its water users' irrigation needs and also to participate in state and federal government efforts to allocate water in years in which water users statewide could benefit.

Purpose

The purpose of this write-up is to set forth the basic concept of a NCMWC and Natomas Basin Conservancy ("Conservancy") mutual participation in a new groundwater well and its eventual use. This is a non-binding draft of that write-up.

Proposed structure

A. Concept at project initiation:

- 1.) *NCMWC*. NCMWC would provide all construction, bidding and management of the installation of a sizable groundwater well.
- 2.) *Conservancy*. The Conservancy would provide:
 - a. land access and use by way of a temporary construction easement or license,
 - b. an easement for a pad on which the well and pump would reside, and
 - c. rights to draw groundwater from beneath its Lucich South¹ tract.²

B. Financial commitment by the Parties:

- 1.) *NCMWC*.
 - a. A grant will be applied for by NCMWC in an attempt to defray the cost of groundwater well installation. NCMWC will manage the grant process and be responsible for any and all accounting and reporting related to the grant.
 - b. After subtracting any grant proceeds from the total cost of the groundwater well hardware and equipment, installation of the same,

including make-ready costs, a “net cost” balance³ will remain. NCMWC will pay one-half the balance of the cost.

- 2.) *Conservancy*. One-half the net cost will be paid for by the Conservancy.
- 3.) *NCMWC*. A detailed cost projection will be prepared by NCMWC and shared with the Conservancy prior to the groundwater well installation so that both sides are clear at all times what their likely cost obligations will be.
- 4.) *NCMWC*. Once the construction and installation of the groundwater well is complete and satisfactorily operating to both parties, NCMWC will provide a full cost accounting of the groundwater well to the Conservancy, which accounting will be used to ascertain the 50 percent “net cost” owed by both parties.

C. Concept at project completion and operation:

- 1.) *NCMWC*.
 - a. All operations and management of the groundwater well will be provided by NCMWC.
 - b. Decisions as to when and if to operate the groundwater well via participation in state, federal or other groundwater exchange programs, water transfer programs, water sales and similar business arrangements that benefit all NCMWC shareholders would be managed as follows: NCMWC initiates proposals for the use of the groundwater well in such a program to the Conservancy and the use of the groundwater well for participation in such a proposed program must be approved in writing by the Conservancy,⁴ which approval will not be unreasonably withheld.⁵
 - c. NCMWC will pay any taxes and fees that may be owed pertaining to the groundwater well, electricity usage, maintenance and repairs, etc.
 - d. Each year, all such costs will be deducted from the revenues received by way of participation in any groundwater exchange program or similar program, and an accounting will be provided the Conservancy by NCMWC. NCMWC will be entitled to a 50 percent share of the remainder of revenue after net costs have been determined.
- 2.) *Conservancy*. The Conservancy’s participation in the operation phase of the project would be passive. Its responsibilities and benefits include:
 - a. protecting to the best of its ability the underlying groundwater resource,
 - b. being available to NCMWC management for consultations on accounting matters,
 - c. protecting the easements on which the NCMWC relies on to manage and service the groundwater well,
 - d. including NCMWC under contract so that NCMWC has authorization to operate the groundwater on habitat land as is designated by the Natomas Basin Habitat Conservation Plan (NBHCP),
 - e. share 50/50 in maintenance and management costs if such costs exceed revenue in any given year such that expenses exceed revenue, and
 - f. the Conservancy will be entitled to a 50 percent share of the remainder of revenue after net costs have been determined.

Benefits to NCMWC:

- 1.) access to land at zero cost,

- 2.) access to groundwater water resources at zero cost to fee simple landowner,
- 3.) reduction in capex by one-half,
- 4.) reduction of maintenance costs by one-half (assuming revenues are inadequate to cover expenses),
- 5.) operational and management flexibility.

Benefits to Conservancy:

- 1.) advancing the implementation of the NBHCP and Metro Air Park Habitat Conservation Plan (MAPHCP) because:
 - a. greater assurance of water availability in the event of surface water delivery reductions (typically caused by drought),
 - b. greater assurance of water availability in the winter months when NCMWC's water deliveries are stopped; managed marsh complexes require water even in these winter months and it has been difficult to assure this to date,
 - c. greater assurance that water would be available for winter flooding of rice fields which enhances the viability of rice operations and the resultant rice environment as key habitat for Giant Garter Snake (GGS),
- 2.) probable source of revenue (assuming 50 percent of net proceeds in any groundwater exchange program or similar program) with which to use to advance implementation of the NBHCP and MAPHCP, especially when habitat fee income is inadequate to cover operations expenses.

Conclusion

This proposed project must be approved by the Boards of Directors of the NCMWC and Conservancy prior to being committed to. This term sheet is preliminary in nature and is non-binding to either party and will remain so at least until such time as the Boards of Directors of the two organizations approve.

Finally, the proposed plan is intended to provide certainty. Certainty for NCMWC shareholders and water users that irrigation water will be available to them for the use in their farming operations, and certainty for the Conservancy to effectively implement the NBHCP and MAPHCP. It also is helpful in facilitating the NCMWC's participation in state and federal efforts to more efficiently and effectively allocate water resources to beneficial uses, especially in water-short years.

¹ The tract proposed for this project would be the Conservancy's "Lucich South" tract so that the well would be strategically located in proximity to overhead electrical power as well as water conveyance structures most essential to NCMWC operations.

² NCMWC's access and use of water beneath the Conservancy's Lucich South tract would serve as full and complete consideration for NCMWC's management and operation of the groundwater well, and also in consideration for its management of future groundwater exchange programs, water sales and similar programs where revenue is generated by the use of the groundwater well.

³ “Net cost” or “net costs” are to be derived from revenue and expense directly attributable to the subject groundwater well, with no offset or deduction for other expenses, including overhead or administration costs or NCMWC and the Conservancy other than those specifically needed to operate and maintain the groundwater well. These costs include power and energy costs, maintenance costs, energy efficiency testing, repairs, signage, physical security, legal and accounting expense necessary to promulgate contracts and agreements for groundwater exchange agreements, water sales, water bank program participation and the defense of the rights to the groundwater well’s use. No staff costs will be applied to the net cost calculation by either NCMWC or the Conservancy.

⁴ An email approval from the executive officer of the Conservancy will suffice as “in writing.”

⁵ Within a specified window of time, the Conservancy may request that NCMWC activate the well in order to irrigate the managed marsh on the Lucich South property. In such an eventuality, the Conservancy will pay 100 percent of energy costs to NCMWC to reimburse it for such energy costs, and will also pay to NCMWC an additional five (five) percent of the energy costs as NCMWC’s share of typical depreciation and wear and tear costs. The Conservancy’s usage of this facility is expected to take place outside the typical irrigation season, and is also expected to be minimal.

Still to be resolved and likely in need of attorney involvement:

- 1.) Limits to water use. At what point can either party put the brakes on the draw down if they believe it to be excessive and a harm to themselves or others?
- 2.) Claims by others. If there are claims made by others against either party for adverse impacts on the water table, which party leads the response and how will it be handled?
- 3.) Right of termination. What happens if the well ceases to operate beyond the control of either party, such as material breach, paying their share of the costs, payment of net proceeds, etc.
- 4.) Applicability and benefit. The well should not be used for the benefit of one landowner or shareholder or even a small group of interested parties, but rather, for the greater good of the NCMWC shareholders overall. Use of the groundwater well that benefits one party would constitute a breach of this agreement and call for its termination.
- 5.) Abandonment. In the event of abandonment, what is the manner of settling and disposing of the well and its pumps and related capital expenditures?