Term Sheet for Negotiations between
Toronto Water and Veolia
Version dated May 14, 2009

Toronto Water has been in discussions with Veolia on how to transition to full time operation of the Pelletizer Facility ("Pelletizer") under the Operations, Maintenance and Pellet Marketing Agreement ("OM&M Agreement") while outstanding work, remaining deficiencies and warranty items are dealt with through the Design Build Services Agreement and DB Amendment (collectively the "Services Agreement").

1. **Guiding Principles of Negotiations**

1. Veolia commenced Secondary Testing of the Pelletizer on October 7, 2008 and terminated the Secondary Testing on December 19, 2008. The Pelletizer failed to meet the Pellet throughput requirements under the Services Agreement and the Parties agree that any further attempts, at this time, to achieve the throughput requirements under the Services Agreement would not yield substantially different results.

2. The Pellet production quantities stipulated in the Services Agreement and OM&M Agreement must be reduced to reflect the reduced throughput capacity of the Pelletizer.

3. The Parties would like the Pelletizer to be put into full time operation as contemplated by the OM&M Agreement at the reduced throughput capacity while Veolia continues to complete its obligations under the Services Agreement, other than Secondary Testing.

4. The Parties will negotiate the final commercial terms related to any amending agreement(s) in accordance with the Term Sheet.

5. To the extent that a final resolution of all outstanding issues under the Services Agreement can be reached, any continuing Services Agreement obligations will be transferred to the OM&M Agreement on terms acceptable to the Parties by way of an amending agreement.

6. Prior to finalizing the amending agreement, the City will investigate, measure and document the odour and noise issues that have been identified by the City’s consultant. If either or both these issues are determined to constitute an Occupational Health and Safety issue and/or a contravention of the Air Certificate of Approval for the ABTP facility, the amending agreement will include a process and protocols by which the two Parties jointly develop and implement measures to resolve the issues.
7. City staff will seek City Council approval of this Term Sheet and authority to enter into and execute any necessary amending agreement(s) based on this Term Sheet and otherwise on terms and conditions satisfactory to the General Manager, Toronto Water, and in a form satisfactory to the City Solicitor and subject to the General Manager, Toronto Water being satisfied that the amendments proposed do not result in unintended consequences in any of the relevant agreements.

8. Capitalized terms in this Term Sheet shall have the same meaning as defined in the Services Agreement and OM&M Agreement.

2. **Issues for Consideration under the Services Agreement**

1. The Services Agreement will continue to remain in place while Veolia works to:
   
   i. complete the remaining scope of work including the construction of the Enhancements (see Veolia email of April 28, 2009);

2. The Parties will negotiate acceptable terms to enable the City to accept the reduced throughput capacity of the Pelletizer as having met the requirements of Secondary Testing under the Services Agreement including:
   
   i. Veolia waives its right to be paid the Secondary Testing completion amount of $799,932.00 (Special Conditions – Section 8 and Schedule F-1 of DB Amendment);
   
   ii. Veolia represents and warrants that the diminished capacity of Pelletizer does not affect reliability, safety and overall performance of the Pelletizer;
   
   iii. Veolia waives and releases all claims against the City related to the Services Agreement including the claim related to the Rake Arm Blades replaced by Veolia in 2008 and any claim related to the calculation of Pellet dry tonnes; and
   
   iv. Parties will amend the Final Mutual Release at Exhibit F-6 of the DB Amendment in order to fully document the defects agreed to by the Parties as well as the variances from the original performance specifications.

3. Veolia will continue to be responsible for Section 8 – Errors by Contractor, Section 18 – Defective Work, for a period of time, which is to be agreed to by the Parties notwithstanding any deemed Full Completion being achieved by virtue of the reduced Secondary Testing requirements.

4. Section 24 – Services Agreement Insurance will continue in place until Veolia obtains the insurance required under the OM&M Agreement satisfactory to the City.
5. Section 26 – Extent of Veolia’s warranty obligation under the Services Agreement on the Pelletizer and on equipment is to be confirmed and agreed to by the Parties including:

   i. Start Date of Warranty;
   ii. Scope of Warranty;
   iii. Veolia’s responsibility for cost of repair;
   iv. Warranty obligations; and
   v. Application of Special Condition 6 - 24 month Warranty for Pellet Cooler.

6. Veolia will be responsible to determine the extent of consultation and approval it requires from its Surety and insurance providers in order to implement the provisions of the amending agreement.

3. Issues for Consideration under OM&M Agreement

1. Veolia to represent and warrant that:

   i. The reduced throughput capacity of the Pelletizer does not affect the reliability of Pelletizer Facility;
   ii. The Pelletizer is safe and suitable for full operation. Also, Veolia to provide reasonably satisfactory evidence to the City that the Pelletizer is complete and ready for full and safe operation except for the ability to achieve the production quantities for Secondary Testing by way of, for example, third party verification by a professional engineer;
   iii. The three incidents (December 4, 2007, April 3, 2008 and March 20, 2009) of equipment malfunction have been fully resolved and repaired and do not pose any threat to the safety of the continued operation of Pelletizer; and
   iv. Veolia is fully responsible for the current condition of Pelletizer and Veolia will continue to have obligations to maintain the Pelletizer.

2. Section 2.1(b) – Parties to agree on Effective Date.

   i. Successful completion of Secondary Testing under the Services Agreement is a precondition to the start of full-time operation under the OM&M Agreement. The Parties agree that subject to finalizing an amending agreement(s) in accordance with this Term
Sheet that a term of such amending agreement(s) will be that Veolia has satisfied the reduced Secondary Testing requirements such that the OM&M Agreement can become operative. Full-time operation of the Pelletizer under the OM&M Agreement to commence on the execution of the amending agreement(s).

3. The amending agreement(s) will provide for the following issues related to the Effective Date:

   i. Agreement that the COLA adjustment will occur on October 1 each year such that the first COLA adjustment shall be on October 1, 2009.

   ii. Payment, if any, for Pellets produced from December 19, 2008 to Effective Date less any payments already made by the City.

4. Section 3.2 (g) – Adjustment is required to the 90 day rolling production guarantee. The failure of Veolia to meet the 90 day rolling production guarantee is to be an Event of Default.

5. Schedule 7 - Amend reporting obligations of Veolia to conform to Effective Date.

6. Section 3.2(c)/3.2(g) – Amend the Performance Guarantee and Production Obligation:

   i. The OM&M Agreement will be amended to reduce the minimum annual Pellet production quantities from 25,000 to 15,000 dry tonnes per year (the “Performance Guarantee”). The target annual Pellet production rate will be reduced from 25,000 to 18,000 dry tonnes per year. Monthly production targets are to be modified accordingly. As Veolia’s fees under the OM&M Agreement are based on actual production quantities, Veolia’s total estimated revenues will decrease proportionately subject to an adjustment in the Per Tonne Price as detailed below.

7. The total compensation to Veolia under the OM&M Agreement will vary depending on the actual quantity of Pellets produced. For example, based on 15,000 dry tonne production per year Veolia would be paid $2,663,100 and based on 25,000 dry tonne production per year Veolia would be paid $3,988,500. [NTD- City and Veolia to confirm calculation]

8. Section 5.4(b) – Amend R&R Cap definition and application.

   i. Under the OM&M Agreement, Veolia’s obligation for the cost of any incident of repair and replacement or corrective maintenance will increase from $20,000 to $60,000 (the “New R&R Cap”). The City will only be responsible for costs which exceed the $60,000 New R&R Cap; and
ii. Defer the application of Section 5.4 for the facility or any individual piece of equipment until the later of eighteen months from the completion of Secondary Testing or the production of 20,000 dry tonnes starting December 19, 2008.

9. Section 8 – Amend Compensation section to reflect revised payments to Veolia.

   i. In order to fund Veolia’s fixed cost labour requirements based on an annual production target of 18,000 dry tonnes rather than the original 25,000 dry tonnes, the Per Tonne Price for annual production up to 18,000 dry tonnes will be increased by $18 per dry tonne which is an all inclusive amount – to be referred to as the “Per Dry Tonne Surcharge.” The surcharge will be applied retroactive to the October 7, 2008 start of Secondary Testing and will be invoiced by Veolia upon execution of the Amending Agreement. Any Veolia revenue shortfalls required to cover all other fixed costs will be the responsibility of Veolia.

   ii. Should Veolia be successful in increasing annual production beyond 18,000 dry tonnes, the Per Dry Tonne Surcharge will be reduced on a linear basis from $18.00 to $0.00 for production from 18,000 Dry Tonnes to 25,000 dry tonnes. There shall be no Per Dry Tonne Surcharge for production of Pellets in excess of 25,000 dry tonnes. Protocols on how to perform this adjustment will be contained in an amending agreement.

10. Section 3.2 (j) – Amend spare parts obligation beyond Schedule 6.

   i. The OM&M Agreement requires Veolia to maintain at all times a minimum on site inventory of spare parts. The minimum spare parts inventory will be expanded at no cost to the City by approximately $100,000 in order to ensure that replacement parts are readily available to commence repairs on a timely basis when an equipment failure occurs. The expanded spare parts inventory will evolve depending on the maintenance history of the Pelletizer and may be drawn down in the final two years of the OM&M Agreement.

11. Section 27.1 – Default by Operator - In event that there are further major incidents, which prevent the Pelletizer from processing any Biosolids for a period of time greater than 45 days or for a total of 60 days within a consecutive 90 day period, this shall be an Event of Default under the OM&M Agreement.

12. Section 15.2 – Veolia will be required to obtain the consent of Veolia Water North America Operating Services, LLC in respect of the Parent Guarantee regarding the amendments.
13. Each Party will pay for their own costs (including legal fees) to negotiate, complete and enter into formal definitive documents to reflect the agreed terms and conditions associated with this Term Sheet and amending agreement(s).

14. It is acknowledged that none of the terms herein shall impose any obligations whatsoever on the Parties in advance of the agreement and execution of all formal definitive documents required to give effect to the negotiated resolution in respect of the failure to achieve Secondary Testing and the City has obtained all necessary approvals from City Council.

Veolia agrees to the terms as set out above and agrees to work cooperatively to finalize amending agreement(s) in accordance with the terms set out above.

Date: ____________________________

VEOLIA WATER CANADA, INC.

Name: ____________________________
Title: ____________________________