



DATE: August 19, 2009

TO: Honorable Mayor and City Councilmembers

FROM: Water Utilities Department

SUBJECT: **APPROVAL OF A DRAFT SEAWATER DESALINATION PROGRAM AGREEMENT WITH THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA, THE SAN DIEGO COUNTY WATER AUTHORITY, AND NINE LOCAL RETAIL AGENCIES FOR PROGRAM FUNDING FOR THE CARLSBAD SEAWATER DESALINATION PROJECT**

SYNOPSIS

Staff recommends that the City Council approve the essential terms of a draft seawater desalination program agreement with the Metropolitan Water District, the San Diego County Water Authority, and nine local retail agencies for program funding for the Carlsbad Seawater Desalination project; and authorize the Mayor to execute the final agreement when approved by the City Attorney.

BACKGROUND

On August 15, 2007, the City Council authorized staff to enter into negotiations with Poseidon for the purchase of desalinated water. The Poseidon Resources Corporation (Poseidon), a company that develops water projects, is developing a seawater desalination project at the Encina Power Plant in Carlsbad. They are proposing to sell the water produced at the desalination facility through long-term water sales agreements.

In August 2001, Metropolitan's Board approved the establishment of the Seawater Desalination Program, which provides financial incentives of up to \$250 per acre foot (AF) for up to 150,000 acre foot per year (AFY) of desalinated seawater produced within its service area. The Seawater Desalination Program (SDP) incentives are provided to offset the cost of producing, distributing and use of desalinated seawater. In 2004, Metropolitan adopted its Integrated Water Resources Plan, which identifies a need for 150,000 AFY of seawater desalination by the year 2025. A year later, in 2005, Metropolitan's Board authorized its General Manager to enter into an agreement with five member agencies (including the Water Authority for 56,000 AFY) for SDP funding.

The Local Retail Agencies (LRAs) consist of nine Water Authority member agencies (see Table 1) that have entered into separate long-term agreements with Poseidon Resources for the purchase of up to 56,000 AFY of desalinated water produced from the project. The desalinated seawater will supplement local water supplies and decrease reliance on imported water supplies.

**Table 1
List of Local Retail Agencies**

1. Carlsbad Municipal Water District
2. Valley Center Municipal Water District
3. Rincon del Diablo Municipal Water District
4. Sweetwater Authority
5. Rainbow Municipal Water District
6. Vallecitos Water District
7. Santa Fe Irrigation District
8. Olivenhain Municipal Water District
9. City of Oceanside

ANALYSIS

Poseidon Resources is constructing the Carlsbad Desalination Project (CDP), which consists of a 50 million gallon per day (MGD) seawater desalination treatment plant, 1 pump station, 1 storage tank, and 13.7 miles of transmission pipelines to deliver the treated water to points of connections to both the member agency distribution system and the Water Authority's Second Aqueduct. The Carlsbad Seawater Desalination project will result in a new water supply which will reduce demands on the Water Authority and Metropolitan for imported water by up to 56,000 AFY.

Under this agreement, the Water Authority will perform certain administrative functions, and serve as a conduit in the invoicing and reconciliation processes, as well as payment by Metropolitan of SDP contributions to the LRAs.

FISCAL IMPACT

The agreement is to provide seawater desalination incentives for the local retail agencies combined of up to \$250/AF for 56,000 AFY of desalinated seawater from the Carlsbad Desalination project. The incentives will go to Poseidon Resources Corporation as per our Water Purchase Agreement to offset the cost of production.

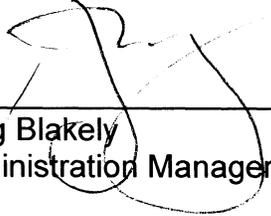
CITY ATTORNEY'S ANALYSIS

The draft agreement has been reviewed by the City Attorney. The final agreement will be reviewed by the City Attorney once completed. Any material changes should be presented to City Council for approval.

RECOMMENDATIONS

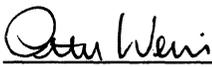
Staff recommends that the City Council approve the essential terms of a draft seawater desalination program agreement with the Metropolitan Water District, the San Diego County Water Authority, and nine local retail agencies for program funding for the Carlsbad Seawater Desalination project; and authorize the Mayor to execute the final agreement when approved by the City Attorney.

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SUBMITTED BY:



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Lonnie Thibodeaux, Water Utilities Director

Teri Ferro, Financial Services Director







AGREEMENT NO. 70025

CARLSBAD SEA WATER DESALINATION PROJECT

SEAWATER DESALINATION PROGRAM AGREEMENT AMONG
THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA,
THE SAN DIEGO COUNTY WATER AUTHORITY,
CARLSBAD MUNICIPAL WATER DISTRICT,
CITY OF OCEANSIDE,
OLIVENHAIN MUNICIPAL WATER DISTRICT,
RAINBOW MUNICIPAL WATER DISTRICT,
RINCON DEL DIABLO MUNICIPAL WATER DISTRICT,
SANTA FE IRRIGATION DISTRICT,
SWEETWATER AUTHORITY,
VALLECITOS WATER DISTRICT, AND
VALLEY CENTER MUNICIPAL WATER DISTRICT

DRAFT June 4, 2009

AGREEMENT NO. 70025
 CARLSBAD SEAWATER DESALINATION PROJECT
 SEAWATER DESALINATION PROGRAM AGREEMENT AMONG
 THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA,
 THE SAN DIEGO COUNTY WATER AUTHORITY,
 CARLSBAD MUNICIPAL WATER DISTRICT, CITY OF OCEANSIDE,
 OLIVENHAIN MUNICIPAL WATER DISTRICT, RAINBOW MUNICIPAL WATER DISTRICT,
 RINCON DEL DIABLO MUNICIPAL WATER DISTRICT, SANTA FE IRRIGATION DISTRICT,
 SWEETWATER AUTHORITY, VALLECITOS WATER DISTRICT, AND
 VALLEY CENTER MUNICIPAL WATER DISTRICT

TABLE OF CONTENTS

<u>Section</u>	<u>Page</u>
RECITALS	3
Section 1: Definitions.....	5
Section 2: Conditions Precedent to Metropolitan Contributions	7
Section 4: Covenants.....	9
Section 5: Ownership and Responsibilities.....	9
Section 6: Invoicing Process	10
Section 7: Reconciliation Process	11
Section 8: Record Keeping and Audit.....	13
Section 9: Term, Amendments, and Termination	15
Section 10: Intellectual Property.....	16
Section 11: Rate Structure Integrity.....	16
Section 12: Use of Metropolitan’s Facilities.....	18
Section 13: Metropolitan’s Imported Water Entitlements	19
Section 14: Hold Harmless and Liability	19
Section 15: Notice.....	19
Section 16: Successors and Assigns.....	20
Section 17: Integration	20
Section 18: Severability	20
Section 20: Governing Law	21
<u>Exhibits</u>	
Exhibit A (Project Description)	
Exhibit B (Annualized Capital Component)	
Exhibit C (Operation and Maintenance Component)	
Exhibit D (Annualized Replacement Component)	
Exhibit E (Deferred Costs)	
Exhibit F (Performance Provisions)	
Exhibit G (Required terms of LRA/Poseidon Agreements)	

AGREEMENT NO. 70025
CARLSBAD SEAWATER DESALINATION PROJECT
SEAWATER DESALINATION PROGRAM AGREEMENT AMONG
THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA,
THE SAN DIEGO COUNTY WATER AUTHORITY,
CARLSBAD MUNICIPAL WATER DISTRICT, CITY OF OCEANSIDE,
OLIVENHAIN MUNICIPAL WATER DISTRICT, RAINBOW MUNICIPAL WATER DISTRICT,
RINCON DEL DIABLO MUNICIPAL WATER DISTRICT, SANTA FE IRRIGATION DISTRICT,
SWEETWATER AUTHORITY, VALLECITOS WATER DISTRICT, AND
VALLEY CENTER MUNICIPAL WATER DISTRICT

THIS AGREEMENT (“Agreement”) is made and entered into as of _____ among the Metropolitan Water District of Southern California (Metropolitan), the San Diego County Water Authority (SDCWA), Carlsbad Municipal Water District (Carlsbad), City of Oceanside, Olivenhain Municipal Water District, Rainbow Municipal Water District, Rincon del Diablo Municipal Water District, Santa Fe Irrigation District, Sweetwater Authority, Vallecitos Water District, and Valley Center Municipal Water District, collectively referred to as “Parties” and individually as “Party.”

RECITALS

- A. Metropolitan is a public agency of the State of California incorporated under the Metropolitan Water District Act, Stats. 1969, ch. 209, as amended, codified at Section 109.1 et seq. of the Appendix to the California Water Code, engaged in transporting, storing and distributing water in the counties of Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Ventura, within the State of California.
- B. SDCWA is a county water authority incorporated under the California County Water Authority Act, Stats. 1943, c.545 as amended, codified at Section 45-1 et seq. of the Appendix to the California Water Code, for the purpose of providing its member agencies in San Diego County with a safe, reliable, and sufficient supply of imported water.
- C. SDCWA is a member public agency of Metropolitan.
- D. Carlsbad Municipal Water District (Carlsbad) incorporated under (get information from SDCWA)
- E. City of Oceanside incorporated under(get information from SDCWA)
- F. Olivenhain Municipal Water District incorporated under(get information from SDCWA)

- G. Rainbow Municipal Water District incorporated under(get information from SDCWA)
- H. Rincon del Diablo Municipal Water District incorporated under(get information from SDCWA)
- I. Santa Fe Irrigation District incorporated under(get information from SDCWA)
- J. Sweetwater Authority incorporated under(get information from SDCWA)
- K. Vallecitos Water District incorporated under(get information from SDCWA)
- L. Valley Center Municipal Water District incorporated under(get information from SDCWA)
- M. Unless this Agreement specifies otherwise, it shall refer to Carlsbad Municipal Water District, City of Oceanside, Olivenhain Municipal Water District, Rainbow Municipal Water District, Rincon del Diablo Municipal Water District, Santa Fe Irrigation District, Sweetwater Authority, Vallecitos Water District, and Valley Center Municipal Water District collectively as Local Retail Agencies (“LRAs”).
- N. Metropolitan’s mission is to provide its service area with adequate and reliable water to meet present and future needs in an environmentally and economically responsible manner.
- O. As part of its Integrated Resources Plan, Metropolitan established the Seawater Desalination Program (SDP) to provide financial incentives for seawater desalination projects that reduce demand for imported water supplies from Metropolitan through the State Water Project and Colorado River Aqueduct.
- P. Poseidon Resources (Channelside) LLC, a Delaware limited liability company (Poseidon), is planning to construct capital facilities collectively known as the Carlsbad Seawater Desalination Project (Project), to treat seawater to potable standards and to sell that water to LRAs for beneficial use within SDCWA’s and Metropolitan’s service area. Each participating LRA has entered into a bilateral agreement with Poseidon to acquire desalinated water produced by the Project.

- Q. Metropolitan, in accordance with its SDP, desires to assist in the development of the Project in its service area by providing financial incentives to SDCWA for production of Desalinated Seawater from the Project.
- R. Metropolitan's SDP and the provision of the financial incentive are premised upon and require verification of actual costs for producing desalinated water.
- S. SDCWA and LRAs desire to take part in Metropolitan's SDP in accordance with the provisions of the SDP and this Agreement.
- T. SDCWA desires to support the Project by transferring to LRAs the financial incentives it receives from Metropolitan under the SDP and this Agreement.
- U. The Parties agree that any information obtained from Metropolitan-funded research or Project implementation under this Agreement shall be shared among all of Metropolitan's member public agencies.

NOW, THEREFORE, in consideration of the promises and covenants set forth in this SDP Agreement, the Parties agree as follows:

Section 1: Definitions

The following words and terms, unless otherwise expressly defined in their context, shall mean the following:

- 1.1 "Contract Yield" shall mean the maximum amount of Desalinated Seawater expected to be produced by the Project pursuant to this Agreement and is established initially at 56,000 acre-feet per Fiscal Year. This initial Contract Yield is subject to reduction pursuant to the provisions of Exhibit F.
- 1.2 "Deferred Cost" shall mean that cost, in dollars per acre-foot, carried forward from the preceding Fiscal Year as calculated in Exhibit E, incorporated herein by this reference.

- 1.3 “Desalinated Seawater” shall mean treated seawater produced by the Project that meets all applicable federal, state and local water quality laws and regulatory requirements for potable uses, developed for delivery within SDCWA’s service area.
- 1.4 “Eligible Yield” shall mean the amount of Desalinated Seawater delivered to LRA’s and SDCWA’s local potable water distribution system from the Project in a Fiscal Year that is eligible to receive Metropolitan’s financial assistance. Eligible Yield shall not exceed Contract Yield and shall exclude any Desalinated Seawater that Metropolitan reasonably determines will not augment water supply available to Metropolitan’s service area, including Metropolitan’s imported water. Eligible Yield is water produced only through the Project and does not include other water sources that have been blended with the Desalinated Seawater.
- 1.5 “Environmental Document” shall mean any final document, review, finding, conclusion, declaration, or determination required for the Project under applicable state or federal law, including but not limited to the California Environmental Quality Act (CEQA) and federal National Environmental Policy Act (NEPA).
- 1.6 “Estimated SDP Contribution” shall mean the financial contribution in dollars per acre-foot, not to exceed \$250 per acre-foot, that Metropolitan pays SDCWA pursuant to this Agreement for monthly Eligible Yield until the Final SDP Contribution is calculated pursuant to procedures set forth in Sections 6 and 7.
- 1.7 “Final SDP Contribution” shall mean the final financial contribution in dollars per acre-foot that Metropolitan pays SDCWA pursuant to this SDP Agreement for Eligible Yield in a Fiscal Year, not to exceed \$250 per acre-foot. The Final SDP Contribution for the Project is equal to the sum of the Project Unit Cost and Deferred Cost minus Metropolitan’s prevailing full service treated water rate applicable to all of Metropolitan’s member public agencies.
- 1.8 “Fiscal Year” shall mean Metropolitan’s fiscal year, which begins on July 1 and ends on June 30.
- 1.9 “Local Retail Agency” or “LRA” shall mean a member public agency of SDCWA that is party to this Agreement.

- 1.10 “LRA-Poseidon Agreement” shall mean any Project water purchase agreement between an LRA or group of LRAs and Poseidon
- 1.11 “Project” shall mean the “Carlsbad Seawater Desalination Project” under development by Poseidon and supported by SDCWA and LRAs, consisting of various capital treatment and distribution facilities capable of producing Eligible Yield, as described in Exhibit A, incorporated herein by this reference.
- 1.12 “Project Unit Cost” shall mean the actual cost to produce and distribute an acre-foot of Eligible Yield by the Project and is comprised of three components: Annualized Capital Component, Operation and Maintenance Component, and Annualized Replacement Component as specified in Exhibits B, C, and D, respectively, incorporated herein by this reference.
- 1.13 “Required Approvals” shall mean any and all authorizations, consents, licenses, Environmental Documents, permits, or approvals as may be required by any applicable federal, state, or local law in order to fully construct and operate the Project.
- 1.14 “Seawater” shall mean water taken directly from the ocean, including estuaries or beach wells.
- 1.15 “Seawater Desalination Program” or “SDP” shall mean the desalination assistance program as authorized by Metropolitan’s Board of Directors and as implemented by Metropolitan’s officers, employees, and agents. The SDP includes all policy directions for the program in place at the time this SDP Agreement is entered into, along with any modifications thereto that occur during the terms of this SDP Agreement.
- 1.16 “Total Deliveries” shall mean all types of water, including Desalinated Seawater, delivered through Project facilities in a Fiscal Year. The quantity of Total Deliveries is used to calculate the Annualized Capital Component, Operation and Maintenance Component, and Annualized Replacement Component, as specified in Exhibits B, C, and D, respectively.

Section 2: Conditions Precedent to Metropolitan Contributions

Metropolitan’s obligation to pay to SDCWA the Estimated or Final SDP Contribution by credit on SDCWA’s monthly billing or otherwise (as set forth in Sections 6 and 7 below) are subject to

satisfaction of the following conditions precedent:

- 2.1 LRA/Poseidon Agreements – SDCWA shall have provided evidence that each LRA has entered into an agreement with Poseidon for purchase of Project water. Each LRA/Poseidon Agreement must be substantially in accord with the SDP and all relevant terms of this Agreement. In addition, each LRA/Poseidon Agreement shall contain the terms set forth in Exhibit G to this Agreement, incorporated herein by this reference. Metropolitan retains sole discretion to determine whether such agreements meet these criteria.
- 2.2 Permits and Approvals – SDCWA shall have provided Metropolitan evidence of all Required Approvals and delivered such information to Metropolitan. No Required Approvals may impose any conditions on the Project that Metropolitan in its sole discretion finds will (a) unreasonably limit the financing, construction, or operation of the Project for the purposes of this Agreement; (b) reduce SDCWA's or LRAs' available water supplies; or (c) impose any condition upon Metropolitan or member public agencies of Metropolitan. Any acceptable conditions shall have been satisfied or waived by the entity or person imposing such conditions.
- 2.3 Environmental Documentation – SDCWA shall have provided Metropolitan evidence of all Environmental Documents. Further, all time periods for commencing any administrative or legal action to challenge any such Environmental Documents, or any Required Approvals that are contingent upon such Environmental Documents, shall have expired with no legal or administrative actions pending. In the case of NEPA, sixty (60) days shall have expired after publication of the Record of Decision in the Federal Register with no legal or administrative actions pending.
- 2.4 Project Description and Milestones - SDCWA shall have provided Metropolitan a detailed Project Description to complement Exhibit A and Project Milestones for implementing the Project.
- 2.5 Litigation Notification – SDCWA shall have certified that it has conducted a search with due diligence and knows of no administrative or legal action, including any arbitration, investigation, or other proceeding, pending before any court, arbitrator, or governmental authority, nor any such action threatened, nor any decree, order, or injunction issued by any court, arbitrator, or

governmental authority and remaining in effect, that (a) relates to the Project; (b) prevents or hinders (or seeks to prevent or hinder) production of Desalinated Seawater; or (c) challenges the validity of this Agreement or the development or operation of the Project.

Section 3: Representations and Warranties

3.1 As applicable, each Party represents and warrants that it has legal authority to purchase, receive delivery of, distribute, or sell desalinated water produced by the Project, and that those authorities are consistent with this Agreement.

Section 4: Covenants

4.1 Each LRA covenants that throughout the term of this Agreement, its agreement with Poseidon for acquisition of desalinated water produced by the Project shall remain in effect.

4.2 Each LRA agrees that it will enforce the terms of this SDP Agreement regarding calculation of Project Costs, record-keeping, and auditing rights.

4.3 Carlsbad covenants that it will obtain from Poseidon and provide to SDCWA all Project costs and associated audits as required under this Agreement. In the event Carlsbad will not be available to meet this obligation in the future, SDCWA shall designate one of the other LRAs to provide this information to Metropolitan

Section 5: Ownership and Responsibilities

5.1 Metropolitan shall have no ownership right, title, security interest, or other interest in the Project.

5.2 The Parties acknowledge that Metropolitan shall have no responsibility for design, environmental compliance, right-of-way acquisitions, permits, construction, Project costs, or any modifications thereof of the Project.

5.3 The Parties acknowledge that Metropolitan shall have no responsibility for operation and maintenance of the Project in accordance with all applicable local, state, and federal laws. Metropolitan shall have no rights, duties, or responsibilities for operation or maintenance of the Project.

- 5.4 Each LRA shall install or cause the installation, operation, and maintenance of metering devices satisfactory to Metropolitan for the purpose of measuring the quantity of Eligible Yield and Total Deliveries to such LRA.
- 5.5 No Party may deliver, transfer, or exchange Project water outside SDCWA's or Metropolitan's service area, unless otherwise approved in writing by Metropolitan.
- 5.6 Until the date the Project starts operation, SDCWA shall provide Metropolitan with semi-annual progress reports in meeting the Project Milestones submitted pursuant to Section 2 on or before July 1 and December 1 of each Fiscal Year. The progress report shall include but not be limited to status of environmental documentation, permits, construction, and forecast of Project production.
- 5.7 All Parties shall assist Metropolitan in efforts to forecast future Project production for the purposes of projecting the region's water demand and supplies.
- 5.8 SDCWA shall notify Metropolitan in writing of any changes to the Project that require new Environmental Documents. Metropolitan shall have the right to review the proposed changes and associated environmental documentation and determine whether the proposed changes are consistent with the SDP policy and principles. Metropolitan shall inform the Parties of its decision to include or exclude proposed changes and associated costs for calculating the Project Unit Cost under this Agreement.

Section 6: Invoicing Process

- 6.1 SDCWA shall notify Metropolitan in writing no less than 30 days prior to the start of Project operation. Before the first invoice submitted under this Agreement, SDCWA, Carlsbad, Poseidon and Metropolitan shall meet to coordinate agreement administration requirements and to determine the Estimated SDP Contribution based on historic cost data and expected Project activities. After the first year of operation, the Estimated SDP Contribution will be determined during the annual reconciliation process pursuant to Section 7 of this Agreement.
- 6.2 After the start of Project operation, each LRA shall certify to SDCWA the amount of Desalinated Seawater delivered to such LRA by the Project. SDCWA in turn shall invoice Metropolitan

monthly for the Estimated SDP Contribution based upon Eligible Yield delivered during the previous month to LRAs. Metropolitan shall pay LRAs for invoiced Estimated SDP Contribution by means of a credit included on the next monthly water service invoice issued to SDCWA in accordance with Metropolitan's Administrative Code. SDCWA agrees to pass the full amount of those credits to LRAs.

- 6.3 Invoices for Estimated SDP Contributions must be received by Metropolitan before 3:00 p.m. on the third working day after the end of the month to receive credit for any preceding month on the next monthly water service invoices issued to SDCWA. Metropolitan will not pay for any invoiced Estimated SDP Contribution that Metropolitan receives more than six months following the end of any month in which a credit is claimed.

Section 7: Reconciliation Process

- 7.1 After the start of Project operation and by December 31 of each year, SDCWA on behalf of LRAs shall obtain from LRAs and provide to Metropolitan records of Project costs, Total Deliveries, and Eligible Yield data for the previous Fiscal Year of operation. SDCWA shall provide to Metropolitan: a) each LRA's and Poseidon's supporting documentation of the actual Project costs required to perform the calculations prescribed in Exhibits B, C, and D; (b) terms and schedule of payments of the Project financing instruments; (c) a description of any changes to the Project financing instruments; and (d) any grants and contributions pursuant to Section 7.4. LRAs shall provide the required data under this Section to SDCWA for submittal to Metropolitan prior to the deadline outlined here. Any costs and supporting documentation not submitted by the deadline will be presumed to be zero for purposes of calculating the Project Unit Cost.
- 7.2 If the reconciliation data is not submitted by December 31 in accordance with Section 7.1, Metropolitan will assess SDCWA a late penalty charge as prescribed in Metropolitan's Administration Code, currently in Section 4507 (K) and set at \$2,500. Metropolitan may suspend its payment of Estimated SDP Contribution if SDCWA fails to provide reconciliation data by the ensuing April 1. During the suspension period, SDCWA shall continue to invoice Metropolitan for the Estimated SDP Contribution based upon the Eligible Yield for water

accounting purposes. Metropolitan will resume payment of the monthly Estimated SDP Contribution once complete data are received and the corresponding reconciliation is complete pursuant to Section 7.3. In the event SDCWA fails to provide reconciliation data by December 31 of the following Fiscal Year, which is 18 months after the end of the Fiscal Year for which a reconciliation is required, this Agreement shall automatically terminate without notice or action by any Party, and SDCWA shall repay to Metropolitan within 90 days of termination all Estimated SDP Contributions for which no reconciliation data was provided.

- 7.3 Within 180 days after Metropolitan receives complete data from SDCWA pursuant to Section 7.1, Metropolitan shall calculate the Final SDP Contribution for the Fiscal Year. The Final SDP Contribution shall then apply retroactively to Eligible Yield for the applicable Fiscal Year. An adjustment shall be computed by Metropolitan for over- or under-payment for Eligible Yield and included on the next monthly water service invoice issued to SDCWA. As part of this reconciliation, Metropolitan shall also consult with SDCWA to determine the Estimated SDP Contribution for the following year based on historic cost data and expected Project activities.
- 7.4 All contributions other than those derived from local public agencies or California Public Utilities Commission-regulated water companies located within SDCWA's service area boundaries, including but not limited to state and federal grants such as the U.S. Bureau of Reclamation and State of California, received by SDCWA, LRAs, or Poseidon prior to and during the term of this Agreement which offset Project Unit Cost shall be deducted in the calculation of Project Unit Cost.

Section 8: Record Keeping and Audit

- 8.1 Each LRA shall establish and maintain accounting records of all costs incurred by the LRA for the construction, operation and maintenance, and replacement parts of the Project as described in Exhibits B, C, and D. Accounting for the Project shall utilize generally accepted accounting practices and be consistent with the terms of this SDP Agreement. These Project accounting records must clearly distinguish all costs for the Project from each LRA's other water production, treatment, and distribution costs. These records shall also be adequate to determine Eligible Yield and Total Deliveries to accomplish all cost calculations contemplated in this SDP Agreement.
- 8.2 Each LRA shall establish and maintain accounting records of all contributions including grants pursuant to Section 7.4.
- 8.3 Each LRA shall collect Total Deliveries and Eligible Yield data for each Fiscal Year of Project operation and retain records of that data based on the metering requirements in Section 5.
- 8.4 Metropolitan shall have the right to audit the records of any Party regarding Project production, deliveries to LRAs, costs and other data relevant to the terms of this SDP Agreement for a period of three full Fiscal Years following termination of this Agreement. Metropolitan may elect to have such audits conducted by its staff or by others, including independent accountants, as designated by Metropolitan. Carlsbad (as a necessary term in its agreement to acquire Project water from Poseidon) shall require Poseidon to make available for inspection to Metropolitan or its designee, upon 30 days advance notice, all records, books and other documents, including all billings and costs incurred by contractors, relating to the construction, operation, or maintenance of the Project; any grants and contributions, as described in Exhibits B, C, and D; or any capital cost financing for the Project. Upon 30 days advance notice and at Metropolitan's request, each Party shall also allow Metropolitan's personnel or its designee to accompany such Party's staff in inspecting Poseidon's records and books for the purpose of conducting such audits of Project costs.
- 8.5 In lieu of conducting its own audit(s), Metropolitan shall have the right to direct any LRA to have an independent audit conducted of all Project costs incurred in any Fiscal Year(s) pursuant

to this SDP Agreement. Such LRA shall then have an audit performed for said Fiscal Year(s) by an independent certified public accounting firm and provide Metropolitan and SDCWA with copies of the audit report within one year after the date the audit was requested. When requested by Metropolitan, Carlsbad shall have an independent audit conducted of Poseidon's costs related to Project construction and operation. The cost of any independent audit performed under this Agreement paid by Carlsbad or other LRA is an eligible Project operation and maintenance cost pursuant to Exhibit C. Based on the results of any independent audit, an adjustment for over- or under-payment of Eligible Yield for each applicable Fiscal Year shall be included by Metropolitan on the next monthly water service invoice to SDCWA.

- 8.6 If an LRA has incurred any capital or operation and maintenance costs that must be included in Project Unit Costs calculations, such LRA shall retain an independent auditor satisfactory to Metropolitan to conduct an initial audit of the Project capital costs incurred by them and their accounting record-keeping practice and shall submit the results to Metropolitan and SDCWA with the first reconciliation.
- 8.7 Carlsbad (as a necessary term in a Poseidon/LRA Agreement) shall require Poseidon to retain an independent auditor satisfactory to Metropolitan and SDCWA to conduct an initial audit of the Project costs and accounting record-keeping practice and submit the results to Metropolitan and SDCWA with the first reconciliation data as outlined in Section 7 herein.
- 8.8 SDCWA and each LRA shall keep all Project records until the end of the third full Fiscal Year following the termination of this SDP Agreement. Carlsbad (as a necessary term in a Poseidon/LRA Agreement) shall require Poseidon to keep all Project records for at least three full Fiscal Years following the termination of this SDP Agreement.
- 8.9 Carlsbad MWD (as a necessary term in its agreement to acquire Project water from Poseidon) shall require Poseidon to establish and maintain accounting records of all costs incurred for the construction, operation and maintenance, and replacement parts of the Project as described in Exhibits B, C, and D. Accounting for the Project shall utilize generally accepted accounting practices and be consistent with the terms of this Agreement.

Section 9: Term, Amendments, and Termination

- 9.1 This SDP Agreement shall commence on the first date herein written and shall terminate 25 years after the date SDCWA notifies Metropolitan that the Project has begun operation or June 30, 2040, whichever is sooner.
- 9.2 The Parties' respective obligations under this Agreement regarding audits and record-keeping shall remain in effect until the end of the third full Fiscal Years after termination of this Agreement.
- 9.3 This Agreement may be amended at any time by the written mutual agreement of the Parties.
- 9.4 If, as a result of the reporting requirements of paragraph 5.6 and consultations among the Parties Metropolitan's General Manager reasonably determines that the Project will not become operational by or before July 1, 2015, Metropolitan shall notify all Parties in writing of that determination. Within 90 days of such notification, Metropolitan's General Manager may seek the Metropolitan Board of Directors' approval to terminate the Agreement. If termination is approved, the Parties shall have 60 days to appeal the Metropolitan Board's decision. In absence of a successful appeal, the Agreement shall automatically terminate and all of Metropolitan's obligations hereunder shall terminate.
- 9.5 Metropolitan, at its sole discretion, may terminate this Agreement, and Metropolitan's obligations under this Agreement shall terminate accordingly upon occurrence of any of the following:
- a. Eligible Yield is not delivered to customers by June 30, 2020;
 - b. Failure of SDCWA or LRAs to comply or cause the compliance with the terms of this SDP Agreement;
 - c. Occurrence of termination criteria in Sections 7.2, 9.5, 11.4, or 13 of this SDP Agreement;
 - d. Amendment or termination of any LRA/Poseidon Agreement that Metropolitan reasonably determines is materially in conflict with the terms and requirements of this Agreement;

- e. Any Party enters into an agreement that renders it unable to perform its responsibilities under this Agreement; or
- f. Any Party transfers or exchanges Project water outside of Metropolitan's service area.

Termination of this Agreement with regard to one Party will not trigger or imply termination of the Agreement with regard to the remaining Parties.

Section 10: Intellectual Property

The Parties agree that any SDP funding under this Agreement is subject to a requirement that Poseidon shall provide Metropolitan and its member public agencies in writing a fully-paid non-exclusive license without time limit to use at no additional cost intellectual property resulting from or developed in the course of development, design, construction, or operation of the Project. The intellectual property subject to this provision includes, without limitation, rights under Patent No. US 6,946,081 B2 Sep 20, 2005, but excludes trade secrets of persons or entities other than Parties or Poseidon.

Section 11: Rate Structure Integrity

11.1 SDCWA and LRAs agree and understand that Metropolitan's rate structure as of January 1, 2004 ("Existing Rate Structure") provides the revenue necessary to support the development of new water supplies by local agencies through incentive payments in the Local Resources Program (LRP), Conservation Credits Program (CCP), and the Seawater Desalination Program (SDP). In particular, the Water Stewardship Rate is the component of Existing Rate Structure that provides revenue for the LRP, CCP and SDP. Further, SDCWA and LRAs acknowledge that Existing Rate Structure and all components within that rate structure were developed with extensive public input and SDCWA participation, and that the elements of Existing Rate Structure have been properly adopted in accordance with Metropolitan's rules and regulations.

11.2 (a) SDCWA and LRAs agree that Metropolitan's rates set under the Existing Rate Structure may be reset throughout the term of this Agreement to account for the cost of service, and that SDCWA and LRAs will address any and all future issues, concerns and disputes relating to Existing Rate Structure, through administrative opportunities available to them pursuant to Metropolitan's public board process. As such, SDCWA and LRAs agree if they file or

participate in litigation or support legislation to challenge or modify Existing Rate Structure, including changes in overall rates and charges that are consistent with the current cost-of-service methodology, Metropolitan may initiate termination of this Agreement consistent with Paragraph 11.4 below. Metropolitan agrees that any change in Existing Rate Structure, including changes in cost-of-service philosophy or methodology would be enacted only after collaboration and discussion with its member public agencies, and Metropolitan's public board review and approval process.

(b) Notwithstanding the foregoing, SDCWA and LRAs retain the right to file and/or participate in litigation and/or to support legislation without triggering the termination of this Agreement if there are material changes to Existing Rate Structure or changes in cost-of-service methodology used to set rates by future Metropolitan board action. SDCWA and LRAs also retain the right to file and/or support litigation should Metropolitan, in setting rates under Existing Rate Structure, fail to comply with public notice, open meeting, or other legal requirements associated with the process of setting water rates and related taxes, fees, and charges. SDCWA and LRA agree that they will not file or participate in litigation, nor will it support legislation affecting Metropolitan's rate structure after any such change in rate structure or violation of the law regarding rate setting processes until, and unless, it has exhausted all administrative opportunities available to them pursuant to Metropolitan's public board process.

11.3 SDCWA and LRAs agree that all users of the Metropolitan conveyance and distribution system should support the LRP, CCP, and SDP, that such projects provide benefits to Metropolitan and the users of the system by making existing distribution and conveyance capacity available for additional delivery, and that under Existing Rate Structure, the Water Stewardship Rate is an element of charges properly adopted by the Metropolitan Board and properly applied to water wheeled through the Metropolitan conveyance and distribution system.

11.4 Should SDCWA or any LRA file or support litigation, or sponsor or support legislation, that would challenge or be adverse to Existing Rate Structure, as described in Paragraph (a) of Section 2, Metropolitan's General Manager may file a 90-day notice of intent to terminate this Agreement with Metropolitan's Executive Secretary, with copies to all members of Metropolitan's Board of Directors, and contemporaneously provide SDCWA and LRAs with a

copy of the notice. Within 30 days of receipt of such notice, SDCWA and LRAs shall have the right to request, in writing, mediation of the dispute by a neutral third party with expertise in finance and rate setting. The mediator shall be selected by agreement of the Parties, or failing agreement within 60 days of such request for mediation, a mediator shall be selected by the Metropolitan Board of Directors from a list of at least four candidates, one from SDCWA, one from LRAs and two of which will be supplied by Metropolitan's General Manager. The cost of the mediation shall be borne equally by the Parties. The request for mediation shall also serve to stay the 90-day notice of intent to terminate, but for no more than 90 days beyond the filing of the notice of request for mediation, unless otherwise agreed in writing by the parties. If mediation does not result in an agreement acceptable to each Party to this Agreement within the time provided herein, the notice of intent to terminate shall be reinstated. The Metropolitan Board of Directors shall act to approve or disapprove termination of this Agreement, and all of Metropolitan's obligations hereunder shall terminate if approved, on or before the ninetieth day following filing of the notice to terminate or, if mediation has been requested as described above, the ninetieth day following the request for mediation (or other date agreed in writing by the Parties.)

11.5 Metropolitan, SDCWA, and LRAs agree that should litigation or legislation brought forth or sponsored by third parties result in changes to Existing Rate Structure, this Agreement will continue in effect unless mutually agreed in writing by the parties.

11.6 Should Metropolitan and its member agencies agree on an alternative rate and revenue structure that obviates the need for this section on Rate Structure Integrity, this section shall be amended or deleted to conform to such action.

Section 12: Use of Metropolitan's Facilities

Any use of Metropolitan's facilities for delivery of Desalinated Seawater shall be the subject of an amendment to this Agreement or a separate agreement between the affected Parties.

Section 13: Metropolitan's Imported Water Entitlements

The Parties agree that this Agreement shall terminate forthwith if Metropolitan reasonably determines that as a result of SDCWA's or LRA's action or support, Metropolitan is required by any statute or administrative order, court, or other entity to reduce, defer, or exchange entitlement to or reduce usage of Colorado River water, State Water Project water, or other water supplies contracted for by Metropolitan as a result of expected or actual production of the Desalinated Seawater by the Project.

Section 14: Hold Harmless and Liability

SDCWA and each LRA agree at its sole cost and expense to protect, indemnify, defend, and hold harmless Metropolitan, its Board of Directors, officers, representatives, agents and employees from and against any and all claims and liability of any kind (including, but not limited to, any claims or liability for injury or death to any person, damage to property, natural resources or the environment, or water quality problems) that arise out of or relate to SDCWA's or such LRA's role in the Project, including without limitation any use, sale, exchange or distribution of Project water. Such indemnity shall include all damages and losses related to any claim made, whether or not a court action is filed, and shall include attorney fees, administrative and overhead costs, engineering and consulting fees, and all other costs related to or arising out of such claim of liability.

Section 15: Notice

Any notice, payment or instrument required or permitted to be given hereunder shall be deemed received upon personal delivery or 24 hours after deposit in any United States post office, first class postage prepaid and addressed to the Party for whom intended, as follows:

The Metropolitan Water District of Southern California Post Office Box 54153 Los Angeles, CA 90054-0153 Attention: Water Resource Management Group Manager	The San Diego County Water Authority 4677 Overland Avenue San Diego, CA 92123 Attention: Director of Water Resources
---	---

Carlsbad Municipal Water District 5950 El Camino Real Carlsbad CA 92008 Attention: General Manager	City of Oceanside 300 N Coast Hwy Oceanside CA 92054-2886 Attention: Water Utilities Director
Olivenhain Municipal Water District 1966 Olivenhain Road Encinitas CA 92024 Attention: General Manager	Rainbow Municipal Water District 3707 Old Hwy 395 Fallbrook CA 92028 Attention: General Manager
Rincon del Diablo Municipal Water District 1920 N Iris Lane Escondido CA 92026-1318 Attention: General Manager	Santa Fe Irrigation District PO Box 409 5920 Linea Del Cielo Rancho Santa Fe CA 92067 Attention: General Manager
Sweetwater Authority 505 Garrett Avenue Chula Vista CA 91910 Attention: General Manager	Vallecitos Water District 201 Vallecitos de Oro San Marcos CA 92069-1453 Attention: General Manager
Valley Center Municipal Water District PO Box 67 29300 Valley Center Road Valley Center CA 92082 Attention: General Manager	

Any Party may change such address by notice given to each of the other Parties as provided in this section.

Section 16: Successors and Assigns

The benefits and obligations of this Agreement are specific to the Parties and are not assignable.

Section 17: Integration

This Agreement comprises the entire integrated understanding among the Parties concerning the Project, and supersedes all prior negotiations, representations, or agreements.

Section 18: Severability

The partial or total invalidity of one or more sections of this Agreement shall not affect the validity of the entire Agreement.

Section 19: No Third Party Beneficiary

This Agreement does not create, and shall not be construed to create, any rights enforceable by any person, partnership, corporation, joint venture, limited liability company, or any other form of organization or association of any kind that is not a party to this Agreement.

Section 20: Governing Law

The law governing this Agreement shall be the laws of the State of California and the venue of any action brought hereunder shall be in Los Angeles County, California.

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IN WITNESS WHEREOF, the parties hereto have executed this Agreement effective as of the date first hereinabove written.

APPROVED AS TO FORM:

THE METROPOLITAN WATER DISTRICT OF
SOUTHERN CALIFORNIA

Karen L. Tachiki
General Counsel

Jeffery Kightlinger
General Manager

By: _____
Deputy General Counsel

By: _____
Debra C. Man
Chief Operating Officer

Date: _____

Date: _____

APPROVED AS TO FORM:

THE SAN DIEGO COUNTY WATER
AUTHORITY

By: _____
General Counsel

By: _____
Maureen Stapleton
General Manager

Date: _____

Date: _____

APPROVED AS TO FORM:

CARLSBAD MUNICIPAL WATER DISTRICT

By: _____
General Counsel

By: _____
General Manager

Date: _____

Date: _____

APPROVED AS TO FORM:

VALLEY CENTER MUNICIPAL WATER DISTRICT

By: _____
General Counsel

By: _____
General Manager

Date: _____

Date: _____

APPROVED AS TO FORM:

RINCON DEL DIABLO MUNICIPAL WATER DISTRICT

By: _____
General Counsel

By: _____
General Manager

Date: _____

Date: _____

APPROVED AS TO FORM:

SWEETWATER AUTHORITY

By: _____
General Counsel

By: _____
Chairman, Board of Directors

Date: _____

Date: _____

APPROVED AS TO FORM:

RAINBOW MUNICIPAL WATER DISTRICT

By: _____
General Counsel

By: _____
General Manager

Date: _____

Date: _____

APPROVED AS TO FORM:

SANTA FE IRRIGATION DISTRICT

By: _____
General Counsel

By: _____
General Manager

Date: _____

Date: _____

APPROVED AS TO FORM:

VALLECITOS WATER DISTRICT

By: _____
General Counsel

By: _____
General Manager

Date: _____

Date: _____

APPROVED AS TO FORM:

OLIVENHAIN MUNICIPAL WATER DISTRICT

By: _____
General Counsel

By: _____
General Manager

Date: _____

Date: _____

APPROVED AS TO FORM:

CITY OF OCEANSIDE

By: _____
City Council

By: _____
Mayor, City of Oceanside

Date: _____

Date: _____

In duplicate

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EXHIBIT A

PROJECT DESCRIPTION

(note: SDCWA to provide more information on intake, outfall, etc. to better define the project boundaries.)

Carlsbad Seawater Desalination Project

Overview

Poseidon Resources LLC (Poseidon), a Delaware limited liability company, will construct and operate the capital facilities collectively known as the Carlsbad Seawater Desalination Project (Project). The Project will treat about 56,000 acre-feet per year (AFY) of seawater to potable standards and to sell that water to nine of San Diego County Water Authority's (SDCWA) local retail agencies (LRA) for beneficial use within SDCWA's and Metropolitan's service area. The desalination facility will be located adjacent to the existing Encina Power Station ("EPS"), immediately south of the Agua Hedionda Lagoon on the Pacific Ocean, within the City of Carlsbad, in northern San Diego County. Attached map shows the project location.

Project Facilities

The Project consists of a seawater desalination treatment plant, xx pump stations, xx storage tanks, and transmission pipelines to deliver the treated water to the points of connections to LRAs distribution system.

The desalination process includes pretreatment, reverse osmosis desalination, and disinfection and product water stabilization. The Project does not require construction of new intake and outfall structures because it will use the EPS' cooling water discharge outfall for water intake to the plant and for disposal of brine generated by the project pursuant to a permit issued by the San Diego Regional Water Quality Control Board.

The transmission pipelines will deliver water from the seawater desalination plant to the cities of Carlsbad, Vista, Oceanside, and San Marcos and eventually connect to the SDCWA's and Vallecitos Water District's distribution system. In addition, another lateral would be constructed a to supply water to the Carlsbad Municipal Water District's Santa Fe reservoir. The rest of LRAs will receive the Project water through SDCWA's distribution system.

Source of water

Source of water will be from the Pacific Ocean via the EPS' cooling water discharge outfall.

Project users

Poseidon has entered into separate agreements with LRAs listed below for the purchase of the Project water, which will be used in the cities of Carlsbad, Oceanside, San Marcos, San Diego, Encinitas, Solana Beach, Rancho Santa Fe, Escondido, Vista, Chula Vista, National City and the unincorporated communities of Rainbow, Bonsall and Fallbrook.

Public Water Agency	Project Water (AFY)	Date Signed
Carlsbad Municipal Water District	16,000 – 25,100 AFY	September 28, 2004
Valley Center Municipal Water District	7,500 AFY	December 20, 2005
Rincon del Diablo Municipal Water District	4,000 AFY	March 14, 2006
Sweetwater Authority	2,400 AFY	January 7, 2007
Rainbow Municipal Water District	7,500 AFY	July 24, 2007
Vallecitos Water District	7,500 AFY	September 5, 2007
Santa Fe Irrigation District	2,000 AFY	September 7, 2007
Olivenhain Municipal Water District	0 – 5,000 AFY	October 12, 2007
City of Oceanside	0 – 5,000 AFY	December 19, 2007

The City of Oceanside and Olivenhain Municipal Water District will receive variable amounts of water from the Project depending on how much Project water is used by Carlsbad.

Project Map – SDCWA to provide a simple location map, not to scale, showing the location of treatment plant and distribution system including pipelines, storage tanks, and pump stations as well as point of connections to each LRA and SDCWA distribution system.

EXHIBIT B

ANNUALIZED CAPITAL COMPONENT

The following provisions apply to costs incurred by Poseidon and each LRA.

1. The annual reconciliation in Section 7 calls for calculating the Project Unit Cost. This Exhibit outlines eligible Project Capital Costs and methods of calculating the Annualized Capital Component, which is one of the components of the Project Unit Cost as defined in Section 1.
2. The Annualized Capital Component shall be computed using only the following incurred costs by Poseidon or LRA for the Project:
 - a. Design and construction management services.
 - b. Construction of Project facilities, more particularly described in Exhibit A.
 - c. LRA's administration of the Project design, construction, and start-up, not to exceed three percent of construction costs unless otherwise approved in writing by Metropolitan.
 - d. Permits, including required data collection.
 - e. lease or purchase of land, right-of-way and easements for Project described in Exhibit A. The land must be owned by a public agency or public trust.
 - f. Environmental documentation and mitigation measures directly related to the implementation or operation of the Project and required to comply with applicable environmental permits and laws, including but not limited to the California Environmental Quality Act, National Environmental Policy Act, and the California and Federal Endangered Species Acts. Environmental documentation costs shall commence with the Notice of Preparation and conclude with the filing of the Notice of Determination. All properties purchased for environmental restoration or mitigation as required to develop the Project must be owned by a public agency or public trust.
 - g. All contributions as outlined in Section 7.4 of this Agreement shall be treated as negative capital cost values for the purpose of computing the Annualized Capital Component.
3. Cost of the following items shall not be used to calculate the Annualized Capital Component:
 - a. Treatment and distribution facilities beyond the Project's points of connection.

- b. Existing facilities, land, right-of-way, and easements owned by SDCWA, LRAs, or Poseidon.
 - c. Feasibility studies.
 - d. Deposit of any reserve funds required as a condition of financing.
 - e. Payments made to another department or element of SDCWA, LRAs, or Poseidon, unless otherwise approved in writing by Metropolitan.
 - f. All other items not specified in Section 1 of this Exhibit.
 - g. Purchase of any land or right-away not owned by a public trust or public agency.
 - h. Fines, penalties, settlements, or judgments due to Project operation.
 - i. Legal fees.
4. Annualized Capital Cost (ACCost) in dollars per year shall be computed using the following procedure:
- a. For fixed-interest rate financing:

$$ACCost = CRF_1 \times P_1 + CRF_2 \times P_2 + \dots + CRF_j \times P_j$$

Where:

P_j is each portion of incurred capital cost for Project with a distinct financing arrangement.

CRF_j is the capital recovery factor for each distinct financing arrangement, as follows:

$$CRF_j = [i \times (1+i)^n] / [(1+i)^n - 1]$$

Where:

i is the interest rate (%).

n is the term of financing (in years) commencing in the first Fiscal Year of Project operation. For all capital financing, cash expenditures, and grants and contributions received after the Project begins operation, annual payments shall be calculated, using the above process, beginning in the Fiscal Year the costs occur.

j is the number of each separate financing element.

In the first Fiscal Year and Fiscal Year n+1 of production of Eligible Yield, each amortization for the calculation of ACCost shall be prorated by the number of days needed to achieve exactly n years of amortization following the first day of production of Eligible Yield.

- b. For variable-interest rate financing, annual payments shall be computed based on the actual payments made in the applicable Fiscal Year according to LRA's or Poseidon's financing documents. Any principal payments toward the Project capital cost before the Project operation will be treated as cash. Carlsbad shall obtain from Poseidon and provide SDCWA with the accumulated paid principal pursuant to Section 7.1.
 - c. For fixed-interest rate financing with a non-uniform annual payment schedule, an economically-equivalent uniform annual payment schedule shall be calculated based on an "Internal Rate of Return" analysis to establish the annualized capital cost.
 - d. Project capital costs not covered by a financing arrangement described above and all grants and contributions as defined in Section 7.4 shall be amortized over 25 years at an interest rate equal to the lesser of:
 - a) Metropolitan's most recent weighted cost of long-term debt on June 30 in the year the capital expenditure occurred; or
 - b) the Fiscal Year average of the 25-bond Revenue Bond Index (RBI) as published in the Bond Buyer, or such other index that may replace the RBI, over the most recent Fiscal Year prior to the date the replacement cost was incurred.
- All grants or contributions shall be amortized as negative capital cost values beginning in the year that money was received.
- e. After the first Fiscal Year of operation, only refinancing changes which lower the Annualized Capital Component shall be included in the Annualized Capital Component calculation of each subsequent Fiscal Year.
 - f. If the Project capital cost is part of a broad financing arrangement, annual payments shall be calculated by prorating the annual payments of the broad financing using the ratio of the Project capital cost for initial principal of the broad financing arrangements.
5. The Annualized Capital Component (ACCom) in dollars per acre-foot for purposes of determining the Project Unit Cost each Fiscal Year shall be calculated using the following formula:

$$\text{ACCom} = \text{ACCost} / \text{Total Deliveries}$$

EXHIBIT C

OPERATION AND MAINTENANCE COMPONENT

The following provisions apply to costs incurred by Poseidon and each LRA.

1. The annual reconciliation in Section 7 calls for calculating the Project Unit Cost. This Exhibit outlines eligible Project Operation and Maintenance Costs and methods of calculating the Annualized Operation and Maintenance Component, which is one of the components of the Project Unit Cost as defined in Section 1.
2. The Operation and Maintenance Component shall be computed using only the following incurred costs by LRAs and Poseidon during the applicable Fiscal Year.
 - a. Professional consulting services for Project operation, maintenance and audit, excluding daily Project operation.
 - b. LRAs and Poseidon's labor costs or contract labor costs equal to:

$$\text{\$_____} \times (\text{CPI/CPI 2009})$$

Where CPI is the Consumer Price Index published by the US Bureau of Labor Statistics in July of applicable Fiscal Year and CPI 2009 is the CPI for July 2009.

In the third year of Project operations, and every third year thereafter, any Party may request the other Parties to revise the Eligible labor cost. Labor cost in the first year of production of Eligible Yield and the last year of this Agreement shall be prorated based on the number of days of production of Eligible Yield.

- c. Chemicals and supplies for Project operation and maintenance.
- d. Net electrical energy (recovered energy shall be deducted from energy purchased) for eligible facilities and distribution system operations.
- e. Contractor services and supplies for Project facilities, operation, maintenance, and repair to maintain reliable system operation and achieve regulatory compliance.
- f. Monitoring required by permits, including water quality sampling and analysis of Desalinated Seawater produced by the Project.
- g. Replacement of Project parts costing less than or equal to \$100,000.
- h. Poseidon's profit, not to exceed 10 percent of the actual O&M costs incurred
- i. All contributions as outlined in Section 7.4 of this Agreement shall be treated as negative operation and maintenance cost values for the purpose of computing the

Operation and Maintenance Component.

- j. Cost of audits paid by LRAs pursuant to Section 8.
 - k. Wheeling charges paid to SDCWA for delivery of Project water to LRAs.
3. Costs of the following items shall not be used to calculate the Operation and Maintenance Component:
- a. Operation and maintenance of any facilities beyond the Project's points of connection.
 - b. Payments made to another department or element of SDCWA, LRAs, or Poseidon, unless otherwise approved in writing by Metropolitan.
 - c. Public outreach, education, and water marketing activities including but not limited to preparing brochures and handout materials, training, meetings, and workshops.
 - d. Fines, penalties, settlements, or judgments due to Project operation.
 - e. Legal fees.
 - f. All others not specified in Section 1 of this Exhibit.
 - g. Reserved funds.
4. The Annualized Operation and Maintenance Component (O&MC) in dollars per acre-foot for purposes of determining the actual Project Unit Cost each Fiscal Year shall be calculated using the following formula:

$$\text{O\&MC} = (\text{Actual Annual Cost of O\&M}) / (\text{Total Deliveries})$$

EXHIBIT D

ANNUALIZED REPLACEMENT COMPONENT

The following provisions apply to costs incurred by Poseidon and each LRA.

1. The annual reconciliation in Section 7 calls for calculating the Project Unit Cost. This Exhibit outlines eligible Project Replacement Costs and methods of calculating the Annualized Replacement Component, which is one of the components of the Project Unit Cost as defined in Section 1.
2. The Annualized Replacement Component shall be computed using incurred costs for the following:
 - a. Replacement cost of major Project parts costing more than \$100,000.
 - b. Salvage value of replaced parts shall be a negative replacement cost.
 - c. Poseidon's profit, not to exceed 10 percent of the replacement cost
 - d. All contributions as outlined in Section 7.4 of this Agreement shall be treated as negative replacement cost values for the purpose of computing the Annualized Replacement Component.
3. Costs of the following items shall not be used to calculate the Annualized Replacement Component:
 - a. Replacement of any facilities beyond the Project's points of connection.
 - b. Any capital or operation and maintenance cost as previously defined in Exhibits B and C, Annualized Capital Component and Operation and Maintenance Component, respectively.
 - c. Reserve funds.
4. The Annualized Replacement Cost (ARCost) shall be calculated using the same procedure as for capital amortization (ACCost) in Exhibit B except that:
 - a. For membrane replacement, n is the number of years the replaced membranes were in service; for all other replacement costs, n is 25 years.
 - b. i is the interest rate in the Fiscal Year of replacement established in Section 4d of Exhibit B.
 - c. P is the actual costs of replacement in the Fiscal Year.
5. The Annualized Replacement Component (ARCom) for each replacement occurrence in dollars per acre-foot shall be calculated using the following procedure:

$$\text{ARCom} = \text{ARCost} / \text{Total Deliveries}$$

EXHIBIT E

DEFERRED COST

Deferred Cost (DC) applicable to the determination of the Final SDP Contribution is computed as follows:

$$DC = EYP \times (PUCP - RateP - 250) / TD$$

where,

DC = Deferred Cost (\$/AF)

EYP = Eligible Yield in the previous Fiscal Year (AF)

PUCP = Project Unit Cost, as defined in Section 1.9, in the previous Fiscal Year (\$/AF)

RateP = Metropolitan's applicable full service treated water rate in the previous Fiscal Year (\$/AF)

250 = Maximum Final SDP Contribution (\$/AF)

TD = Total Deliveries in the Fiscal Year that the reconciliation is performed

- There shall be no DC value carryover upon Agreement termination.
- If DC calculated as a negative number using the above equation, DC will be Zero.

Example:

The following hypothetical example demonstrates how DC is calculated and used in calculation of the SDP Contribution:

Fiscal Year	Met's Water Rate (\$/AF)	Total Deliveries (AF)	Eligible Yield (AF)	Project Unit Cost (\$/AF)	DC (\$/AF)	SDP Contribution (\$/AF)
1	431	2,600	2,100	781	0	250
2	431	3,000	2,500	670	70	250
3	431	3,500	3,000	721	0	250
4	431	4,000	3,500	600	30	199
5	431	4,200	4,200	585	0	154
-	-	-	-	-	-	-
-	-	-	-	-	-	-

Fiscal Year 1: DC = 0 because project was not operating in the previous year

SDP Contribution = 781 - 431 > 250 → SDP Contribution = 250 \$/AF

Fiscal Year 2: DC = 2,100 x (781 - 431 - 250) / 3,000 = 70 \$/AF

SDP Contribution = 670 + 70 - 431 > 250 → SDP Contribution = 250 \$/AF

Fiscal Year 3: DC = 2,500 x (670 - 431 - 250) / 3,500 < 0 → DC = 0

SDP Contribution = 721 - 431 > 250 → SDP Contribution = 250 \$/AF

Fiscal Year 4: DC = 3,000 x (721 - 421 - 250) / 4,000 = 30 \$/AF

SDP Contribution = 600 + 30 - 431 = 199 \$/AF

Fiscal Year 5: DC = 3,500 x (600 - 431 - 250) / 4,200 < 0 → DC = 0

SDP Contribution = 585 - 431 = 154 \$/AF

EXHIBIT F

PERFORMANCE PROVISIONS

1. This Exhibit outlines expected minimum Project production to ensure the IRP goal for SDP is achieved, which was the basis for entering into this SDP Agreement. In addition, these Performance Provisions conform to the recommendation of a recent internal audit on local resources program to reduce Metropolitan’s financial exposure to non-performing projects and allocating that financial assistance to other projects that could help the region to achieve IRP water supply reliability goal. Failure to meet these Performance Provisions will result in Metropolitan taking steps to develop alternative resources.

2. The following Contract Yield adjustments apply:
 - a. If the Eligible Yield does not reach the target yield of 37% of the Contract Yield during the 1st through 4th full Fiscal Year following Start of Operation, then Metropolitan will reduce the Contract Yield (or the Revised Contract Yield) by the shortfall using the highest Eligible Yield produced in that period. For example, the Contract Yield of a project with the following performance will be revised from 56,000 AFY to 52,000 AFY for Scenario 1 while there would be no adjustment under Scenario 2:

Contract Yield = 56,000 AFY

	Scenario 1	Scenario 2
Full Fiscal Year after Agreement Execution	Eligible Yield (AFY)	Eligible Yield (AFY)
1	10,000	10,000
2	12,000	16,000
3	14,000	20,000
4	16,720	24,000

$$37\% \text{ of the Contract Yield} = 0.37 \times 56,000 = 20,720 \text{ AFY}$$

Scenario 1: Shortfall = 20,720 – 16,720 = 4,000 AFY
Revised Contract Yield = 56,000 – 4,000 = 52,000 AFY

Scenario 2: Since, the Eligible Yield in the year 4 is greater than 20,720, no adjustment is required.

- b. If the Eligible Yield does not reach the target yield of 63% of the Contract Yield during the 5th through 9th full Fiscal Year following Start of Operation, then Metropolitan will reduce the Contract Yield (or the Revised Contract Yield) by the shortfall using the highest Eligible Yield produced in that period. For

example, the Revised Contract Yield of a project with the following performance will be revised from 52,000 AFY to 48,000 AFY for Scenario 1 while there would be no adjustment under Scenario 2:

	Scenario 1	Scenario 2
Full Fiscal Year after Agreement Execution	Eligible Yield (AFY)	Eligible Yield (AFY)
5	18,000	28,000
6	20,000	30,000
7	24,000	32,000
8	28,760	36,000

Scenario 1:

$$\text{Revised Contract Yield} = 52,000 \text{ AFY}$$

$$63\% \text{ of the Revised Contract Yield} = 0.63 \times 52,000 = 32,760 \text{ AFY}$$

$$\text{Shortfall} = 32,760 - 28,760 = 4,000 \text{ AFY}$$

$$\text{Revised Contract Yield} = 52,000 - 4,000 = 48,000 \text{ AFY}$$

Scenario 2:

$$\text{Contract Yield} = 56,000 \text{ AFY}$$

$$63\% \text{ of the Contract Yield} = 0.63 \times 56,000 = 35,280 \text{ AFY}$$

Since, the Eligible Yield in the year 8 is greater than 35,280, no adjustment is required.

- c. If the Eligible Yield does not reach the target yield of 100% of the Contract Yield during the 9th through 12th full Fiscal Year following Start of Operation (and every four-year period thereafter), then Metropolitan will reduce the Contract Yield (or the Revised Contract Yield) by the shortfall using the highest Eligible Yield produced in that period. The adjustment will be made using the same methodology shown in the above example.

EXHIBIT G

REQUIRED TERMS OF LRA-POSEIDON AGREEMENT FOR ACQUISITION OF WATER FROM CARLSBAD SEAWATER DESALINATION PROJECT

The agreement between each LRA and Poseidon regarding acquisition of water from the Carlsbad Seawater Desalination Project shall include the following terms:

Audits and Record-Keeping

Poseidon shall provide all reasonable assistance and cooperation to enable Carlsbad or any LRA to comply with its audit, cost-accounting, disclosure, and record-keeping provisions of this Agreement.

Indemnification

“Poseidon agrees at its sole cost and expense to protect, indemnify, defend, and hold harmless Metropolitan Water District of Southern California, its Board of Directors, officers, representatives, agents or employees from and against any and all claims and liability of any kind (including, but not limited to, any claims or liability for injury or death to any person, damage to property, natural resources or the environment, or water quality problems) that arise out of or relate to construction, operation, repair, or ownership of the Carlsbad Seawater Desalination Project. Such indemnity shall include all damages and losses related to any claim made, whether or not a court action is filed, and shall include attorney fees, administrative and overhead costs, engineering and consulting fees, and all other costs related to or arising out of such claim of liability.”

“Poseidon agrees at its sole cost and expense to protect, indemnify, defend, and hold harmless San Diego County Water Authority, its Board of Directors, officers, representatives, agents or employees from and against any and all claims and liability of any kind (including, but not limited to, any claims or liability for injury or death to any person, damage to property, natural resources or the environment, or water quality problems) that arise out of or relate to construction, operation, repair, or ownership of the Carlsbad Seawater Desalination Project. Such indemnity shall include all damages and losses related to any claim made, whether or not a court action is filed, and shall include attorney fees, administrative and overhead costs, engineering and consulting fees, and all other costs related to or arising out of such claim of liability.”