

MEMORANDUM

TO: Old Lyme Shores Beach Association
FROM: Hinckley, Allen & Snyder LLP
DATE: October 27, 2021
RE: Sewage Treatment Contract and Consent Order Strategy

Executive Summary

The Old Lyme Shores Beach Association ("OLSBA") should take a two-step approach to dealing with the increased sewage treatment costs. First, the conveyance system as designed by Fuss & O'Neill is likely the best technical solution to the community pollution problem identified by the Connecticut Department of Energy and Environmental Protection ("DEEP"). However, the cost for this solution is significantly more than originally anticipated. The ideal solution is to approach DEEP with a request to increase the Clean Water Fund Grant for the difference in originally estimated costs and the new cost estimates. This will allow the Association to implement the most environmentally sound solution.

If DEEP refuses to increase the Grant to cover the increased costs, then OLSBA should approach DEEP about renegotiating the entire arrangement. This will consist of coordinating with DEEP to modify or replace the existing Consent Order. At the same time, the OLSBA will have to breach a number of its agreements with third parties (including other beach associations) in order to extricate itself from obligations under these agreements. There may be some damage exposure resulting from these breaches but they should be minimal since OLSBA will no longer be participating in the joint project (as the costs associated with the portion of the project in OLSBA territory will no longer exist).

Issue

Old Lyme Shores Beach Association is one of a number of beach associations (the Old Colony Beach Club Association ["OCBA"] and the Miami Beach Association ["MBA"]) (collectively, the "Associations") under a 2018 Consent Order (the "Order") issued by the Connecticut Department of Energy and Environmental Protection. The Order makes the determination that a community pollution problem exists within the Associations due to inadequate sewage infrastructure. The Order requires the implementation of a regional wastewater system whereby wastewater from the Associations is conveyed to the City of New London for treatment (the "Regional System" or "Regional Solution"). The implementation of the Regional System

includes the installation of new sewer lines and pump stations to convey wastewater from the Association towns to the City of New London via the towns of East Lyme and Waterford. Pursuant to this requirement, the Associations have entered into a series of contracts with each other and third parties. Included in these contracts are separate agreements between each Association and the State of Connecticut for loans and grants under the Clean Water Fund Program ("Clean Water Fund Contract(s)").

The Associations have completed the design phase of the Regional System. Recently, the Associations worked with Fuss & O'Neill to solicit bids for the construction phase of the Regional System. Bids recently came in with construction costs significantly higher than originally anticipated. These increased costs call into question whether the Regional System is still the "most technically and economically feasible" solution to the community pollution problem.¹

Proposed Solution Overview

This memo presents a two-step approach. The primary concern is that the Regional System is no longer the most *economically* feasible solution. A Regional System may be the *best* environmental solution to the problem, but may no longer be the most feasible. With that in mind, the OLSBA should first approach DEEP about increasing the level of Grant funding available under the Clean Water Program. Ideally, Grant money would be available to cover the delta between the initial estimated costs of the Regional System and the most recent bids.

If, however, DEEP is unable or unwilling to increase the amount of grant funding available to OLSBA, OLSBA must take a coordinated approach to renegotiate the Order and the associated contracts (discussed below). This would include approaching DEEP to modify the existing Order (or to reissue a new order) that will allow OLSBA more latitude to explore alternative options to remediate the community pollution problem.² With DEEP's approval to explore alternative solutions, OLSBA would then approach the parties to the various contracts associated with the Order in order to either modify the existing contracts or notify the parties of OLSBA's intent to breach. In fact, the other Associations may be confronting the same economic impracticalities OLSBA is confronted with.

Breaching certain contracts may result in damages. Outlined below is a discussion of each individual contract and the potential damages that may arise from each and their respective likelihood. Ideally, OLSBA will be able to walk away from the existing contracts and implement an alternative solution to the community pollution problem for less than the proposed cost of the Regional System or amicably in conjunction with the Associations.

Notably, this approach relies on the ability to negotiate with DEEP. Theoretically, DEEP could enforce the Consent Order against OLSBA and the Associations regardless of the change in cost

¹ Order, at ¶ A.5.

² OLSBA could implement this alternate plan with Fuss & O'Neill or other environmental consultant.

estimates.³ However, the Order relies on the regional solution being the “most ... economically feasible” solution. Given the significant increase in cost estimates this may no longer be the case and this should provide sufficient leverage to get DEEP to the negotiating table.

Individual Contracts - Approach

A. DEEP

The Order is the defining document for the rest of the contracts. The Order requires that the Associations design and build a regional wastewater conveyance system (Regional System).⁴ The Order does not include a termination clause. Worse case, DEEP could pursue an injunction and penalties for noncompliance.⁵ The Associations are each joint and severally liable under the Order.⁶

A breach of the Order exposes OLSBA to significant penalties and potential litigation. However, the Order relies on the Regional Solution as the “most technically and *economically feasible*” solution to the community pollution problem.⁷ Whether or not the mandated solution is still the most economically feasible solution is now unclear given the recent bids.

First, it should be made clear to DEEP that while OLSBA still believes that the Regional Solution may still be the best environmental solution, it is impracticable given the economics. Without an increase in grant funding under the Clean Water Fund Contract to cover the gap between the initial cost estimate and the recent bids, it is not economically feasible for OLSBA to proceed.

Under the Clean Water Fund Contract, an increase in the Project Grant is available “upon written evidence from the [OLSBA] to the State that the actual amount of the Grant Eligible Costs exceeds the estimated Project Grant.”⁸ “Grant Eligible Costs” consist of the total project cost minus funds received from other sources and any local share to be paid by the OLSBA.⁹ If the total project costs increase, and no other source of funding is available, the Eligible Project Costs should increase under the formula laid out in the Clean Water Fund Contract.¹⁰

³ See, e.g., Order, at ¶ B.7.

⁴ Order, ¶ B.1.b-c.

⁵ Order, ¶ B.7.

⁶ Order, ¶ B.17.

⁷ Order, at ¶ A.5 (emphasis added).

⁸ Agreement CWF No. 720-D, § 2.2(a).

⁹ Id. at § 2.2. More accurately, Grant Eligible Costs are those costs as defined in General Statutes § 22a-478 for “eligible water quality projects” as defined by the same regulation.

¹⁰ Under General Statutes § 22a-478(c)(2), “[a] combined sewer project shall receive (A) a project grant of fifty percent of the cost of the project, and (B) a loan for the remainder of the costs of the project ...” However, under § 22a-478(c)(5), project grants for “water pollution control” projects in towns (or in discrete areas within towns) with less than five thousand people are limited to grants in the amount of 25% of design and construction costs. Similarly, other

DEEP may offer to increase the loan amount rather than increasing the grant amount. All loans under the Clean Water Program carry an interest rate not to exceed two percent.¹¹ OLSBA may consider an increased loan amount; however, as OLSBA will be required to repay the loan, this may not be a feasible alternative.

If DEEP is unable to sufficiently increase the grant under the Clean Water Fund Contract (or OLSBA is unable to increase the loan, assuming such option is available), OLSBA should assert that, given the significant increase in construction costs, the solution mandated under the Order may no longer be the most technically and economically feasible resolution to the community pollution problem. Other solutions, including ones previously reviewed and dismissed as being too expensive, may now be more economically feasible. Therefore, it would be prudent for OLSBA to re-evaluate other available options, including pulling out of the combined sewer project and installing local septic and sewer systems that solve the pollution problem as it exists in the area controlled by the OLSBA.

OLSBA should request that DEEP allow it to work with F&O (or an alternate engineering firm if there is a conflict with F&O's continued work for the other Associations) to re-evaluate a local solution for the pollution problem. If the cost estimate for this solution comes in at less than what it would cost for OLSBA to participate in the Regional System, then OLSBA should request that DEEP modify the Order to allow OLSBA to continue with a local solution. In the meantime, OLSBA will work with the parties to its other contracts related to the Order to eliminate any ongoing and future obligations and limit damages to both itself and the other Associations.

B. Clean Water Fund Contract

As noted above, OLSBA's first step should be to approach DEEP to receive an increase in Grant funds pursuant to Section 3.2 of the Clean Water Fund Contract. However, if DEEP is unable or unwilling to increase the Grant funds, OLSBA may need to either renegotiate or otherwise extricate itself from the Clean Water Fund Contract.

There are no termination provisions in the Clean Water Fund Contract. However, pursuant to sections 3.3(b) and 4.5(b) of the Contract, any moneys loaned or granted and not spent on the project are required to be refunded to the State. OLSBA would simply inform the State that, pursuant to negotiations with DEEP, OLSBA is no longer pursuing the construction phase of the

eligible water quality projects (not otherwise defined by the statute) are eligible for grants at 25% of the project cost. General Statutes § 22a-478 (c)(8). Exactly what kind of project the Regional System falls under is not defined by the Clean Water Fund Contract, but Section 3.1 indicates that different portions of the project are treated differently for grant allocation purposes; in other words, the project portion that consists of a combined sewer project is treated as such, whereas the portion of the project that consists of a water pollution control facility is treated as such, etc. Under this Section, it is possible that the total grant may be limited to less than 50% of the total project costs. However, the current grant amount for OLSBA consists of less than 25% (~22.5%); therefore, there should be room for the State to increase the grant funding.

¹¹ General Statutes § 22a-478(c)(11); § 22a-478(d).

project and would pay back to the State any grant or loan funds disbursed but not yet spent. Pursuant to Section 4.6(a) of the Contract, OLSBA may pay back any portion of the principal on the loan early without any penalty. OLSBA would merely owe the accrued interest on the principal to the date of the payment.

It is possible that the State could view the failure to move forward with the Regional System as an event of default under the Contract. Pursuant to Section 9.1(d), the OLSBA may be in default if it fails to perform or observe any covenant included in the Contract for more than thirty days and without excuse, and fails to proceed in good faith to correct its default. Such a default could require the State to call the loan under Section 9.2(a), which requires repayment of the loan obligation in full. Similarly, OLSBA is required to refund the grant money in full.¹²

Ideally, OLSBA will wrap the negotiation of the Clean Water Fund Contract into the negotiations with DEEP on the Order. If OLSBA is going to have to analyze the renewed economic feasibility of a local solution, it may be that the local solution is also eligible under General Statutes § 22a-478 to receive grant or loan funding under the Clean Water Program. If that is the case, it may be necessary to either rescind the existing Clean Water Fund Contract and enter into a new one, or modify the existing Contract to encompass the proposed new work.

Short Summary of Potential Damages: Cost of interest accrued on loan to date. However, if the breach is considered a default event, then State may call the entire loan and grant, plus interest (including, theoretically, amounts spent already on design).

C. Fuss & O'Neill Agreement

The Fuss & O'Neill Agreement ("F&O Agreement") requires Fuss & O'Neill ("F&O") to design and construct the Regional System, including the sewer lines and pump stations. The design phase is complete and F&O has worked with the Associations to solicit bids for the construction phase.

The F&O agreement can be terminated with minimal damages to OLSBA. The scope of services under the F&O Agreement consists of the "design, permitting and construction" of the proposed Regional System.¹³ The construction services include, among other things, "attend[ing] ... preconstruction conference(s) ... with the [chosen construction] Contractor," conducting inspections and site visits, and providing assistance with contract interpretation.¹⁴ While unilateral termination without cause is not allowed, the contract is terminable "by either party upon seven days' written notice in the event of substantial failure by the other party to perform"¹⁵ Upon such termination, F&O "will be paid for all service rendered to the date of termination, all Reimbursable Expenses and termination expenses."

In order to terminate the F&O Agreement, OLSBA must so notify F&O. If OLSBA refuses to move forward with the construction phase of the contract, it would be a "substantial failure" to

¹² Clean Water Fund Contract, § 9.2(b).

¹³ F&O Agreement, § 1.2.

¹⁴ See F&O Agreement, §§ 2.14.1, 2.14.4, 2.14.5, 2.14.7, 2.14.9

¹⁵ F&O Agreement, §§ 6.8.

perform. F&O would then be able to terminate the contract. In this scenario, OLSBA would be required to pay F&O for work done so far, including reimbursable expenses, plus termination costs. As OLSBA is responsible for these costs anyway, damages arising from this termination should be minimal.¹⁶

Short Summary of Potential Damages: Expenses paid to date, reimbursable expenses incurred to date, termination costs.

D. New London Agreement

The agreement between the Associations and the City of New London, dated April 27, 2018 (the “New London Agreement”), calls for the Associations to purchase 120,000 gallons per day of sewage treatment in its sewage treatment system.¹⁷ The fee for this treatment is variable based on New London’s cost but starts at \$2.20 for every 1000 gallons of sewage treated.¹⁸ Under this Agreement, the Associations also agreed to a connection fee in the amount of \$1,440,000 to be paid over ten years,¹⁹ and to pay 1.2% of the New London treatment plan’s operating costs for the duration of the agreement.²⁰ Specifically to OLSBA, Old Lyme agreed to pay a connection fee of \$642,049 along with a \$47,883 fee for joining the agreement late.

The New London Agreement terminates if the Associations have not utilized any capacity by September 1, 2023.²¹ Otherwise, the Agreement is only terminable upon the material breach of one party.²²

Should OLSBA breach this agreement, we can minimize potential damages. If OLSBA determines (after consultation with DEEP) that the Regional System is no longer the most economically feasible, OLSBA can contact New London and the Associations and give notice that OLSBA will not proceed under the agreement. To the extent that OLSBA has paid any connection fees and/or late-joining fees, those will not be recoverable. As for any unpaid connection fees, OLSBA should be able to minimize any damages. This will apply to any late fees as well.

The general rule in breach of contract cases is that the award of damages is designed to place the non-breaching party in the same position as that which it would have been in had the contract been performed.²³ Therefore, the non-breaching party, New London, should only receive what would otherwise have been profit under the contract as damages.²⁴ To the extent that any

¹⁶ It may be possible to minimize termination expenses if F&O can be contracted to perform the re-analysis of a local solution.

¹⁷ New London Agreement, § 2.1.

¹⁸ Id. at § 2.2.

¹⁹ Id. at § 2.3.

²⁰ Id. at § 2.4.

²¹ Id., at § 3.1.

²² Id. at § 3.2.

²³ *Torosyan v. Boehringer Ingelheim Pharmaceuticals, Inc.*, 234 Conn. 1, 32 (1995).

²⁴ See *Kay Petroleum Corp v. Piergrossi*, 137 Conn. 620, 624 (1951) (“[u]nless they are too speculative and remote, prospective profits are allowable as an element of damage”).

connection charges were related to the actual cost of connection, such charges should not be recoverable as damages.

Similarly, with the sewage treatment costs and associated operating costs, treatment has yet to start. Therefore, should OLSBA withdraw from the agreement, damages should be limited to the City of New London's lost profit from the treatment (of OLSBA's sewage only) over the term of the contract (20 years).²⁵ However, because New London has not incurred costs under this portion of the contract if OLSBA breaches (as New London would not be treating any water from OLSBA), OLSBA has a strong argument that New London did not suffer any damages.²⁶

Short Summary of Potential Damages: Potential profits due to New London under the contract prior to breach.

E. Old Lyme Agreement

Under the Agreement to Add Town of Old Lyme to Beach Association's Cost-Sharing Agreement for Sewer Project ("Old Lyme Agreement"), the Association's agree to share the costs of the design and construction of the Regional System based on the percentage of households utilizing the system within each Association.²⁷ OLSBA's share of these costs under the Old Lyme Agreement is 29.7%.²⁸

The Agreement may be terminated only upon the mutual consent of all parties.²⁹ Ideally, the other Associations will recognize that the increased costs for the Regional System is not sustainable and will want to follow our lead and reevaluate the local remedy option. This is likely the only way that all parties could mutually agree to terminate the agreement. Otherwise, termination is unlikely.

²⁵ See *Torosyan, supra*, 234 Conn. at 32; New London Agreement, § 3.1.

²⁶ See, e.g., *Coppola Construction Co. v. Hoffman Enterprises Ltd. Partnership*, 157 Conn. App. 139, 162 (2015) (a party seeking damages must prove the extent of damages suffered); *Semec Electric Company, Inc. v. Skanska USA Building, Inc.*, 195 Conn. App. 695, 719-20 ("The injured party, however, is entitled to retain nothing in excess of that sum which compensates him for the loss of his bargain ... the law of contract damages limits the injured party to damages based on his actual loss caused by the breach.") (Citations omitted.) In this case, New London already has the existing capacity; it has gone to no new expense to make this capacity available to OLSBA. Further, any cost savings seen by New London because OLSBA is no longer a party to the Agreement – and therefore not pushing any sewage through to New London's system for treatment – should be passed on to OLSBA. *Id.*, at 720 ("The concept of actual loss accounts for the possibility that the breach itself may result in a saving of some cost that the injured party would have incurred if he had to perform... In such circumstances, the amount of the cost saved will be credited in favor of the wrongdoer.") (Citations omitted.)

²⁷ Old Lyme Agreement, §2.1(c).

²⁸ *Id.* at § 1.

²⁹ *Id.* at § 3.2.

Any costs paid for design work so far will likely be unrecoverable.³⁰ However, OLSBA should be able to save the vast majority of future construction costs contemplated under this contract. Damages for any future work will be minimal because the percentage of each Association's costs under the agreement is dictated by the number of households utilizing the sewer system – in other words, the more water sent through the system (by more households), the more each Association pays. If OLSBA withdraws from the Agreement, OLSBA will be serving zero households and will be pumping zero water through the system. Therefore, OLSBA's costs for constructing the system under the cost sharing portion of the agreement will be nothing.

OLSBA's breach will also lower the total volume of water flowing through the system, potentially changing the design structure such that a less extensive system and/or smaller pump stations may be used. If system redesign is required, OLSBA may be liable for the redesign costs, as the redesign would be a direct consequence of OLSBA's breach.³¹ However, any benefit of lower construction costs due to the lower volume of water flowing through the pipes should also accrue to OLSBA.³²

Short Summary of Potential Damages: Damages for any change in design costs; however, no damages then for future construction or operation costs.

F. East Lyme Agreement

Under an agreement with the East Lyme Water and Sewer Commission (the "East Lyme Agreement"), the Associations have agreed to pay East Lyme to connect their Regional System to the existing East Lyme system and pump their wastewater through East Lyme on its way to New London.³³ Under this agreement, the Associations will construct a "sewer main" (defined as a "force main pipe and related facilities") within East Lyme's territorial limits.³⁴ The design, construction, and operation and maintenance of the "sewer main" is the responsibility of the Associations.³⁵ Additionally, East Lyme is allocating 120,000 gallons per day of its wastewater conveyance system to the Associations.³⁶ The total cost of this allocation is \$537,852.75 over 20 years in semi-annual payments with 2% interest compounded semi-annually, minus the initial down payment of \$13,446.32.³⁷ The Associations are also responsible for a share of all future capital improvements in the East Lyme sewer system and must pay an annual operation and maintenance fee to East Lyme.³⁸

³⁰ See *Id.*, § 2.1(a).

³¹ See *Warning Lights & Scaffold Service, Inc. v. O & G Industries, Inc.*, 102 Conn. App. 267, 271 (2007) (damages are recoverable when they are the direct and proximate result of defendant's breach).

³² *Semec Electric, supra*, 195 Conn. App. at 720.

³³ East Lyme Agreement, ¶ 2.

³⁴ *Id.* at ¶¶ 2, 3.

³⁵ *Id.*, at ¶¶ 3, 5.

³⁶ *Id.* at ¶ 7.

³⁷ *Ibid.*

³⁸ *Id.* at ¶¶ 8, 9.

The East Lyme Agreement is only terminable upon the mutual consent of all parties (or upon conclusion of any legal proceedings terminating the agreement).³⁹ Similarly, the Agreement may only be modified by similar mutual consent.⁴⁰ OLSBA's share of the Association costs is 29.34%.⁴¹

Should OLSBA breach this Agreement prior to the flow of any water through the system will eliminate any operation, maintenance and ongoing capital system costs. If OLSBA withdraws prior to these improvements, OLSBA will not be using the system, and the reduction in flow would reduce wear and tear on the system.⁴²

OLSBA's withdrawal from the agreement means the total system allocation for the remaining Associations will decrease. In other words, OLSBA will no longer be creating flow through the system, reducing the need for the overall allocation. Ideally, the remaining Associations and East Lyme re-negotiate and lower the allocation accordingly. However, if East Lyme refuses, East Lyme should only be able to recover what it would have made in profit from the allocation (to OLSBA only) over the term of the contract (20 years).⁴³

Finally, with OLSBA no longer using the system, the "sewer main" to be constructed in East Lyme may need to be redesigned as a smaller system. While OLSBA may have exposure for design change costs, any changes to the system will likely result in reduced construction and maintenance costs. Since OLSBA will reap the benefit of these reductions,⁴⁴ OLSBA's damages should be limited to the change in design costs.

Short Summary of Potential Damages: Damages for change in construction and design costs for "sewer main;" East Lyme's profits on sewer allocation fees.

G. Easements

There are four easement agreements the OLSBA has entered into: the Sahlin Agreement (with Diane Sahlin), the Maratta Agreement (with Janet Maratta), the Boulanger Agreement (with Scott and Kathleen Boulanger) and the Old Lyme Agreement (with the town of Old Lyme). Nothing need happen under any of these agreements for OLSBA to pull out of its obligations relating to the Regional System. Notably, the remaining Associations will still need to use OLSBA's land and acquired easements to construct their sewer across OLSBA's property. There is no benefit in trying to unwind or otherwise undo any of these easements. Specifically, there are no remaining obligations to OLSBA under the Boulanger and Old Lyme Agreements. OLSBA does not appear to have promised anything to Maratta under the Maratta Agreement. Finally, if OLSBA is going to move back to septic, Ms. Sahlin may want to keep the septic

³⁹ Id., ¶ 17.

⁴⁰ Id., ¶ 21.

⁴¹ Id., Ex. A.

⁴² *Semec Electric*, *supra*, 195 Conn. App. at 720 (breaching party gets benefit of any reduction in costs due to their breach).

⁴³ See *Torosyan*, *supra*, 234 Conn. at 32; East Lyme Agreement, ¶ 7.

⁴⁴ *Semec Electric*, *supra*, 195 Conn. App. at 720.

system OLSBA has otherwise agreed to remove under the Sahlin Agreement. Otherwise, OLSBA will be required to remove the septic system pursuant to the Agreement, and nothing more.

Conclusion

There are multiple strategic paths available to OLSBA. The most prudent is to approach DEEP and request that, due to the increased cost of the Regional System, OLSBA must be allowed to re-evaluate its options to resolve the identified community pollution problem. If DEEP is insistent that the Regional Solution is the only solution, then OLSBA should demand an increase in the Grant amount under the Clean Water Fund Contract to cover the difference between the original, proposed costs, and the updated cost estimate.

If no such Grant increase is available, OLSBA needs to argue that a local, septic-based system, or a smaller, local sewer treatment system is the more economically and technically feasible solution for OLSBA. Ideally, DEEP will agree this method is best. This approach will allow OLSBA to extricate itself from its obligations under both the Consent Decree and the Clean Water Fund Contracts without the risk of litigation or default. Further, DEEP's support will give OLSBA leverage when negotiating with the parties regarding the remaining contracts.

The F&O Agreement presents minimal damages exposure, as costs upon breach only consist of expenses to date and "termination costs." To the extent that F&O can be engaged both by the other Associations to re-evaluate the proposed system given the withdrawal of OLSBA, and can be engaged by OLSBA directly to evaluate the feasibility of system alternatives, any damages F&O may have would likely be completely mitigated or eliminated.

Damages under the New London Agreement should be similarly minimal. Ideally, the remaining Associations and New London will agree to lower the allocation by an amount proportionate to OLSBA's allocation. If not, then OLSBA may expect damages claim in the amount of profit that New London would have made over the course of the Agreement. As OLSBA will no longer be using the New London system, there should be no damages for ongoing operation and maintenance costs.

Similarly, under the East Lyme Agreement, the remaining Associations and East Lyme should be able to lower the allocation by an amount proportionate to OLSBA's allocation. If not, then OLSBA may have exposure to East Lyme's lost profit on OLSBA's allocation over the next 20 years. As OLSBA would no longer be East Lyme's system, any ongoing operation and maintenance costs or future capital costs should be nonexistent.

Finally, under the Old Lyme Agreement, OLSBA may have exposure in design changes, as the system will likely need to be (at least partly) redesigned due to OLSBA no longer participating. However, because any reduction in volume in the system should accrue to OLSBA so any other future costs for operation and maintenance of the system should be eliminated.