ITEM NO. 13

STAFF REPORT

CITY OF OCEANSIDE

DATE: September 22, 2010

TO: Honorable Mayor and City Councilmembers

FROM: Water Utilities Department

SUBJECT: **RESOLUTION AGREEING TO TERMINATE ALL EXISTING AGREEMENTS RELATING TO THE CARLSBAD DESALINATION PROJECT**

SYNOPSIS

Staff recommends that the City Council adopt a resolution agreeing to terminate all existing agreements relating to the Carlsbad Desalination project (Project).

BACKGROUND

On December 19, 2007, the City Council approved the water purchase agreement between the City of Oceanside and Poseidon for the purchase of desalinated water. 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.

On January 20, 2010, the City Council approved Amendment 1 adjusting a deadline to the water purchase agreement with Poseidon Resources (Channelside) LLC (Poseidon) of San Diego.

The City Council approved a City Manager Item on June 23, 2010, in support of the San Diego County Water Authority (Water Authority) directly negotiating a Water Purchase Agreement with Poseidon in lieu of executing an Amended and Restated Water Purchase Agreement with the City of Oceanside.

ANALYSIS

The approved Term Sheet between Poseidon and the Water Authority has conditions precedent that Poseidon is required to satisfy in order for negotiations on the Water Purchase Agreement to commence. One of the conditions precedent is the following:

(3) Poseidon, and all member agencies that have existing water purchase agreements with Poseidon, executing agreements or taking other action assuring the Water Authority that no previous agreements with respect to the Project will cause

potential liability for the Water Authority or otherwise impede the implementation of the Project pursuant to this Term Sheet (which actions may include executing an acknowledgement of this Term Sheet, requesting that the Water Authority enter into the negotiations contemplated by this Term Sheet and waiving any claims they may have as a consequence thereof, including claims that such negotiations interfere with an existing business relationship, and agreeing to terminate all existing agreements with each other relating to the Project on or prior to the Contract Date).

This condition must be satisfied in order for face-to-face negotiations on the Water Purchase Agreement to commence.

FISCAL IMPACT

Does not apply.

CITY ATTORNEY'S ANALYSIS

The referenced documents have been reviewed by the City Attorney and approved as to form.

COMMISSION OR COMMITTEE REPORT

Does not apply.

RECOMMENDATIONS

Staff recommends that the City Council adopt a resolution agreeing to terminate all existing agreements relating to the Carlsbad Desalination project (Project).

PREPARED BY:

Greg Blakely
Administration Manager

SUBMITTED BY:

Peter A. Weiss
City Manager

REVIEWED BY:

Michelle Skaggs Lawrence, Deputy City Manager

Cari Dale, Water Utilities Director

Exhibit A: Term Sheet
Exhibit B: Resolution

RESOLUTION NO.

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF OCEANSIDE AGREEING TO TERMINATE ALL EXISTING AGREEMENTS RELATING TO THE CARLSBAD DESALINATION PROJECT

WHEREAS, the City of Oceanside ("City")has reviewed the Term Sheet Dated July 22, 2010, between the San Diego County Water Authority ("Water Authority") and Poseidon Resources (Channelside) LP ("Poseidon") for a proposed water purchase contract for the Carlsbad Desalination Project; and

WHEREAS, the City requests that the Water Authority enter into negotiations with Poseidon for a water purchase contract pursuant to the Term Sheet; and

WHEREAS, the City represents and warrants that there are no agreements between the City and any other party that would impair or impede the Water Authority from executing a water purchase contract as contemplated by the Term Sheet; and

WHEREAS, the City waives and agrees to not assert any claim or cause of action for money damages or other legal or equitable remedy against the Water Authority, or Poseidon, or both the Water Authority and Poseidon arising from the negotiation or execution of a water purchase contract as contemplated by the Term Sheet; and

WHEREAS, the City intends to terminate any existing agreement it may have for purchase or delivery of water from the project described in the Term Sheet on or prior to the date of any water purchase contract between the Water Authority and Poseidon as contemplated by the Term Sheet; and

WHEREAS, nothing in this resolution constitutes a commitment, direction, or other limitation on the discretion of the City or the City's representative to the Water Authority with respect to consideration by the Water Authority board of directors of a water purchase agreement as contemplated by the Term Sheet;

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PASSED AND ADOPTED by the City Council of the City of Oceanside, California, this _____day of _____, 2010, by the following vote:

AYES:

NAYS:

ABSENT:

ABSTAIN:

_____
MAYOR OF THE CITY OF OCEANSIDE

ATTEST:

_____
City Clerk

APPROVED AS TO FORM:

_____
City Attorney

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF OCEANSIDE AGREEING TO TERMINATE ALL EXISTING AGREEMENTS RELATING TO THE CARLSBAD DESALINATION PROJECT

Term Sheet

Proposed Water Purchase Contract

Carlsbad Seawater Desalination Project

The San Diego County Water Authority

and

Poseidon Resources (Channelside) LP

July 22, 2010

TERMINOLOGY

Subject	Meaning
1. Parties	San Diego County Water Authority (the "Water Authority"). Poseidon Resources (Channelside) LP ("Poseidon").
2. Plant, Delivery System, and Project	A reverse osmosis seawater desalination plant, including the seawater intake and concentrate disposal facilities to be located on a site adjacent to the NRG Encina Power Station ("Plant"), and the associated pipeline and booster pumps ("Delivery System") capable of delivering 56,000 acre-feet/year of desalinated water ("Product Water") into the San Diego County Water Authority's distribution system. The "Project" consists of the Plant and Delivery System, and is consistent with the EIR.
3. Water Purchase Contract	A contract ("Contract") between Poseidon and the Water Authority under which the Water Authority will purchase Product Water under terms set forth in the Contract following completion of construction of the Project.
4. Contract Date	The date on which the Contract is executed and delivered by the parties.
5. EPC Contractor	A proposed contract between Poseidon and a Joint Venture Partnership of IDE Technologies, Inc. and a construction contractor to be selected by Poseidon from a pre-qualified list approved by the Water Authority (the "EPC Contractor") for the design and construction of the Project.
6. Operating Agreement	A proposed contract between Poseidon and Ambient Technologies, Inc. (the "Operating Contractor"), and guaranteed by IDE Technologies, Inc. for the operation and maintenance of the Plant.
7. MWD	Metropolitan Water District of Southern California.
8. MWD Agreement	The MWD Seawater Desalination Program Agreement between the Water Authority and MWD.
9. EIR	The environmental impact report for the Project certified by the city of Carlsbad in June, 2006, and one addendum in September, 2009.

NEGOTIATION AND APPROVAL PROCESS

Subject	Understanding
1. Purpose	The purpose of this Term Sheet is to set forth the basis for negotiations toward a possible Contract between the parties. It is a summary only and is not comprehensive or definitive. The parties understand that substantive terms and detailed provisions not noted or fully developed in this Term Sheet are expected to be included in any final Contract.
2. Not a Contract	This Term Sheet is not a contract. The proposed terms and conditions set forth herein do not bind either party in any manner, and in particular do not commit the Water Authority to purchase Product Water.
3. Definitive Equity Commitment	A. Definitive Equity Commitment Date The parties understand that Poseidon intends to continue to seek a definitive equity commitment from one or more financial institutions, based on this Term Sheet, to provide equity in an amount and upon terms sufficient to obtain Project debt financing for Project construction. The date on which a definitive equity commitment is delivered to the Water Authority is the "Equity Commitment Date." While Poseidon pursues a definitive equity commitment, the Water Authority intends to prepare a draft form of the Contract and provide it to Poseidon. B. Definitive Equity Commitment Defined A definitive equity commitment is an executed agreement, in form and substance satisfactory to the Water Authority, setting forth detailed terms for equity investment in the Project, including the investment amount, the form of investment, ownership interest, timing of investment, target closing date, Project governance, and conditions to funding. The definitive equity commitment shall be from an entity with adequate capitalization to fund the full equity investment necessary for Project funding, and shall not be contingent on the need to raise any further capital.
4. Contract Negotiations	A. Commencement The parties intend to enter into negotiations for a definitive Contract following (1) the Equity Commitment Date, (2) Poseidon terminating all existing confidentiality agreements with the Water Authority, and waiving any claims based thereon, (3) Poseidon, and all member agencies that have existing water purchase agreements with Poseidon,

Subject	Understanding
	executing agreements or taking other action assuring the Water Authority that no previous agreements with respect to the Project will cause potential liability for the Water Authority or otherwise impede the implementation of the Project pursuant to this Term Sheet (which actions may include executing an acknowledgement of this Term Sheet, requesting that the Water Authority enter into the negotiations contemplated by this Term Sheet and waiving any claims they may have as a consequence thereof, including claims that such negotiations interfere with an existing business relationship, and agreeing to terminate all existing agreements with each other relating to the Project on or prior to the Contract Date), and (4) authorization by the Water Authority board of the commencement of negotiations. <u>B. Negotiating Parties</u> The Water Authority intends to receive reasonable assurances that the individuals and counsel representing Poseidon in the negotiations fully represent the interests of Poseidon and of the providers of all necessary construction equity, and that the Water Authority will not face Poseidon change of control issues. <u>C. Termination of Negotiations</u> The parties acknowledge that either party may suspend, terminate or renew negotiations at any time and for any reason without consequence.
5. Water Authority Due Diligence	During the equity commitment and negotiating periods, the Water Authority intends to conduct a complete due diligence examination of Poseidon and the Project. Poseidon intends to fully cooperate with the examination, and provide all documents and information requested by the Water Authority in connection therewith. Due diligence will address, among other things, (1) Poseidon's investors, ownership structure, management, financial condition and contingent liabilities; (2) any existing agreements, commitments, understandings, rights and claims of any other party pertaining to Poseidon and the Project; (3) Plant and Delivery System design specifications, (4) the proposed EPC Agreement and EPC Contractor; (5) the proposed Operating Agreement and operating contractor; (6) legal entitlements; (7) litigation; (8) development equity, construction equity and debt arrangements, participation and terms; (9) financial projections for the Project; (10) all procurements, negotiations

Subject	Understanding
	and discussions Poseidon has engaged in for contractors and subcontractors for the Project; (11) any and all land leases for property or appurtenant facilities including, but not limited to, the site lease with NRG and land lease with the State Lands Commission; and (12) pre-treatment pilot testing protocols, results and issues.
6. No Water Authority Responsibility for the Project	Poseidon understands and acknowledges that its proposal for the Project is unsolicited and that the Water Authority does not assume any responsibility for the Project whatsoever. Any Contract resulting from the negotiations will be a contract solely for the purchase of Product Water. Poseidon has planned and developed and will implement the Project completely at its own risk. Poseidon will be solely responsible for the efficacy of the Project and its permitting, financing, design, construction, commissioning and capability of successfully passing acceptance tests producing Product Water to the standards of the Contract. No due diligence performed by the Water Authority shall represent or constitute an endorsement of the Project or any transfer of liability to the Water Authority for the Project or its performance.

TERMS AND CONDITIONS OF
THE PROPOSED WATER PURCHASE CONTRACT

Subject	Proposed Term/Condition
1. Term	The term of the Contract will begin on the Contract Date and will terminate 30 years from the Commercial Operation Date. The Contract may be extended for up to three additional years, under the conditions described in Item 13J.
2. Roles of the Parties	A. Poseidon Poseidon will design, permit, finance, construct, commission, start-up, and acceptance test the Project, all in conformity with applicable law, prudent industry practices and the requirements of the Contract. Upon the completion of construction, passage of acceptance tests and commencement of the commercial operation of the Project ("Commercial Operation Date"), Poseidon will operate and maintain the Plant (and, until its potential purchase by the Water Authority as contemplated in Item 9, the Delivery System) in accordance with prudent industry practices and applicable laws and regulations sufficient to meet the performance and regulatory requirements of the Contract. B. The Water Authority Without bearing any responsibility or liability, the Water Authority will cooperate with Poseidon during the construction period. The Water Authority will provide rights of way necessary for the Delivery System, and any information, reviews and approvals by the Water Authority necessary to connect the Delivery System to the Water Authority's distribution system. From and after the Commercial Operation Date, the Water Authority will purchase Product Water as provided for under the Contract.
3. Financing Period	A. Initial Financial Close Date In the event a Contract is successfully negotiated and executed, Poseidon shall achieve financial close (with all permanent financing in place for the Project) by July 1, 2011 (the "Initial Financial Close Date"). B. Failure to Achieve Financial Close by Initial Financial Close Date If Poseidon fails to achieve financial close for the Project by the Initial Financial Close Date, the Water Authority may terminate the Water Purchase Contract. Poseidon may, however, extend its right to achieve financial close until

Subject	Proposed Term/Condition
	January 1, 2012 (the "Extended Financial Close Date") by posting, on or before the Initial Financial Close Date, a Letter of Credit ("LOC") in a negotiated stated amount. <u>C. Achievement of Financial Close</u> If Poseidon succeeds in achieving financial close before the Initial Financial Close Date or, if the LOC has been posted, the Extended Financial Close Date, as the case may be, Poseidon will proceed to construct the Project and, if applicable, the Water Authority will return the LOC. <u>D. Failure to Achieve Financial Close by Extended Financial Close Date</u> If Poseidon fails to achieve financial close by the "Extended Financial Close Date", the Water Authority may draw on the letter of credit in its full stated amount, retain the LOC proceeds for its own account, and terminate the Contract.
4. Financing Plan	<u>A. Poseidon Responsibilities</u> Poseidon will be solely responsible for the financing of the Project. Poseidon will keep the Water Authority regularly informed of its progress in executing the plan of financing. <u>B. Amount of Financing</u> Poseidon may not issue additional Project debt without the approval of the Water Authority given in its sole discretion, except (1) debt for Project completion, (2) refinancing debt, (3) debt necessary to pay capital costs resulting from uninsured force majeure events and Included Changes in Laws, and (4) debt for other purposes to be negotiated. <u>C. Capital Amortization Period</u> The amortization term of any Project debt financing or refinancing undertaken will not exceed the term of the Contract, unless agreed to by the Water Authority in its sole discretion.
5. Design and Construction of the Plant and Delivery System	<u>A. Construction Period Design Reviews for the Plant</u> During the Construction Period, the Water Authority will have the right, but not the obligation, to periodically review the design of the Plant for compliance with the EPC Agreement and design specifications as set forth in the Contract. The Water Authority will not have approval authority over the design of the Plant, except as such may relate to compliance with the requirements of the Contract.

Subject	Proposed Term/Condition
	Poseidon will agree to consider and respond to any other comments or concerns made by the Water Authority. <u>B. Construction Period Design Reviews for the Delivery System</u> The Water Authority will review, comment and agree upon the design and construction quality requirements for the Delivery System to be included in the Contract and the EPC Agreement. During construction, the Water Authority will periodically review and comment on the evolving design for consistency with the contractual design and construction quality requirements and for consistency with the Water Authority's standards and requirements for similar facilities. The procedures, extent and nature of such reviews will be determined during negotiations. The Water Authority will not have design approval rights once the Contract is signed, except for such consistency determinations. Poseidon will retain all design liability. <u>C. Construction Period Reporting and Review for the Project</u> Poseidon will attend monthly progress meetings with the Water Authority and will provide the Water Authority access to information regarding the Delivery System. Poseidon will consider and respond to any other comments or concerns made by the Water Authority. The Water Authority will have the right to observe and inspect construction of the Project at any reasonable time. The Contract will detail the Water Authority's inspection rights and requirements, and Poseidon's obligations during the construction of the Delivery System and the Connection Facilities. <u>D. Start-Up and Acceptance Testing of the Plant</u> The Contract will set forth acceptance test standards and procedures designed to assure the Water Authority that the Plant will be capable, on a long term basis, of meeting the requirements of the Contract. The Water Authority will have the right to review and comment on the acceptance test protocol to be developed in accordance with the requirements of the Contract, and to observe Plant start-up and acceptance testing. <u>E. Construction and Start-Up of the Delivery System</u> The Contract will also set forth acceptance test standards specifically for the Delivery System, and provide the Water Authority with the right to review and comment on the

Subject	Proposed Term/Condition
	acceptance test protocol for the Delivery System. The Water Authority will have inspection oversight rights for the Delivery System throughout the construction and testing phases. Upon completion of start-up and acceptance testing of the Delivery System, the Water Authority will conduct a final inspection of the Delivery System and provide Poseidon with a written punch list. Upon satisfactory completion of the punch list, the Water Authority will provide a written recommendation to Poseidon to proceed with the filing of the notice of completion. <u>F. Modifications Due to Included Changes in Law During the Construction Period</u> In the event that capital improvements or modifications are required due to an Included Change in Law occurring during the Construction Period, Poseidon will inform the Water Authority of such need and of the schedule for and an estimated cost of addressing such need. Poseidon will mitigate the effects of the Included Change in Law, and minimize the delay in design or construction and minimize the cost of such capital improvements or modifications. The Water Authority will be responsible for such costs, but only if: (1) the Commercial Operation Date is achieved; and (2) such Included Change in Law is not imposed as the result of the acts or omissions of Poseidon. Poseidon will inform the Water Authority as to the occurrence of any Excluded Changes in Law during the Construction Period and their impacts, but the Water Authority shall bear no risk with respect thereto.
6. Pre-Treatment Pilot Testing	The parties recognize the potential necessity of further pre-treatment pilot testing based on the selected Plant technology, and the potential need to conduct such testing during the final design phase following the Contract Date if the additional testing work cannot be completed during the equity commitment and negotiating periods. The Contract will contain all necessary assurances that Poseidon will have the financial and technical resources necessary to provide for any additional pre-treatment facilities and capacity that may be demonstrated to be required, either upon completion of such additional pre-treatment pilot testing or during Plant commissioning and acceptance testing.

Subject	Proposed Term/Condition
7. Delay in Achieving Commercial Operation Date	A. Scheduled Commercial Operation Date The Scheduled Commercial Operation Date will be the earlier of (1) January 1, 2015, or (2) the date that is 40 months following the actual date of financial close, as such date may be extended due to Uncontrollable Circumstances. Poseidon shall pay negotiated daily delay liquidated damages for each day of unexcused failure to achieve the Commercial Operation Date by the Scheduled Commercial Operation Date. B. Scheduled Commercial Operation Date Extension If Poseidon fails to achieve the Commercial Operation Date by January 1, 2015, the Water Authority may terminate the Contract, without the obligation to pay any termination fee or to purchase the Project, and bring a damage action.
8. Delivery System	A. Delivery System Description The Delivery System will be defined as in the current Carlsbad Municipal Water District water purchase agreement with Poseidon. B. Delivery System Adequacy The Delivery System will be adequate to transport and deliver Product Water at all times to the Water Authority's delivery point in the quantities required by the Contract.
9. Delivery System Purchase	Within a negotiated period following the Commercial Operation Date, and following the achievement of an output factor of no less than an average of 85% during that period and other purchase conditions to be established, the Water Authority will either be obligated, or have the option, to purchase the Delivery System for a purchase price to be stipulated in the Contract. Following any such purchase, the Water Purchase Price will be adjusted appropriately.
10. Operation	A. Poseidon's Obligation to Operate the Plant Upon the achievement of the Commercial Operation Date, Poseidon will operate and maintain the Plant in accordance with the terms of the Contract, prudent industry practices and applicable laws and regulations sufficient to meet the contractual performance and regulatory requirements. B. Operation and Maintenance of the Delivery System The Delivery System will be operated and maintained by Poseidon, unless operated by the Water Authority following

Subject	Proposed Term/Condition
	any purchase of the Delivery System. C. Operator Poseidon will, prior to the Contract Date, contract for the operation and maintenance of the Plant with the Operating Contractor. The Operating Contractor will not be replaced without the Water Authority's approval. Poseidon will deliver a copy of the proposed Operating Agreement to the Water Authority for review and comment prior to execution. D. Operations and Maintenance Manual Two months prior to the Commercial Operation Date, Poseidon will provide the Water Authority with a draft copy of the Plant's operation and maintenance manual for review and comment. E. Life-Cycle Maintenance The Contract will contain all necessary assurances that the Plant will be properly maintained, repaired and replaced over the term of the Contract. These will include a requirement to have a CMMS system and use it to perform ordinary and capital maintenance; periodic maintenance inspections; establishing the required condition of the Plant at the end of the term; and conducting a maintenance deficiency assessment near the end of the term, coupled with the posting of security for the performance of the work and price offsets for failure to rectify any such deficiency. F. Restoration of the Plant In the event of damage to the Plant, Poseidon will be obligated to repair or replace damaged components to enable the restoration of full operations and the full performance of its obligations under the Contract, whether through the application of insurance proceeds or Poseidon's own capital. In order to provide for the circumstance under which Poseidon is not able to restore the Plant, Poseidon agrees that the Project's financing documentation will enable the Water Authority, at the Water Authority's sole option, to purchase the Plant for an amount equal to Poseidon's outstanding indebtedness, net of available insurance proceeds. The parties will negotiate whether and to what extent there will be any recognition given in the Water Authority's end-of-term purchase option price in circumstances where: (1) an uninsurable force majeure event occurs after the 20th year of operations; (2) Poseidon invests

Subject	Proposed Term/Condition
	money in the restoration costs; and (3) such investment increases the value of the Plant beyond the value the Plant would have had at the end of the term absent such investment. <u>G. Water Authority's Right to Monitor</u> The Water Authority will have the right to monitor the operation and maintenance of the Plant in order to confirm compliance with the requirements of the Contract. The Water Authority will have the right to conduct periodic inspections of the Plant, and will notify Poseidon of any operations and maintenance deficiencies found for rectification by Poseidon. The Water Authority will have the right to engage consultants and advisors for inspections and to review Poseidon performance and provide performance reports and recommendations to the Water Authority.
11. Capital Modifications, Merchant Capacity and Excess Production	Poseidon will not substantially change or modify the Plant, or expand the capacity of the Plant (including developing any merchant capacity for the production of water for sale to third parties), without the approval of the Water Authority, which may be withheld in its sole discretion. Without the prior approval of the Water Authority, which may be withheld in its sole discretion, Poseidon may not access the Project's associated seawater intake or concentrate discharge facilities for use in a separate standalone seawater desalination plant or other type of municipal and industrial water supply project located on or near the Encina Power Station. Commencing on the twentieth anniversary of the Commercial Operations Date, the Water Authority may propose modifications to the Plant to extend the useful life of one or more components of the Plant and Poseidon shall use commercially reasonable efforts to implement such modifications, subject to: (1) such modifications not adversely affecting Poseidon's ability to perform its obligations under the Contract; (2) Poseidon being able to raise sufficient financing for such modifications and obtain any necessary consent from its then-current lenders for such modification; and (3) the Water Purchase Price being equitably adjusted to compensate Poseidon for its cost of implementing such modification.

Subject	Proposed Term/Condition
	Poseidon shall not produce excess Product Water without prior agreement with the Water Authority to take and purchase the excess Product Water at a marginal or variable rate, exclusive of fixed capital and operations costs. Excess Product Water shall not be sold to any person other than the Water Authority.
12. Water Authority Directed Capacity Expansions	The Water Authority shall have the right to direct the expansion of the capacity of the Plant and purchase the additional Product Water, subject to mutual agreement between Poseidon and the Water Authority as to terms and conditions.
13. Water Quantity	A. Water Quantity Commitments Poseidon will agree to produce and deliver, and the Water Authority will agree to take (on a "take-if-delivered" basis), 56,000 acre-feet per year of Product Water. For the actual quantity of Product Water taken, the Water Authority will pay a per-acre foot unit charge as set forth in Item 18. B. Payment for Available Water that is Not Taken In the event that the Water Authority does not take the Product Water it is required to take under Item 13A, the Water Authority will nonetheless pay Poseidon a per-acre foot charge, based on the Delivery Schedule. C. Delivery Schedule The schedule for periodic deliveries of Product Water (daily, monthly, quarterly) will be mutually agreed to by the parties on an annual basis. The annual delivery plan will be incorporated into the Water Authority's Annual Aqueduct Operation Plan. D. Operating Committee Poseidon, the Operating Contractor, and the Water Authority will establish an Operating Committee to address daily flow changes and operations. E. Delivery Point Prior to Water Authority's purchase of the Delivery System, Poseidon will deliver Product Water to the Delivery Point, which will be located in San Marcos, adjacent to the Water Authority's Second Aqueduct.

Subject	Proposed Term/Condition
	F. Delivery Point after Water Authority Purchase of the Delivery System After the Water Authority's purchase of the Delivery System, Poseidon will deliver Product Water to the Delivery Point, which will be located at the fence line adjacent to the Plant. G. Water Ownership The Water Authority will own all Product Water received and accepted at the Delivery Point. H. Product Water Pressure and Hydraulic Transients Guarantee Poseidon will guarantee Product Water pressure, and guarantee against hydraulic transients damaging the Water Authority's Delivery System, distribution system and other property. I. Distribution System Emergencies In the event of emergencies in its distribution system, the Water Authority may demand a curtailment of Plant operation and Product Water deliveries, with such curtailments treated as a Water Authority Uncontrollable Circumstance excusing the Water Authority from its purchase obligation for the duration of the emergency. J. Product Water Not Delivered Due to Uncontrollable Circumstances Product Water which Poseidon would have delivered to the Water Authority but which Poseidon is unable to deliver due to a Poseidon Uncontrollable Circumstance or a Water Authority Uncontrollable Circumstance shall be delivered by Poseidon and purchased by the Water Authority from any excess Product Water on a negotiated basis, or during an extension of the term of the Water Purchase Contract not to exceed three years. K. Respective Cost Obligations of the Parties Poseidon will be responsible for all costs incurred in producing and delivering Product Water to the Delivery Point, and the Water Authority will be responsible for all costs incurred in receiving and distributing Product Water after the Delivery Point.
14. Water Quality	A. Product Water Quality Requirements Generally Product Water delivered by Poseidon will meet all legal

Subject	Proposed Term/Condition
	potable water quality requirements and not exceed regulatory or maximum contaminant levels established by the state, federal, and local agencies. A detailed set of water quality specifications will be incorporated in the Contract. B. Third Party Claims Regarding Product Water Quality Poseidon will be solely liable for any fines, penalties or damages that may be incurred by either party due to Poseidon's failure to meet water quality requirements. Poseidon will indemnify the Water Authority against any fines, penalties or damages (including third party tort claims) that may be incurred by the Water Authority due to the delivery of Product Water that does not meet the Product Water quality requirements. C. Limitation on the Water Authority's Obligation to Accept Product Water The Water Authority will not be obligated to accept or pay for Product Water that does not meet the Product Water quality requirements.
15. Performance Liquidated Damages	A. Product Water Quantity Failures At any time following the third month after the Commercial Operation Date, if Poseidon fails to deliver on a quarterly basis at least 11,900 acre feet of Product Water meeting the Product Water quality requirements, Poseidon will pay to the Water Authority negotiated liquidated damages for each acre-foot of the shortfall. B. Product Water Quality Failures The Contract will specify liquidated damages for Product Water quality non-compliance. C. Poseidon Failure to Comply With Testing and Reporting Requirements Poseidon will pay liquidated damages per incident for the failure to comply with testing and reporting requirements under the Contract, the amount of such damages to be specified in the Contract.
16. Raw Water Risks	The Contract will set forth the assumed raw water quality parameters upon which Poseidon's performance guarantees are based. If (1) actual raw water quality parameters are outside those assumed, or (2) specific negotiated events occur affecting raw water quality (such as pollution events),

Subject	Proposed Term/Condition
	Poseidon will be entitled to relief from its water quantity production guarantee, but not its water quality guarantee, nor shall it be entitled to any price relief.
17. NRG	Poseidon shall bear all risks relating to NRG and NRG's generating plant and property, except (1) the occurrence of force majeure events damaging or destroying the raw water intake, outfall and any other NRG facilities necessary for the conveyance of raw water to the Plant and the discharge from the Plant, and (2) other reasonable exceptions negotiated by the parties (in which event Poseidon shall be entitled only to relief from its water quantity production guarantee, but not its water quality guarantee or any price relief). Such NRG risks include NRG sale, merger or bankruptcy; NRG lease breach, default and termination; changes in law, permit modifications or denials, or regulatory orders affecting the NRG plant.
18. Water Purchase Price	A. Water Authority's Obligation to Pay for Product Water The Water Authority will only pay for Product Water that meets the Product Water quality requirements and is actually delivered or ready to be delivered to the Delivery Point. B. Water Purchase Price The price payable by the Water Authority for Product Water shall consist of (1) the negotiated Unit Price per acre-foot, multiplied by (2) the number of acre-feet of Product Water purchased by the Water Authority. Any extraordinary items (such as costs payable by the Water Authority associated with Included Changes in Law and amounts payable by Poseidon for non-compliance with the MWD Agreement, liquidated damages or indemnity payments) shall be paid or credited as a separate element of the Water Purchase Price, or shall be reflected in a revised Unit Price, as appropriate. C. Unit Price The negotiation of the Unit Price will be determined in accordance with the following principles: 1. The Unit Price will be based on the capital and operating costs of the Project (as opposed to the "avoided cost" of water). 2. The Unit Price will not exceed the Base Price

Subject	Proposed Term/Condition
	established in the existing Carlsbad water purchase agreement. 3. Poseidon will provide full transparency to the Water Authority with respect to capital costs, operating costs, and financial returns to Poseidon, the equity investor(s), and lenders to the Project. 4. The Unit Price will support the financing, construction and operation of a high-quality desalination facility that operates in a highly reliable manner. 5. The Unit Price will provide financial incentive to Poseidon for efficient plant operations. The Water Authority will reserve the right to provide wholesale power to the Project. 6. The Unit Price will be the lowest and least volatile price that is consistent with the other principles. 7. The Unit Pricing structure will determine how actual debt service costs, and future refinancing savings will be reflected in the Unit Price. 8. The Unit Price will not be finalized until the underlying capital and operational costs of the Project have been established through binding contracts, and these contracts and the financing costs and draft financing documents have been received, reviewed and accepted as reasonable by the Water Authority. <u>D. Site Conditions Risk</u> Poseidon shall bear all performance and price risk associated with any differing site conditions and regulated site conditions (such as hazardous substances and cultural resources). <u>E. Grants and Subsidies Benefit Water Authority</u> Any subsidy, grant or contribution received directly or indirectly by the Water Authority or Poseidon from the MWD or any other local, regional, state or federal governmental agency will be for the full benefit of the Water Authority. The parties will also consider alternative approaches regarding federal, state, regional and local financial support to help reduce the cost of the Product Water.

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	F. Notification of Annual Price Adjustments For budgetary purposes, Poseidon will notify the Water Authority no later than a date to be specified in the Contract prior to the start of the next succeeding contract year of the Water Purchase Price that will be in effect for the coming contract year based on the specified index adjustments. G. Annual "True-Up" Process There will be an annual "true-up" process, based upon the Water Purchase Price paid by the Water Authority and other costs or liabilities that may have been incurred by either party, for which responsibility is addressed in the Contract, through which the amounts that were paid by the Water Authority and the amounts that were due from the Water Authority will be confirmed or reconciled. If it is determined that the Water Authority paid less than the amounts actually due, the Water Authority will pay any such additional costs to Poseidon within 60 days of such determination. If it is determined that the Water Authority paid more than was actually due, Poseidon will credit such overpayment against the next immediate billing to the Water Authority.
19. No Payment Obligation Before Commercial Operation Date; Exception	A. General The Water Authority will have no obligation to purchase Product Water or make any payment whatsoever to Poseidon prior to the Commercial Operation Date. If that date does not occur, the Water Authority will not have any payment obligations. If Included Change in Law costs are incurred prior to the Commercial Operation Date, the Water Authority will be obligated to pay such costs only as an increase in the Water Purchase Price payable after the Commercial Operation Date, on a negotiated, amortized basis (subject to the limitations specified in Item 23). B. Exception Following approval by the State Department of Public Health of the introduction of Product Water into the Water Authority's distribution system and prior to the Commercial Operation Date, the Water Authority will purchase Product Water meeting quality standards. The price of the water and the duration of this commitment will be negotiated.

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20. Public Information and Outreach	A. Public Outreach Regarding the Plant and Delivery System After the Contract Date, the Water Authority will have the right to review and approve public communications regarding the Plant and the Delivery System prepared by Poseidon or its contractors or subcontractors, prior to the release of such communications. B. Plant Tours Poseidon and its contractors or subcontractors will make the Plant available for and help conduct Water Authority tours during the construction period and after start of commercial operations, subject to reasonable notice by the Water Authority. C. Site Access Water Authority staff, consultants and contractors will be provided access to the site and all facilities owned or leased by Poseidon during the construction period and after the start of commercial operations, subject to reasonable notice by the Water Authority.
21. Insurance	A. Poseidon Insurance Obligations Poseidon will obtain and maintain, in amounts to be agreed upon with the Water Authority, insurance as follows: commercial general liability insurance; builder's risk and property and casualty insurance that will provide for the full replacement value of the Project; motor vehicle insurance; workers compensation; business interruption insurance in an amount sufficient to cover a minimum of one year of fixed operating and financing costs and, as appropriate, pollution liability insurance. B. Insurance Costs and Risks Poseidon will bear all costs associated with any insurance deductibles, and replacement cost exceedences associated with builders' risk and property insurance coverage. Poseidon will also bear the risk of any insurance unavailability. C. The Water Authority's Right to Obtain Insurance The Water Authority may purchase such insurance on behalf of Poseidon, if Poseidon fails to do so, and will be reimbursed by Poseidon for any costs so incurred.

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22. Uncontrollable Circumstances	A. Defined Uncontrollable Circumstances are force majeure and other events beyond a party's reasonable control (after exercising diligence to prevent the occurrence and to mitigate the effect of the occurrence) that materially and adversely affect a party. Inclusions and exclusions will be negotiated. Changes in Law are handled separately from Uncontrollable Circumstances. B. Poseidon Performance Relief A Poseidon Uncontrollable Circumstance will entitle Poseidon to schedule and water quantity guarantee relief, to the extent that they are adversely affected by Uncontrollable Circumstances. C. No Poseidon Price or Water Quality Relief A Poseidon Uncontrollable Circumstance will not entitle Poseidon to any price relief or any water quality guarantee relief. D. Mitigation and Restoration In the event of an Uncontrollable Circumstance, the affected party will use commercially reasonable efforts to respond to the event and to mitigate its effects and, as soon as is practicable, to restore conditions to the level at which it can fully perform its obligations under the Contract. E. Water Authority Performance Relief The Water Authority will be entitled to relief from its obligation to take and purchase Product Water to the extent its ability to receive delivery of Product Water is adversely affected by a Water Authority Uncontrollable Circumstance. The Water Authority will purchase "make-up" Product Water following any such occurrence as described in Item 13J.
23. Changes in Law	A. Defined A Change in Law is the enactment of a new law, or an amendment to an existing law, after the Contract date applying generally to water treatment facilities, treated water quality, and wastewater discharge that materially delays completion of the Project or increases the cost of producing Product Water, because of new or different equipment, construction, or processes required to comply with the new or amended law. "Law" includes any federal, state or local laws, statutes, codes and regulations; and all governmental

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	approvals, such as licenses, permits, consents and entitlements. <u>B. General Exclusions</u> Changes in Law do not include: (1) any law enacted or adopted on or before the Contract date to take effect after the Contract date; (2) any change in tax law; (3) any increases in fines or penalties for violation of applicable law; (4) any increase in the severity of enforcement actions typically taken by a regulatory agency; (5) any change in law that does not require greater stringency than the Contract itself requires; and (6) changes in permits, approval, entitlements in consequence of enforcement, lapse, or invalidation of an existing permit. <u>C. Changes in Law Affecting NRG's Facility</u> If a change in law occurs that requires the Plant's raw water intake system, wastewater discharge system and related pumping facilities to be modified and operated on a "stand-alone" basis, separate from NRG facility operations, the water purchase price will be increased to reflect the capital and operating costs necessary to respond to the change in law up to a maximum amount of $20 million (index linked) and $2.5 million (indexed linked) for the capital and operating costs, respectively. Any excess cost will be borne by Poseidon. <u>D. Changes in Law Affecting NRG's Seawater Intake Structure</u> A Change in Law also will not include any change in law pertaining to the operation by NRG of its existing seawater intake structure, including any requirement under Section 316(b) of the federal Clean Water Act or similar regulation. <u>E. Changes in Law Affecting NRG Discharge Facility Operations</u> A Change in Law also will not include any change in law pertaining to the operation by NRG of its discharge facilities under its NPDES permit, similar permit or any provision of the federal Clean Water Act or California Porter- Cologne Act. <u>F. Compliance With Environmental Mitigation Measures</u> Poseidon will bear the risk of complying with all environmental mitigation measures required by or in connection with the EIR and governmental approvals for the Project, excluding measures required due to a Change in

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	Law. G. Construction Government Approval Risk Poseidon will be responsible for obtaining and maintaining all governmental approvals required for the Project during construction and acceptance testing (including the California Department of Public Health's drinking water permit) through the Commercial Operation Date. Poseidon will bear the risk of the denial, delay in issuance of, or imposition of any term or condition in connection with any such governmental approval and of compliance with all such governmental approvals. The occurrence of any such risk will not be Change in Law unless it is caused by the enactment of a statute or the promulgation of regulations of general applicability. H. Operating Governmental Approvals Poseidon will also be responsible for obtaining and maintaining all governmental approvals required during the operating period, through the end of the Contract term. Poseidon will bear the risk of the denial, delay in issuance of or imposition of any term or condition in connection with any such governmental approval. The occurrence of any such risk will not be a Change in Law unless (1) it is caused by the enactment of a statute or the promulgation of regulations of general applicability, or (2) it is imposed by a regulatory body, in either case imposing standards more stringent than those existing in law on the Contract date. I. Relief Poseidon will be entitled to both performance relief (excluding, however, water quality guarantee relief) and price relief (including increases in the Water Purchase Price to reflect mitigated cost increases) associated with responses to Changes in Law. Poseidon will be responsible for an initial amount (index linked and to be negotiated and included in the Contract) of such costs in each contract year. Poseidon will use all commercially reasonable efforts to implement responses to Changes in Law at the lowest cost practicable. The Water Authority's maximum exposure for Change in Law costs will not exceed an amount (index linked and to be negotiated and included in the Contract) per contract year. J. Water Purchase Price Increase Limitation There will be a maximum water purchase price increase

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	limitation that will cap the Water Authority's annual exposure to Change in Law costs. <u>K. Poseidon Actions</u> No relief of any kind will be permitted for Changes in Law which are imposed as the result of the acts or omissions of Poseidon.
24. MWD Agreement Compliance	Poseidon acknowledges that the contribution payments required to be made by MWD under the MWD Agreement are material inducements for the Water Authority to execute the Contract, and that the MWD Agreement is subject to automatic termination if Plant construction has not commenced by January 1, 2012, or if no allowable yield is produced by January 1, 2015. If MWD terminates the MWD agreement under either such circumstance (and the termination is not caused by an Uncontrollable Circumstance or Water Authority fault), there shall be deducted from the Water Purchase Price the amount of all MWD contribution payments that would have been made but for such termination. Poseidon shall perform the Water Authority's obligations under the MWD Agreement, notwithstanding the fact that Poseidon is not a party thereto.
25. Events of Default and Termination	<u>A. Events of Default</u> The Contract will include negotiated events of default. <u>B. Remedies</u> Upon the occurrence of an event of default, the non-defaulting party may pursue any remedies available at law or in equity. <u>C. Water Authority Step-In Rights</u> The Water Authority will have the right to step in and cure defaults that are not cured by Poseidon or Poseidon's debt holders.
26. Record Keeping, Reporting	<u>A. Poseidon Maintenance and Retention of Records</u> Poseidon will maintain records pertaining to its performance under the Contract. The Water Authority will have the right to inspect such records during regular business hours (including audit rights for up to five years after each year of the Contract, or as provided for under applicable law, whichever is longer), to verify performance, quantity, quality, delivery of Product Water to the Delivery Point and price.

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	Poseidon will establish and maintain accounting records of all costs in conformance with the MWD Agreement between the Water Authority and MWD. MWD and the Water Authority will have the right to audit in accordance with the MWD Agreement. <u>B. Poseidon Reporting Requirements</u> Poseidon will provide monthly and annual reports to the Water Authority regarding Plant performance, including: Product Water quantities produced; Product Water quality (subject to additional water quality reporting requirements); maintenance and capital repairs and replacements performed; any operating problems encountered and corrective measures taken; regulatory and Contract compliance. <u>C. Measurement Devices Inspection</u> The Water Authority will have the right to inspect Poseidon's measurement devices periodically during regular business hours to verify that calibration is accurate. The Water Authority will also have the right to conduct independent verification of calibration. If Poseidon's measurement devices are found to be in need of recalibration, Poseidon will pay for and undertake such recalibration, and will also reimburse the Water Authority for all costs associated with the Water Authority inspection and testing.
27. Water Authority Plant Purchase Options	<u>A. Plant Purchase Option During the Term</u> The Water Authority will have the right to purchase the Plant at any time following the tenth anniversary of the Commercial Operation Date. The purchase price will be an amount equal to outstanding debt, debt breakage fees, an equity return, actual contractor breakage costs, and actual demobilization costs, or another amount to be negotiated. <u>B. The Water Authority Purchase Option Upon Poseidon Default</u> Upon a Poseidon default, the Water Authority may terminate the Contract and may, but will not be obligated to, purchase the Plant for a negotiated purchase. Poseidon's Plant financing, lease and other agreements and arrangements will accommodate this purchase option. <u>C. End of Term Plant Purchase Option</u> The Water Authority will have the right to purchase the Plant

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	for one dollar at the end of the term of the Contract. The Cabrillo Ground Lease will be modified, as required, to effectuate this purchase option.
28. Security for Performance by Project Contractors	A. Construction Bond Poseidon will obtain and maintain or will cause the EPC contractor to obtain and maintain performance and payment bonds in an amount sufficient to obtain non-recourse financing (or as otherwise agreed to by the parties) for the construction of the Project. B. Operations Bond Poseidon will obtain and maintain or will cause the Operating Contractor to obtain and maintain an operations performance bond in an amount sufficient to obtain non-recourse financing (or as otherwise agreed to by the parties) for the operation and maintenance of the Plant.
29. Security for Performance by Poseidon	On the financial close date, Poseidon will provide to the Water Authority an evergreen letter of credit in an amount to be negotiated (and index linked) as security for the performance of its obligations to the Water Authority under the Contract.
30. General Indemnity	Poseidon will indemnify the Water Authority for claims arising from Poseidon's misrepresentation, negligence or breach of the Contract.
31. Litigation Risk Indemnity	Poseidon will also indemnify the Water Authority against third party litigation of the kind typically initiated by opponents of projects similar to the Project seeking to prevent project construction and operation (such as litigation) involving environmental reviews, permits, and legal entitlements, other than third party lawsuits challenging the Water Authority's power or authorization to enter into the Contract, or resulting from a Water Authority breach of the Contract.
32. Representations and Warranties	The Contract will include customary representations and warranties regarding: legal standing in California; legal authority to enter into the Contract; absence of material adverse litigation or legal conditions; no conflict with other agreements or commitments; proper approvals of Contract. Poseidon will make representations and warranties as to CEQA compliance.

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33. Tax Risks	Poseidon will bear all tax risks. This includes all existing taxes payable with respect to construction, operation, maintenance, management, services on water purchases; income, sales, possessory interest, excise and value added taxes; tax law changes; new taxes; and adverse tax law determinations pertaining to bond tax exemption, tax accounting treatment, tax credit depreciation, amortization or otherwise. A tax is a governmental imposition of any kind, and includes fees and charges.
34. Liability Limitations	The Contract will contain no stated dollar limitation on damages for non-performance. Special, consequential and punitive damages will be mutually waived.
35. Dispute Resolution	The parties will agree to attempt to resolve disputes, first, through negotiation and non-binding mediation and, if negotiations and mediation are unsuccessful, then to pursue other remedies available in law or in equity.
36. Assignment by Poseidon	Poseidon will not assign the Contract without the prior written approval of the Water Authority, which approval may be given or withheld in its sole discretion. Notwithstanding the foregoing, Poseidon will have the right to collaterally assign the Contract to its lenders, and the Water Authority will reasonably consent to such assignment.
37. Poseidon's Contractors and Subcontractors	The Contract will specify minimum financial, technical and experience qualifications, standards and requirements for any Poseidon contractors and subcontractors, and for any party it may engage to replace or substitute for such contractor or subcontractors. Poseidon will provide adequate information to the Water Authority regarding the qualifications of any proposed initial or substitute contractor or contractor. Notwithstanding the above, Poseidon may not replace or substitute the EPC Contractor or the Operating Contractor without the Water Authority's approval, which will not be unreasonably withheld.
38. Governing Law	California