

**EXHIBIT 20-D**

**CITY OF SAND CITY**

**RESOLUTION SC 07-95, 2007**

**RESOLUTION OF THE SAND CITY COUNCIL AUTHORIZING THE CITY ADMINISTRATOR TO ENTER INTO A LEASE AGREEMENT FOR A TERM OF 15 YEARS WITH CALIFORNIA-AMERICAN WATER (CAW) TO OPERATE AND MAINTAIN THE SAND CITY WATER SUPPLY PROJECT'S DESALINATION FACILITY AND RELATED INFRASTRUCTURE**

**WHEREAS**, the Sand City Water Supply Project (SCWSP) has been an on-going top priority of the City's capital improvement program for the last several years; and

**WHEREAS**, the SCWSP is now at a phase of development where commitments need to be made in terms of construction contracting and determining the appropriate water purveyor to maintain and operate all of the facilities related to the SCWSP; and

**WHEREAS**, on September 18, 2007, the City Council approved and adopted an addendum to the SCWSP Final EIR which describes the nature of the water supply project as now envisioned and specified in a lease agreement with California-American Water; and that no further environmental analysis is necessary; and

**WHEREAS**, California - American Water (CAW) is the logical desalination plant operator for the SCWSP system given the company's level of water treatment expertise, its regional commitment to continue to be the primary water purveyor on the Monterey Peninsula, the company's current status as the water supply purveyor to Sand City, and its expressed strong interest in maintaining and operating the desalination plant at its own expense for a period of no less than fifteen (15) years; and

**WHEREAS**, the City of Sand City and California-American Water have come to mutually acceptable terms as further expressed in the lease agreement attached hereto as Exhibit A and incorporated herein by this reference. Said agreement allows CAW to operate the desalination facility subject to reasonable compensation to the City of Sand City in exchange for the company benefit of having up to 300 acre-feet per year of potable water supply for future water customers in Sand City and to also serve as a "cushion" against potential sanctions by the State Water Resources Control Board or Seaside Groundwater Basin Watermaster. Said agreement shall not limit the rights of the City of Sand City to charge appropriate water hookup fees as may be determined by the City Council.

**NOW, THEREFORE, BE IT RESOLVED** that the City Council of the City of Sand City hereby:

1. Authorizes the City Administrator to enter into a lease agreement with California-American Water in substantially the same form as the attached Exhibit A and to execute a memorandum of the attached lease and a form acceptable to the City Attorney; and

**Sand City Resolution SC 07-95, 2007**

2. Directs the City Clerk to forward a copy of the signed lease agreement to the Monterey Peninsula Water Management District and to record the memorandum of lease in the Official Records of Monterey County.

**PASSED AND ADOPTED** by the Sand City Council on this 9<sup>th</sup> day of October, 2007 by the following vote:

AYES: Council Members Blackwelder, Carbone, Hubler, Morris, Pendergrass

NOES: None


ABSENT: None

ABSTAIN: None

ATTEST:

APPROVED:

  
Linda K. Scholink, City Clerk

  
David K. Pendergrass, Mayor

CITY OF SAND CITY

and

CALIFORNIA-AMERICAN WATER COMPANY, INC.

**LEASE AGREEMENT**

Dated as of October 10, 2007

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SCHEDULE X  
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SCHEDULE B

Definitions  
Description of Land Parcel  
Basic Rent

THIS LEASE AGREEMENT, dated as of October 10, 2007 (this "Lease"), is between the CITY OF SAND CITY, a municipal corporation (hereinafter referred to as the "Lessor"), having an address at City Hall, 1 Sylvan Park, Sand City, CA 93955, as Lessor, and CALIFORNIA-AMERICAN WATER COMPANY a California corporation (hereinafter referred to as the "Lessee"), having an address at 303 H Street, Suite 250, Chula Vista, CA 91910 as Lessee.

RECITALS:

WHEREAS, pursuant to Section 9 of Article XI of the California Constitution and the general municipal laws of the State of California and Lessor's other general authority and power, Lessor has undertaken to construct a reverse osmosis desalination facility (the "Project") with a projected annual production capacity of three hundred (300) acre-feet per year to better serve the needs of its inhabitants for potable water; and

WHEREAS, Lessor desires to enter into an operating lease (within the meaning of the FASB rules) with Lessee to maintain and operate the Project; and

WHEREAS, the parties wish to set forth their relationship which will enable the operation of the Project, in furtherance of the corporate purposes of the Lessor.

NOW, THEREFORE, Lessor and Lessee hereby agree, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged and agreed, one to the other, as follows:

1. Demise; Assignment of Water Rights.

(a) In consideration of the agreements and provisions of this Lease, Lessor hereby grants, demises and lets to Lessee, and Lessee hereby leases from Lessor, subject to the terms and conditions hereinafter set forth and for the Term as described in Article 2 hereof, all of Lessor's right, title and interest in the Land Parcel and the Project Improvements as of the Basic Term Commencement Date, which includes all tangible equipment and personal property described in or contemplated by the Approved Plans, or now or hereafter constructed or placed on, affixed or appurtenant to, or used in connection with, the Project and the Land Parcel, together with any and all accessions, additions, improvements, substitutions and replacements thereto or therefor, (all of the foregoing, collectively, the "Leased Property"). As further reflected in the Approved Plans, the Project Improvements include, but are not limited to (i) offsite extraction wells, pumps and feed-water pipelines, (ii) the reverse osmosis desalination facility, (iii) a concentrate discharge pipeline and related blending station, (iv) a horizontal injection well adjacent to the beach, (v) a backup electrical power generator, and (vi) and a pipeline connection between the desalination facility and the Lessee's transmission main located at the intersection of Catalina and Olympia Streets. During the Term, Lessee shall have: (i) an exclusive right to occupy and possess the Land Parcel and all Project Improvements installed thereon for the purposes described in this Lease; (ii) an exclusive right to use all Project Improvements not located on the Land Parcel; and (iii) a non-exclusive right to use and possess any rights-of-way where the Project Improvements are installed outside of the Land Parcel for the purposes described in this Lease.

(b) In addition to the demise of the Leased Property, Lessor hereby assigns to Lessee, for as long as the Lease remains in effect, all of Lessor's rights under the Final Decision entered in California American Water vs. City of Seaside, et al (Superior Court Case No. M66343, Monterey County) to produce brackish water from the Aromas Sands formation of the Seaside Groundwater Basin.

2. Term.

(a) Subject to the provisions hereof, Lessee shall have and hold the Leased Property for a term (the "Basic Term") which shall begin on the Basic Term Commencement Date and continue for fifteen (15) years, unless sooner terminated or extended as hereinafter provided. Prior to the Basic Term, it is contemplated this agreement shall be deemed to be a binding agreement by Lessor and Lessee to commence the Lease on the Basic Term Commencement Date, subject to the terms hereof.

(b) So long as no Event of Default shall have occurred and be continuing on the last day of the Basic Term, Lessee may elect to extend and renew this Lease with respect to the Leased Property and the assignment of rights to the Aromas Sands brackish water beyond the Basic Term for one (1) additional fifteen (15) year term, ("Renewal Term"). The election to extend this Lease shall be deemed to have been exercised by Lessee by its giving written notice to Lessor not less than one hundred eighty (180) days prior to the expiration of the Basic Term of Lessee's election to extend this Lease.

(c) Notwithstanding any other provision of this Lease, at Lessee's sole option, this Lease may be terminated prior to the commencement of the Basic Term if (i) construction of the primary Project Improvements to be located on the Land Parcel is not commenced prior to January 31, 2008; (ii) completion and delivery (including completion of start-up testing) of the Project Improvements does not occur prior to March 31, 2009; or (iii) Project construction costs exceed Ten Million Dollars (\$10,000,000.00)

(d) Notwithstanding any other provision of this Lease, either Lessor or Lessee may terminate this Lease prior to the Basic Term Commencement Date if, after both parties have used their best efforts to secure such entitlements, either Lessor or Lessee have not obtained all government approvals necessary to construct or operate the Project Improvements.

3. Rent.

(a) Lessee shall pay the rent provided for in Schedule B (as the same may be amended, modified, supplemented or replaced from time to time pursuant to the terms of this Lease) annexed hereto ("Basic Rent"), on the dates and in the amounts therein set forth, to Lessor, [by check or by bank wire transfer or electronic funds transfer of immediately available funds for credit to account number \_\_\_\_\_, held in the name of Lessor at \_\_\_\_\_ Bank. (ABA routing number \_\_\_\_\_), or at such other place within the continental United States to which bank wire or electronic funds transfers can be made as Lessor may from time to time designate to Lessee in writing at least ten (10) days prior to the applicable payment date.

(b) Lessee shall not be obligated to pay any rent other than Basic Rent, it being agreed that this is not a "net lease." Lessee will, however, be directly responsible for paying its costs of operating and maintaining the Leased Premises, including costs relating to materials, supplies, cleaning, maintenance, routine repairs, liability insurance and utilities.

4. Use. Lessee may only use the Leased Property as a desalination facility. Lessee shall operate the Leased Property, consistent with Prudent Industry Practices, to produce potable water throughout the Term, and deliver the water produced by the Leased Property to Lessee's water distribution system for Monterey County. Potable water produced from the desalination facility may be used only to: (i) offset production from Lessee's existing sources of supply for its Monterey County water distribution system; or (ii) to serve connections for new and expanded water uses within Sand City authorized by the Monterey Peninsula Water Management District. Lessor may allocate up to 300 acre feet per year of production from the desalination facility for new and expanded water uses within Sand City upon such new or expanded uses receiving all necessary permits, licenses, or other entitlements necessary to conduct such use, including an necessary permits required by the Monterey Peninsula Water Management District. Lessee acknowledges and agrees that Lessor may charge hook up fees to for the right to a new or expanded water use in Sand City and that no portion of such fee shall be payable to Lessee.

5. Delivery of Leased Premises Upon Completion of Project Improvements. The Project Improvements are to be built in accordance with the Approved Plans and are to be completed at least 30 days before the outside date set forth in Section 2(c) to permit full commissioning and start-up testing to be completed by such outside delivery date. The Project Improvements must be completed without any mechanics liens, and Lessee shall do a complete inspection to ensure it is satisfied with the condition of the Leased Premises before it takes delivery. As a further condition to commencement of the Basic Term, Lessee shall conduct all of the start-up testing and the Project shall demonstrate that it is able to produce potable desalinated water at one hundred percent (100%) of its rated capacity of 300 acre feet per year over a 8 week period without any breakdowns or other interruptions, and without any excess utility usage or heat generation or other unforeseen costs or problems beyond what is expected in the specifications.

In the event that the commissioning is completed in a satisfactory manner, the parties shall sign a certificate evidencing Lessee's acceptance of the Project, and the Basic Term shall commence. The certificate will be accompanied by a schedule of all equipment that comprises the Leased Property, as agreed to by Lessor and Lessee upon completion of startup testing. If the Project does not perform in accordance with its specifications, then, at Lessee's sole option, it may (i) provide Lessor and the DB Contractor an agreed additional period of time to rectify any deficiencies, (ii) accept delivery with a pro rata reduction in Basic Rent to correspond to the Project's shortfall in meeting its specifications, or (iii) terminate this Lease.

6. Taxes and Other Charges; Lessee's Right to Contest.

(a) Lessee acknowledges that the possessory interest created under this Lease may be subject to property taxation and Lessee may be subject to the payment of such property taxes. Except as set forth below, Lessee shall pay and discharge, on or before the last

day upon which the same may be paid without interest or penalty, all taxes, assessments, levies, fees, water and sewer rents and other governmental and similar charges, general and special, ordinary or extraordinary, and whether or not the same shall have been within the express contemplation of the parties hereto, and any interest and penalties thereon, which are levied or assessed or are otherwise due during the Term and which relate to or arise out of (i) the use, occupancy, operation or possession of the Leased Property, or any part thereof, or the transactions contemplated by this Lease, (ii) the Leased Property or the interest of Lessee therein, (iii) Basic Rent payable by Lessee hereunder or, (iv) gross receipts from the Leased Property. If any tax or assessment levied or assessed against any Leased Property may legally be paid in installments, Lessee shall have the option to pay such tax or assessment in installments; provided, however, that, upon the termination or expiration of the Term, Lessee shall pay any such tax or assessment which it has been theretofore paying in installments in full on or prior to such termination or expiration date. Such taxes, assessments, fees, water and sewer rents and other governmental charges shall be apportioned between Lessor and Lessee as of the date on which this Lease terminates or expires with respect to the Leased Property so long as such taxes, assessments, fees, rents or charges would otherwise be payable by Lessor.

(b) Notwithstanding the foregoing, nothing in this Lease shall require payment by Lessee of (i) any franchise, estate, inheritance, succession, transfer (other than transfer taxes, recording fees, or similar charges payable in connection with a conveyance hereunder to Lessee pursuant to any provision hereof), gross or net income or profits or gross receipts taxes of Lessor or any other Indemnified Party, (ii) any taxes (including any minimum taxes and withholding taxes) imposed by any federal, state or local government on, or measured by, the gross or net income of Lessor or any other Indemnified Party, or any tax preferences or dividends paid, or (iii) any taxes in the nature of capital gains, excess profits, accumulated earnings or personal holding company taxes, unless any such tax is in lieu of, or a substitute for, any other tax or assessment upon, or with respect to, the Leased Property, which, if such other tax or assessment were in effect, would be payable by Lessee hereunder. Lessee shall furnish to Lessor promptly (and in any event within thirty (30) days after the later of (i) the date the same becomes due and payable and (ii) the date of written demand by Lessor, as the case may be) proof of the payment of any such tax, assessment, fee, rent or charge which is payable by Lessee. Such taxes, assessments, fees, water and sewer rents and other governmental charges shall be apportioned between Lessor and Lessee as of the date on which this Lease terminates or expires with respect to the Leased Property.

(c) Notwithstanding the provisions of paragraphs (a) through (c) of this Article 6 and the provisions of Article 8 hereof, Lessee shall have the right to contest, by appropriate legal proceedings, any tax, charge, levy, assessment or Lien, and/or any Legal Requirement affecting the Leased Property, and to postpone payment of, or compliance with, the same during the pendency of any such contest, provided that (i) the commencement and continuation of such proceedings shall suspend the collection thereof from, and suspend the enforcement thereof against Lessor, the other Indemnified Parties, and the Leased Property; (ii) no part of the Leased Property nor any Basic Rent or other sums payable by Lessee hereunder shall be in imminent danger of being sold, forfeited, attached or lost; (iii) there shall not exist (A) any material interference with the use and occupancy of the Leased Property or any part thereof, or (B) any interference with the payment of Basic Rent; (iv) Lessee shall diligently prosecute such contest to a final settlement or conclusion, or, if Lessee deems it advisable to



abandon such contest, Lessee shall promptly pay or perform the obligation which was the subject of such contest; and, (v) during the permitted contest there shall not be a risk of the imposition of criminal liability on Lessor or any other Indemnified Party for failure to comply with the obligation which was the subject of such contest.

7. Legal Requirements; New or Expanded Water Uses

(a) Lessor shall use reasonable efforts to obtain all necessary approvals from all Governmental Authorities requisite to the construction and operation of the Project. Lessor shall obtain all approvals necessary to increase connections for new and expanded water uses in Sand City as provided in Article 4, and Lessee shall provide any assistance requested by Lessor to secure all other necessary approvals for the construction and operation of the Project for the purposes described in Article 4.

(b) During the Term, Lessor shall provide Lessee any assistance it requests to help Lessee maintain or renew existing permits, licenses and authorizations or to obtain new approvals which may be required.

(c) Lessee shall, at all times during the Term, at Lessee's own cost and expense, (i) perform and comply, and cause the Leased Property to comply, in all material respects with all Legal Requirements, provided that Lessor shall not impose any new zoning or other requirements applicable to the Project during the Lease (ii) comply in all material respects with all provisions of insurance policies required pursuant to Article 12 hereof and (iii) comply in all material respects with the provisions of all material contracts, agreements, instruments and restrictions existing and approved by Lessee at the commencement of this Lease, or thereafter suffered or permitted by Lessee, affecting the Leased Property or any part thereof, or the ownership, occupancy, use, operation or possession thereof.

(d) Nothing in this Lease shall be construed as requiring Lessee to obtain permits, licenses, or any other entitlement on behalf of a developer seeking to develop a new or expanded water use.

(e) Nothing in this Lease shall be construed as obligating Lessee to construct at its expense any infrastructure or other improvements necessary to serve new or expanded water uses. All infrastructure expenses for new and expanded water uses will be allocated pursuant to California Public Utilities Commission rules and regulations for investor-owned water utilities, or other applicable law.

8. Liens. Lessee acknowledges that good title to the Leased Property will be vested in Lessor prior to delivering possession to Lessee. The Project Improvements shall be delivered to Lessee at the commencement of the Basic Term without any Liens or other claims. During the Basic Term, subject to the provisions of paragraph (d) of Article 6 hereof, Lessee will promptly, but no later than sixty (60) days after its Actual Knowledge of the filing thereof, at its own expense remove and discharge of record, by bond or otherwise, any Lien (other than Permitted Encumbrances) upon the Leased Property which arises solely out of Lessee's possession, use, operation and occupancy of the Leased Property.

9. Indemnification; Fees and Expenses.

(a) Prior to the Basic Term Commencement Date, Lessor shall fully indemnify Lessee and all applicable Indemnified Parties against any and all liabilities, obligations, losses, damages, costs, expenses, actions, suits and causes of action or claims of any kind or nature relating to this Lease or the Leased Premises or the transactions contemplated hereby, except to the extent that such liabilities, obligations, losses, damages, costs, expenses, actions, suits, and causes of action or claims are a result of, or claimed to be a result of, the failure of Lessee to perform any Legal Requirement or contractual obligation on its part to be performed, or the negligence, recklessness or intentional acts of Lessee.

(b) During the Basic Term, and subject to the limits in (c) below, Lessee shall indemnify the Lessor and other applicable Indemnified Parties against all liabilities, obligations, losses, damages, costs, expenses, actions, suits and causes of action or claims, of any kind or nature, (the foregoing, collectively, "Losses", and, individually, a "Loss") arising from the use, operation, maintenance, or management of the Leased Property during the Basic Term in connection with any of the following events: (A) any injury to or death of any person, and/or any damage to, or loss of, Property on the Leased Property directly connected with the, use, nonuse, occupancy, operation, possession, condition, construction, maintenance, repair or rebuilding of the Leased Property; (B) any claims by third parties relating to any violation or alleged violation of (1) any provision of this Lease, or (2) any Legal Requirement affecting the Leased Property or the operation of the Leased Property as described in Article 4.

(c) Notwithstanding the foregoing or the provisions of Article 10 hereof, Lessee shall not be required pursuant to this Article 9, Article 10 hereof or otherwise hereunder to indemnify: (i) Lessor or any other Indemnified Party for any property or other damage that is covered or should have been covered by the insurance to be maintained by Lessor, (ii) Lessor or any particular Indemnified Party for any Losses resulting from, arising out of or which would not have occurred but for Lessor's or such other Indemnified Party's own negligence, fraud or willful misconduct; (iii) Lessor or any particular Indemnified Party for any Losses resulting from, arising out of or which would not have occurred but for a breach by Lessor or such Indemnified Party of any representation, warranty or covenant made by Lessor or such Indemnified Party in this Lease or any other related document; (iv) any Indemnified Party for any taxes, except as set forth in Article 6 hereof; (v) any Indemnified Party for any losses resulting from the authorization or giving or withholding of any future amendments, supplements, waivers or consents with respect to the Lease or the Leased Premises by such Indemnified Party other than such as have been consented to in writing by the Lessee; (vi) any Indemnified Party for any Losses resulting from, arising out of or which would not have occurred but for acts or events solely with respect to any portion of the Leased Property that occur after return of possession thereof to the Lessor or its designee pursuant to and in accordance with the terms of this Lease; or (vii) for Loss or Losses arising from a defect in the design or construction of the Leased Property. Lessor shall also indemnify Lessee against all liabilities solely to the extent that such liabilities are a result of a defect in the design or construction of the Leased Property.

(d) Nothing in this Article 9 or in Article 10 hereof shall be construed to give rise to any third party beneficiary rights with respect to any Person who is not an Indemnified Party.

10. Environmental Matters.

(a) Without limiting the generality of any of the provisions of this Lease, Lessee covenants that, at all times during the Term, the Leased Property, the Lessee, all sublessees and any assignee of Lessee shall comply in all material respects with all applicable Environmental Laws and Environmental Permits.

(b) Without limiting the generality of the provisions of Article 9 hereof, Lessee agrees to indemnify, defend and hold harmless each of the Lessor and the Indemnified Parties and each of their respective employees, assigns, officers, directors, shareholders, partners, trustees and beneficiaries (each an "Environmental Indemnity Party"), from and against any and all Losses which may be suffered or incurred by, or asserted against, such Environmental Indemnity Party to the extent arising directly or indirectly out of any environmental contamination of the Land Parcel or Leased Property or resulting from Lessee's operation of the Leased Property, including, without limitation, (i) the presence, use, storage, transportation, disposal, release, threatened release, discharge, emission or generation of any Hazardous Substances or of any material, waste or substance which is directly or indirectly a product of, or contains, petroleum, including crude oil or any fraction thereof, natural gas, or synthetic gas usable for fuel or any mixture thereof, from, on, over, under or in the Leased Property in violation of any Environmental Law or Environmental Permit, whenever discovered, and including any such liability with respect to other Property caused by such Hazardous Substances and/or environmental contamination located on or emanating from the Land Parcel and/or Leased Property, or (ii) the violation or alleged violation by Lessee, or any Person claiming by, through or under Lessee, of any Environmental Law or Environmental Permit, provided, however, that (A) Lessee shall in no event be required to indemnify any Environmental Indemnity Party for any liability caused by such Hazardous Substances and/or such environmental contamination occurring after Lessee has returned the Leased Property to Lessor in accordance with the terms of this Lease, unless such liability relates to the period prior to such return of the Leased Property; (B) shall Lessee be not liable for any violation relating to Hazardous Substances in the Project Improvements built by Lessor, it being agreed that Lessor shall indemnify Lessee and its applicable Environmental Indemnity Parties against any such related liabilities; and (C) Lessee shall not be liable for any violation arising from a defect in the design or construction of the Leased Property.

11. Maintenance and Repair; Modifications; Assignment of Warranties.

(a) On and as of the Basic Term Commencement Date, Lessee shall deliver to Lessor an Officer's Certificate certifying that it has received the Project Improvements in new condition, repair and appearance, subject only to minor "punchlist items", if any, which are approved by Lessee and set forth in writing on such date with respect to the Project Improvements. All "punchlist items" shall be corrected by Lessor within 30 days after the Basic Term Commencement Date. Any punchlist items not corrected within that 30 day period may, at the sole option of Lessee: (i) be corrected by Lessee and Lessor shall reimburse Lessee for all

costs incurred to correct said punchlist items; (ii) be corrected pursuant to other agreement between Lessor and Lessee; or (iii) remain uncorrected with a pro rata reduction in Basic Rent to correspond to the Project's shortfall in meeting its specifications.

(b) Lessee will, at its own cost and expense, keep and maintain the Leased Property, including any altered, rebuilt, additional or substituted equipment, structures and other improvements or Modification thereto (as defined herein), in the same condition as delivered to Lessee on the Basic Term Commencement Date, ordinary wear and tear and the consequences of casualty (described in paragraph (c) of Article 12 hereof), condemnation or taking excepted, and (except as otherwise provided in paragraph (c) of Article 12 hereof with respect to repairs following a casualty to be made by Lessor, as owner) will make all ordinary repairs and replacements, foreseen or unforeseen, which may be required, as reasonably determined by Lessee, to be made upon, or in connection with, the Leased Property in order to keep the same in such condition, ordinary wear and tear and the consequences of casualty (described in paragraph (c) of Article 12 hereof), condemnation or taking excepted, including taking, or causing to be taken, all actions necessary to maintain the Leased Property in compliance, in all material respects, with any applicable Legal Requirements, including all applicable Environmental Laws and Environmental Permits. Without limiting the generality of any of the foregoing, Lessee shall keep the Project Improvements in good working order and operating condition, in accordance with: (i) applicable manufacturer's standard operating and maintenance procedures; and (ii) operating, maintenance, repair and replacement procedures recommended by the DB Contractor and agreed to by Lessee, as necessary to enforce warranty claims against any vendor or manufacturer of any portion of the Equipment.

(c) Lessor hereby assigns to Lessee whatever claims and rights Lessor may have against the DB Contractor, any other contractor, vendor, engineer, architect or manufacturer under the provisions of the respective construction, design, sales or manufacturer's warranty agreements or other agreements, and Lessor agrees to execute and deliver, at Lessee's expense, such documents as may be necessary to enable Lessee to obtain customary warranty service and servicing obligations furnished by all such contractors, vendors, sellers or manufacturers. Notwithstanding the foregoing, in the event that due to gradual coast or beach erosion, either (i) the extraction wells and associated piping or (ii) the injection well, need to be relocated, then Lessor shall be responsible for such work at its own cost. Such work shall be completed by Lessor as soon as possible.

(d) During the Term, so long as no Event of Default hereunder has occurred and is continuing, Lessee may make any modifications, alterations, additions and/or improvements to the Leased Property, whether or not structurally integrated with the Project Improvements (each a "Modification"); provided that no such Modification: (i) materially or adversely affects the value, utility, operation and/or useful life of the Leased Property, or (ii) violates in any material respect any agreement or restriction (including, without limitation, any Legal Requirement, Environmental Law or Environmental Permit) to which the Leased Property is subject; and provided further that such Modification is of comparable style, quality, workmanship and materials to the Project Improvements as originally constructed, as certified in writing by Lessee. Lessor and Lessee shall meet and confer regarding any material Modifications to the Leased Property. Title to any Modification (i) required to be made to the Leased Property to ensure that the Leased Property was and/or would continue to be in compliance with any

Legal Requirements applicable thereto; or, (ii) that cannot be removed without (A) causing material damage to the Leased Property or (B) materially and adversely affecting the value, utility, operation or useful life of the Leased Property (as determined by reference to the value, utility, operation and useful life of the Leased Property without regard to such Modification), as certified in writing by Lessee (collectively, "Non-severable Modifications"), shall vest with Lessor and be subject to this Lease without any increase in Basic Rent as a result of such Non-severable Modifications. Subject to the immediately succeeding sentence, title to all other Modifications (collectively, "Severable Modifications") shall vest with Lessee. In the event that Lessee returns the Leased Property to Lessor, Lessee shall be entitled to remove any Severable Modifications prior to such return of the Leased Property, provided, however, that if any such Severable Modifications are not so removed prior to the return of the Leased Property to Lessor by Lessee, title thereto shall thereupon vest with Lessor subject to Lessor's acceptance thereof. If Lessor does not accept such Severable Modification upon return of the Leased Property, Lessee shall remove such Severable Modification from the Leased Property upon demand of Lessor. Any Modification shall be made at the sole cost and expense of Lessee, unless otherwise agreed with Lessor that it should be made by and at the cost of Lessor.

## 12. Condemnation and Casualty

(a) Lessor agrees that it will not initiate any condemnation, eminent domain or other similar proceedings against the Leased Premises.

(b) If the Leased Property, or any part thereof shall be damaged or destroyed by fire or other casualty, and Lessee may not, or does not, elect to terminate this Lease pursuant to paragraph (c) of this Article 12, then Lessee shall give prompt written notice of such casualty to Lessor. Lessor shall, at Lessor's own cost and expense, proceed with diligence and promptness to carry out any necessary demolition and to restore, repair, replace, and/or rebuild the Leased Property in order to restore the Leased Property to a condition and fair market value, utility and remaining useful life not less than the condition and fair market value, utility and remaining useful life thereof immediately prior to such casualty. Lessor and Lessee shall meet and confer regarding casualty repairs, including but not limited to, the nature of the repairs, the replacement equipment, contractor qualifications, potential disruptions to operations, and schedule. No repair work done by Lessor pursuant to this paragraph shall violate the terms of any restriction, easement, condition or covenant or other matter affecting title to the Leased Property, and all repair work done by Lessor pursuant to this paragraph (b) of Article 12 shall be undertaken and completed in a good and workmanlike manner and in compliance in all material respects with all Legal Requirements then in effect with respect to the Leased Property. During the period that the Leased Property is inoperable, Basic Rent shall fully abate hereunder by reason of any damage to or destruction of, the Leased Property. If the proceeds of any casualty insurance policy maintained by Lessor are less than the estimated cost of restoring, replacing or rebuilding the Leased Property to the condition and fair market value required above in this paragraph (b), then Lessor shall make-up any such deficiency with its own funds.

(c) If, at any time during the Basic Term or any Renewal Term, (i) all or a substantial portion of the Leased Property shall be condemned or taken in the exercise of the power of eminent domain by any sovereign, municipality or other public or private authority; or (ii) shall be damaged or destroyed by fire or other casualty, and the Leased Property cannot

readily be fully restored within six (6) months with funds available from Lessor or under its casualty insurance, then Lessee may, in any such case, give written notice to Lessor of Lessee's intention to terminate this Lease with respect to the Leased Property not later than one hundred twenty (120) days after the occurrence of such casualty, condemnation or taking.

(d) Lessee's notice to Lessor shall (i) contain a description of the relevant condemnation, taking or casualty, and (ii) specify the date on which this Lease shall terminate with respect to the Leased Property. Upon any complete termination of this Lease, Lessor shall reimburse to Lessee of any advance rent applicable to the period after the termination. Upon termination, Lessee shall have no further obligations hereunder except pursuant to any provisions of this Lease which, by their terms, expressly survive such termination.

13. Insurance.

(a) Prior to the commencement of the Basic Term, Lessor shall, at its own cost and expense, maintain or cause to be maintained (by the DB Contractor building the Project Improvements) with respect to the Leased Property valid and enforceable insurance of the following character:

(i) Commercial General Liability Insurance or Comprehensive General Liability Insurance with Broad Form CGL endorsement with limits of not less than \$1,000,000 each occurrence and \$2,000,000 general aggregate. Completed Operations coverage shall extend two years beyond completion of performance under the DB Contract. The DB Contractor and any related architects and/or engineers shall also obtain adequate Professional Liability or Errors and Omissions insurance.

(ii) Worker's Compensation Insurance as required by laws and regulations applicable to and covering employees performing under this Lease. Employer's Liability Insurance protecting employer against common law liability, in the absence of statutory liability, for employee bodily injury arising out of the master-servant relationship with a limit of not less than \$1,000,000 each accident, \$1,000,000 disease-policy limit, \$1,000,000 disease-each employee.

(iii) All-Risk Property Insurance with a limit equal to the replacement cost of the Leased Property during the Basic Term.

(b) During the Basic Term, Lessee shall be responsible for maintaining the type of insurance described in clause (a)(i) and (a)(ii) and Lessor shall maintain the insurance in clause (a)(iii). Lessor may elect to self-insure the risks related to the losses under the clause (a)(iii) insurance.

(c) In addition to the foregoing, every insurance policy maintained in accordance with this Article 13 shall: (i) name the other party as additional loss payee as its interest may appear with respect to (a)(iii); (ii) provide that the issuer waives all rights of subrogation against Lessor or Lessee or any other person insured under such policy, (iii) provide that thirty (30) days advance written notice of cancellation, modification, termination or lapse of coverage shall be given to Lessor and Lessee; and (iv) be primary relative to the respective use,

occupancy and operations of premises by Lessor or Lessee and without right or provision of contribution as to any other insurance carried by Lessor or Lessee or any other interested party.

(d) Lessee and Lessor shall deliver to the other prior to the Basic Term certificates of insurance, reasonably satisfactory to Lessor and Lessee, evidencing all of the insurance required under paragraph (a) of this Article 13; provided, however, that Lessor shall not be obligated to deliver such certificates of insurance with respect to required insurance coverages as to which Lessor has retained the risk of loss (self-insured). After the expiration of any required insurance policy, the primary insured shall deliver to the other party certificates of insurance evidencing the renewal of any such policy. Lessor shall provide Lessee with written notice of any determination to self-insure with respect to any risk theretofore covered by externally procured insurance.

(e) Lessee and Lessor shall comply with all of the terms and conditions of each insurance policy maintained pursuant to the terms of this Lease to the extent necessary to avoid invalidating such insurance policy or impairing the coverage available thereunder.

14. Quiet Enjoyment.

(a) So long as no Event of Default under this Lease shall have occurred and be continuing, Lessor covenants that Lessee shall and may at all times peaceably and quietly have, hold and enjoy the Leased Property during the Term without hindrance by Lessor or any Person claiming through or under Lessor.

15. Subletting; Assignment.

(a) Neither this Lease nor the Leased Property shall be mortgaged, by Lessee. Any such mortgage or pledge shall be null and void.

(b) Lessee may only assign its interest in this Lease in connection with the consolidation or merger of Lessee into any other Person or the sale, lease or other transfer or disposal of all or substantially all of Lessee's assets in the Monterey Peninsula area (whether in one transaction or in a series of related transactions), if and only if (i) the assignee of Lessee's interest, or the corporation or other Person which results from any such consolidation, merger, acquisition, sale, lease, transfer and/or disposition of assets, if not Lessee, assumes all of Lessee's obligations, duties and liabilities under this Lease; and (ii) any such assignment, consolidation, merger, acquisition, sale, lease, transfer and/or disposition of assets would not result in a violation of any regulatory requirement applicable to Lessor, including but not limited to any and all licensing requirements applicable to the operator of the Leased Property.

16. Events of Default and Remedies.

(a) Any of the following occurrences or acts shall constitute an event of default under this Lease (each an "Event of Default"):

(i) if Lessee shall default in making payment of any installment of Basic Rent, which default shall continue for ninety (90) days after the same first becomes due and payable; or

(ii) if Lessee or Lessor shall default in the performance of any covenant, agreement or obligation on the part of Lessee or Lessor, as applicable, to be performed under this Lease, and such default shall continue for a period of thirty (30) days after written notice thereof is received by the defaulting party, unless such default is curable and the defaulting party shall be diligently proceeding to correct such default (but in no event for a total period of longer than one hundred eighty (180) days after the receipt of such notice as provided above); or

(iii) if Lessee or Lessor shall file a petition in bankruptcy or for reorganization or for an arrangement pursuant to the Bankruptcy Code, or shall be adjudicated bankrupt or become insolvent or shall make an assignment for the benefit of its creditors, or shall admit in writing its inability to pay its debts generally as such debts become due, or shall be dissolved, or shall suspend payment of its obligations, or shall take any corporate action in furtherance of any of the foregoing; or

(iv) if a petition or answer shall be filed proposing the adjudication of Lessee or Lessor as bankrupt, or proposing its reorganization pursuant to the Bankruptcy Code, and (A) Lessee or Lessor, as applicable, shall consent to the filing thereof, or (B) such petition or answer shall not be discharged or denied within sixty (60) days after the filing thereof; or

(v) if a receiver, trustee or liquidator (or other similar official) shall be appointed for, or take possession or charge of, Lessee or Lessor, or of all or substantially all of the business or assets of Lessee or Lessor or its estate or interest in the Leased Property, and such official shall not be discharged within sixty (60) days thereafter, or if Lessee or Lessor shall consent to or acquiesce in such appointment; or

(vi) if, as of the time when the same shall have been made, any representation or warranty of Lessee or Lessor set forth herein, or in any consent, notice, certificate, demand, request or other instrument delivered by or on behalf of Lessee or Lessor, as applicable, in connection with or pursuant to this Lease shall prove to have been incorrect or untrue in any material respect as of the time when made, and the condition or circumstance giving rise to such incorrect or untrue representation or warranty shall continue for a period of thirty (30) days after Lessee or Lessor has Actual Knowledge thereof, unless such condition or circumstance is curable and Lessee or Lessor shall be diligently proceeding to correct such condition or circumstance (but in no event for a total period of longer than one hundred eighty (180) days after Lessee or Lessor has Actual Knowledge thereof); or

(b) This Lease and the term and estate hereby granted are subject to the limitation that, whenever an Event of Default shall have occurred and be continuing, the non-defaulting party may, at its option, elect to exercise any one or more of the rights and remedies set forth in the following paragraphs.

(i) Terminate this Lease upon giving an additional 30 days written notice and in the case of default by Lessee, the Lessor may re-enter the Leased Premises upon termination. Such notice shall specify the date of such termination, and the Term with respect to the Leased Property shall expire by limitation at midnight on the date specified in such notice as fully and completely as if said date were the date herein originally fixed for the expiration of the



Term hereby granted, and Lessee shall thereupon quit and peacefully surrender the Leased Property to Lessor, and, upon the date following the date specified in such notice, or at any time thereafter, Lessor may re-enter the Land Parcel.

(ii) Sue to collect damages caused by the breach by the other party, including, if applicable, following a default by Lessee, make a claim for accrued unpaid Basic Rent through the time of any re-entry by Lessor. Lessor shall only be entitled to sue for the present value of the balance of Basic Rent due under the Lease to the extent the Basic Rent exceeds the greater of (A) fair market rental of the Leased Property or (B) the actual rental obtained by Lessor upon a reletting. Lessor shall have a duty to mitigate Lessee's damages by diligently trying to relet the Leased Property at the best available rent.

(c) The non-defaulting party may exercise any other right or remedy which may be available to it under applicable law or at equity, including, without limitation, bringing a suit for specific performance, and the non-defaulting party may proceed by appropriate court action to enforce the terms hereof or to recover damages for the breach hereof or to rescind this Lease.

(d) If an action shall be brought for the enforcement of any provision of this Lease in which it is found that an Event of Default has occurred, the non-defaulting prevailing party shall be entitled to seek reimbursement of its attorneys' fees and expenses.

(e) No right or remedy herein is intended to be exclusive of any other right or remedy, and every right and remedy shall be cumulative and in addition to any other legal or equitable right or remedy given hereunder, or at any time existing hereunder or at law. The failure of Lessor or Lessee to insist upon the strict performance of any provision or to exercise any option, right, power or remedy contained in this Lease shall not be construed as a waiver or a relinquishment thereof for the future.

17. Notices. All notifications, notices, demands, requests and other communications herein provided for or made pursuant hereto shall be in writing and shall be sent by (i) registered or certified mail, return receipt requested, and the giving of such communication shall be deemed complete on the third (3rd) Business Day after the same is deposited in a United States Post Office with postage charges prepaid, (ii) reputable overnight delivery service, and the giving of such communication shall be deemed complete on the immediately succeeding Business Day after the same is deposited with such delivery service or (iii) legible fax with original to follow in due course (failure to send such original shall not affect the validity of such fax notice), and the giving of such communication shall be complete when such fax is received:

(a) if to Lessor, addressed to such party at its address set forth in the first paragraph of this Lease, or at such other address in the continental United States as Lessor may furnish to Lessee in writing, or

(b) if to Lessee, addressed to such party at its address set forth in the first paragraph of this Lease, or at such other address in the continental United States as Lessee may furnish to Lessor in writing.

18. Estoppel Certificates. Each party hereto agrees that, at any time and from time to time during the Term, it will promptly, but in no event later than thirty (30) days after written request by the other party hereto or more than once per year, execute, acknowledge and deliver to such other party or to any prospective purchaser, assignee or mortgagee or other Person designated by such other party, a certificate stating, to such party's Actual Knowledge, (a) that this Lease is unmodified and in full force and effect (or if there have been modifications, that this Lease is in full force and effect as modified, and setting forth any modifications); (b) the date to which Basic Rent and other sums payable hereunder have been paid; (c) whether or not a default by Lessee in the payment of Basic Rent or any other sum of money due or required to be paid hereunder has occurred and is continuing, and whether or not any other default by Lessee hereunder has occurred and is continuing with respect to which a notice of default has been served or of which the signer of the estoppel certificate has Actual Knowledge, and, if there is any such default, specifying the nature and extent thereof; (d) whether or not there are any setoffs, defenses or counterclaims against enforcement of the obligations to be performed hereunder existing in favor of the party executing such certificate; and (e) stating that Lessee is in possession of the Leased Property or, alternatively, setting forth the parties in possession and identifying the instruments pursuant to which they took possession.

19. Surrender.

(a) Upon the expiration or earlier termination of the Term, Lessee shall peaceably surrender the Leased Property to Lessor in the condition required by Article 11 of this Lease.

(b) Without limiting the generality of the foregoing, upon the surrender and return of the Leased Property to Lessor pursuant to this Article 18, the Leased Property shall be (i) in accordance and compliance with all Legal Requirements and (ii) free and clear of any Lien.

(c) Lessee acknowledges and agrees that a breach of any of the provisions of this Article 18 may result in damages to Lessor that are difficult or impossible to ascertain and that may not be compensable at law. Accordingly, upon application to any court of equity having jurisdiction over the Leased Property, Lessor shall be entitled to a decree against Lessee requiring specific performance of the covenants of Lessee set forth in this Article 18.

20. Separability. If any provision of this Lease or the application thereof to any Person or circumstance shall to any extent be invalid and unenforceable, the remainder of this Lease, or the application of such provision to persons or circumstances other than those as to which it is invalid or unenforceable, shall not be affected thereby, and each provision of this Lease shall be valid and shall be enforceable to the fullest extent permitted by law.

21. Recording. Simultaneously with the execution of this Lease, Lessor and Lessee have executed a mutually acceptable form of memorandum of lease which shall be promptly recorded in the real property records of Monterey County, California.

22. Limitation on Recourse. All obligations of the Lessee under this Lease shall be on a non-recourse basis to its shareholders, officers, and directors and their respective

parent companies, subsidiaries and affiliates (other than the Lessee). The sole recourse of the Lessor or any other Person for any obligation of the Lessee under this Lease shall be to the Lessee and its assets; provided that the limitation on recourse set forth in this Article 21 shall not limit any rights of the Lessor or any other Person under applicable law relating to fraudulent transfers or voidable preferences.

23. Force Majeure.

(a) If by reason of "force majeure," as defined in this Article 23, a party is rendered unable, wholly or in part, to carry out its obligations under this Lease, and if such party gives notice and reasonably full particulars of such force majeure in writing to the other party promptly after the occurrence of the cause relied on, the affected party, and only so far as and to the extent that it is affected by such force majeure, shall be excused from performance hereunder without liability; provided, however, such cause shall be remedied with all reasonable dispatch.

(b) For purposes of this Agreement, "force majeure" shall mean an event that creates an inability to perform that could not be prevented or overcome by the due diligence of the affected party, including but not limited to, any act, omission or circumstance occasioned by or in consequence of any acts of God, strikes, lockouts, acts of the public enemy, wars, sabotage, blockades, insurrections, riots, epidemics, landslides, lightning, earthquakes, fires, storms, hurricanes, tornadoes, floods, washouts, civil disturbances, explosions, power outages the failure or inability to obtain any necessary governmental authorization which has been sought or requested, as the case may be, in good faith by all reasonable legal means, and any other cause, whether of the kinds herein enumerated or otherwise, not reasonably within the control of the affected party. In the event the production from the extraction wells, falls below the level needed to operate the Project at a capacity sufficient to supply water for new and expanded water hookups in Sand City due to depletion of the aquifer or some other natural cause, then such event shall be considered as a "force majeure" event.

(c) For "force majeure" events occurring prior to Lessor filing a Notice of Assignment with the Monterey Peninsula Water Management District pursuant to that District's Sand City Water Supply Project Ordinance, where such "force majeure" event cannot be cured within six (6) months, then either party shall have the right to terminate this Lease. For "force majeure" events occurring after to Lessor's filing a Notice of Assignment with the Monterey Peninsula Water Management District pursuant to that District's Sand City Water Supply Project Ordinance, where such "force majeure" event cannot be cured within six (6) months, then Lessee shall have the right to terminate this Lease.

24. Miscellaneous.

(a) This Lease embodies the entire agreement between Lessor and Lessee relating to the subject matter hereof and supersedes all prior agreements and understandings, written or oral, relating to such subject matter.

(b) This Lease shall be binding upon, and shall inure to the benefit of and be enforceable by, the parties hereto and their respective successors and assigns permitted hereunder.

(c) No term or provision hereof or Appendix, Exhibit or Schedule hereto may be amended, changed, waived, discharged, terminated or replaced orally except by a written instrument, in accordance with applicable terms and provisions hereof, executed by each of the parties hereto.

(d) No failure, delay, forbearance or indulgence on the part of any party in exercising any right, power or privilege hereunder shall operate as a waiver thereof, or as an acquiescence in any breach, nor shall any single or partial exercise of any right, power or remedy hereunder preclude any other or further exercise thereof or the exercise of any other right, power or privilege.

(e) Any provision of this Lease which is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof, and any such prohibition or unenforceability in any jurisdiction shall not invalidate or render unenforceable such provision in any other jurisdiction.

(f) This Lease shall be construed, governed and applied in accordance with the laws of the State of California, without regard to the conflicts of law principles thereof.

(g) In connection with this Lease, Lessee and Lessor hereby agree that any action, proceeding, or dispute regarding this lease shall be filed in the Superior Court of the State of California, in and for the County of Monterey. Nothing in this paragraph shall be construed as a waiver of Lessees' rights under California Code of Civil Procedure section 394.

(h) This Lease may be executed in any number of counterparts, each of which shall be an original, and such counterparts together shall constitute but one and the same instrument.

IN WITNESS WHEREOF, Lessor and Lessee hereto have each caused this Lease to be duly executed and delivered in their name and on their behalf, respectively, as of the day and year first written above.

Lessor:

CITY OF SAND CITY

By: Kelly Morgan  
Name: Kelly Morgan  
Title: City Administrator

Lessee:

CALIFORNIA AMERICAN WATER

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

## SCHEDULE X

### Definitions

“Actual Knowledge” means actual knowledge of (i) an Authorized Officer or (ii) any other officer or official whose responsibilities include administration of the transactions contemplated by the Lease.

“Affiliate” of any specified Person means any other Person directly or indirectly controlling or controlled by or under direct or indirect common control with such specified Person or, in the case of a specified Person which is a partnership, any general partner of such partnership. For purposes of this definition, “control” when used with respect to any specified Person means the power to direct the management and policies of such Person, directly or indirectly, whether by contract, through the ownership of voting securities or the power to appoint and remove directors or trustees, or otherwise; and the terms “controlling” and “controlled” have meanings correlative to the foregoing.

“Approved Plans” means the plans for the Project Improvements, in the form existing as of the date hereof, a copy of which have been received and approved by Lessee.

“Authorized Officer” means with respect to Lessee, the chief financial officer, any vice president, the treasurer or any assistant treasurer of the Lessee, or any other officer of the Lessee designated by the Lessee as an Authorized Officer of the Lessee from time to time, and with respect to Lessor, any official or any officer whose responsibilities include Administration of this transaction.

“Bankruptcy Code” means Title 11 of the United States Code, as amended, or any successor statutory provisions.

“Basic Rent” has the meaning set forth in Article 3 of the Lease.

“Basic Term” has the meaning set forth in Article 2 of the Lease.

“Basic Term Commencement Date” means the Completion Date or, if such day is not the first day of a calendar month, the first day of the calendar month next succeeding the Completion Date.

“Business Day” means a day when banks are open for business in California.

“Code” means the Internal Revenue Code of 1986, as amended from time to time, or any successor statute.

“Complete” or “Completion” means that (a) the materials and equipment for the Project Improvements have been installed and checked for alignment, lubrication, rotation and hydrostatic and pneumatic pressure integrity, (b) the electrical systems have been installed and tested, (c) the electrical continuity and ground fault tests and mechanical tests and calibration have been completed, (d) the instrumentation has been loop checked, (e) the Project Improvements have been flushed and cleaned out as necessary, (f) the Project Improvements are

ready to commence start-up and testing, (g) the Project Improvements have been constructed substantially in accordance with the Approved Plans, including, without limitation, the specifications applicable thereto, and (h) the Project Improvements are capable of operating safely. The following shall not prevent certification of Substantial Completion, but shall be remedied, cured or resolved within sixty (60) days after the Basic-Term Commencement Date:

- (i) any redundant part or piece of equipment which is missing or inoperable which does not affect the safe operation of the Project Improvements;
- (ii) any disputed contract issue which has been submitted for arbitration;
- (iii) any non-conforming item which has been agreed to be corrected and the material placed on order which does not affect the safe operation of the Project Improvements; or
- (iv) any punchlist items which will not prevent start-up of the Project Improvements.

“Completion Date” means the date, if any, on or before the Outside Completion Date, on which the following have occurred: (i) Substantial Completion has been achieved, and (ii) Lessee has satisfactorily completed all start-up commissioning for the Project Improvements.

“Construction Period” means the period of time from the Closing Date to the Basic Term Commencement Date.

“DB Contract” means the Contract for Water Supply Project, Water Treatment Facilities for Brackish Water to Domestic Water, Sand City, California” by and between Lessor and the DB Contractor, as originally executed or as the same may from time to time be supplemented, modified, amended or replaced in accordance with the applicable provisions thereof and the approval of the Lessee.

“DB Contractor” means CDM Constructors, Inc., and any successors and permitted assigns thereof.

“Economic Abandonment” has the meaning set forth in paragraph (c) of Article 11 of the Lease.

“Environmental Indemnity Party” has the meaning set forth in paragraph (b) of Article 10 of the Lease.

“Environmental Laws” means and includes, but shall not be limited to, the Resource Conservation and Recovery Act (42 U.S.C. § 6901 et seq.), as amended by the Hazardous and Solid Waste Amendments of 1984, the Comprehensive Environmental Response, Compensation and Liability Act (42 U.S.C. § 9601 et seq.), as amended by the Superfund Amendments and Reauthorization Act of 1985, the Hazardous Materials Transportation Act (49 U.S.C. § 1801 et seq.) the Toxic Substances Control Act (15 U.S.C. § 2601 et seq.), Clean Air Act (42 U.S.C. § 7401 et seq.), the Clean Water Act (33 U.S.C. § 1251 et seq.) the Federal Insecticide, Fungicide and Rodenticide Act (7 U.S.C. § 136 et seq.), the Occupational Safety and Health Act (29 U.S.C. § 651 et seq.) and all applicable federal, state and local environmental laws, including



obligations under the common law, ordinances, rules, regulations, private agreements (such as covenants, conditions and restrictions) and publications, as any of the foregoing may have been or may be from time to time amended, supplemented or supplanted, and any other federal, state or local laws, including obligations under the common law, ordinances, rules, regulations, private agreements (such as covenants, conditions and restrictions) and publications, now or hereafter existing relating to regulation or control of Hazardous Substances or environmental health and safety.

“Environmental Permits” means all permits, licenses and any other authorizations to conduct operations at the Leased Property that are required under any and all applicable Environmental Laws.

“Fair Market Rental Value” means an amount equal to the fair market rental value that would be obtained in an arm’s-length transaction between an informed and willing lessor and an informed and willing lessee, in either case under no compulsion to rent, and neither of which is related to the Lessor, calculated as the value of the Leased Premises for its use at its present location determined on the basis of the value of the Land Parcel subject to existing governmental zoning and use restrictions and with regard to the value of the Project Improvements.

“FASB” means the Financial Accounting Standards Board, or any successors thereto that perform substantially similar functions.

“Final Determination” means, with respect to a private letter ruling or a technical advice memorandum of the Internal Revenue Service, written notice thereof in a proceeding in which the Lessee had an opportunity to participate and otherwise means written notice of a determination from which no further right of appeal exists or from which no appeal is timely filed with any court of competent jurisdiction in the United States in a proceeding to which the Lessee was a party or in which the Lessee had the opportunity to participate.

“GAAP” means generally accepted accounting principles as in effect in the United States of America at the time of application.

“Governmental Action” means all permits, authorizations, registrations, consents, approvals, waivers, exceptions, variances, orders, judgments, decrees, licenses, exemptions, publications, filings, notices to and declarations of or with, or required by, any Governmental Authority, or required by any Legal Requirements, and shall include, without limitation, all citings, environmental and operating permits and licenses that are required for the use, occupancy, zoning and operation of the Project Improvements.

“Governmental Authority” means any foreign or domestic federal, state, county, municipal or other governmental or regulatory authority, agency, board, body, commission, instrumentality, court or quasi-governmental authority or any political subdivision thereof.

“Hazardous Substances” means (i) those substances included within the definitions of or identified as “hazardous substances”, “hazardous materials”, or “toxic substances” in or pursuant to, without limitation, the Comprehensive Environmental Response Compensation and Liability Act of 1980 (42 U.S.C. § 9601 *et seq.*) (“CERCLA”), as amended by Superfund Amendments and Reauthorization Act of 1986 (Pub. L. 99-499, 100 Stat. 1613) (“SARA”), the Resource

Conservation and Recovery Act of 1976 (42 U.S.C. § 6901 et seq.) (“RCRA”), the Occupational Safety and Health Act of 1970 (29 U.S.C. § 651 et seq.) (“OSHA”), and the Hazardous Materials Transportation Act, 49 U.S.C. § 1801 et seq., and in the regulations promulgated pursuant to said laws, all as amended; (ii) those substances listed in the United States Department of Transportation Table (40 CFR 172.101 and amendments thereto) or by the Environmental Protection Agency (or any successor agency) as hazardous substances (40 CFR Part 302 and amendments thereto); (iii) any material, waste or substance which is or contains (A) asbestos, (B) polychlorinated biphenyls, (C) designated as “hazardous substance” pursuant to Section 311 of the Clean Water Act, 33 U.S.C. § 1251 et seq., (33 U.S.C. § 1321) or listed pursuant to Section 307 of the Clean Water Act (33 U.S.C. § 1317); (D) flammable explosives; (E) petroleum products and substances; (F) radioactive materials; and (iv) such other substances, materials and wastes which are or become regulated as hazardous, toxic or “special wastes” under applicable local, state or federal law, or the United States government, or which are classified as hazardous, toxic or as “special wastes” under federal, state or local laws or regulations.

“Indemnified Parties” means the Lessor or Lessee, as applicable, and all shareholders, officers, directors, employees, attorneys and agents of any of the foregoing, and any Person holding any beneficial interest in any of the foregoing.

“Indenture” means the Indenture of Trust, dated as of August 1, 1997, from Issuer to Indenture Trustee, as originally executed or as the same may from time to time be supplemented, modified, amended or replaced in accordance with the applicable provisions thereof and of the Operative Documents.

“Land Parcel” means the land situated in Monterey County, California, more particularly described in Schedule A to the Lease.

“Leased Property” means the Project Improvements, together with the Land Parcel.

“Legal Requirements” means all applicable laws, rules, orders, ordinances, regulations and requirements and conditional permissions now existing or (except to the extent any exemption or so called “grandfathering” provision is available) hereafter enacted or promulgated, of every government and municipality and of any agency thereof having jurisdiction over the Lessee, Lessor or the Leased Property, relating to the ownership, use, occupancy, maintenance or operation of the Leased Property, or the improvements thereon, or the facilities or equipment thereon or therein, or the streets, sidewalks, vaults, vault spaces, curbs and gutters adjoining the Leased Property, or the appurtenances to the Leased Property, or the franchises and privileges connected therewith or the transactions contemplated by the Lease, including but not limited to the operation of the Lease Property in the manner described in Article 4 and including, without limitation, all applicable building laws, health codes, safety rules, handicapped access, zoning and subdivision laws and regulations and Environmental Laws.

“Lien” means any mortgage, pledge, security interest, production payment, encumbrance, lien or charge of any kind whatsoever. For the purposes of the Lease, any Person shall be deemed to own subject to a Lien any asset which it has acquired or holds subject to the interest

of a lessor or vendor under any capital lease or other title retention agreement relating to such asset.

“Outside Completion Date” has the meaning set forth in Article 2 of the Lease.

“Permitted Encumbrances” means, with respect to the Leased Property: (a) rights reserved to or vested in any municipality or public authority to condemn, appropriate, recapture or designate a purchaser of the Leased Property; (b) any Liens thereon for taxes, assessments and other governmental charges and any Liens of mechanics, materialmen and laborers for work or services performed or material furnished in connection with the Leased Property, which are not due and payable, or the amount or validity of which are being contested as permitted by Article 6 of the Lease; and (c) Liens granted by Lessor in connection with any bonds issued to fund the Project, as long as such lender receiving such lien has granted Lessee satisfactory rights of non-disturbance.

“Person” means an individual, a corporation, a partnership, an association, a joint stock company, a trust, an unincorporated organization, a governmental body or a political subdivision, a municipal corporation, a public corporation or any other group or organization of individuals.

“Project Improvements” has the meaning set forth in Article 1 of the Lease.

“Prudent Industry Practices” means any of the practices, methods and acts engaged in or approved by a significant portion of the municipal water treatment and supply industry operating in the immediate area surrounding the Leased Property during the Term of this Agreement. Prudent Industry Practices are not to be interpreted, construed or limited to the optimum industry practices, methods or acts, but rather as a range of acceptable practices, methods or acts consistent with the duties and obligations of Contractor under this Agreement.

“Regulations” means the applicable proposed, temporary or final Income Tax Regulations promulgated under the Code, as such regulations may be amended and/or supplemented from time to time.

“Renewal Term” has the meaning set forth in paragraph (b) of Article 2 of the Lease.

“Sublessee” means the Lessee or any other Person who is lessee of the Project Improvements and sublessee of the Demised Premises pursuant to a Sublease.

“Subsidiary” means any corporation or other entity of which securities or other ownership interests having ordinary voting power to elect a majority of the board of directors or other persons performing similar functions are at the time directly or indirectly owned by the Lessee.

“Term” means (a) the Basic Term and any Renewal Term(s) which may be effected pursuant to Article 2 of the Lease or (b) such shorter period as may result from earlier termination of the Lease as provided therein.

“Term Termination Date” means the last day of the Basic Term or a Renewal Term, as applicable.

“Termination Date” has the meaning set forth in paragraph (c) of Article 2 of the Lease.

“Work” means all items of work required by the Design/Build Contract and the Approved Plans necessary to design, acquire, construct and install the Project Improvements.

**SCHEDULE A**

**LEGAL DESCRIPTION**

For the

**SAND CITY DESALINATION PLANT FACILITY LAND PARCEL  
LANDS OF THE SAND CITY REDEVELOPMENT AGENCY**

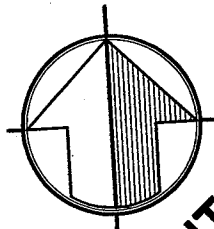
ALL THAT REAL PROPERTY LOCATED IN THE CITY OF SAND CITY, COUNTY OF MONTEREY, STATE OF CALIFORNIA DESCRIBED AS FOLLOWS:

BEING LOTS 2, 4, 6, 8, 10, AND 12, AND THE SOUTHERLY 10.00 FEET OF LOTS 1, 3, 5, 7, 9, AND 11 OF BLOCK 17, "MAP OF EAST MONTEREY" FILED OCTOBER 18, 1887 IN VOLUME 1 OF CITIES AND TOWNS, AT PAGE 22, IN THE OFFICE OF THE COUNTY RECORDER FOR THE COUNTY OF MONTEREY, CALIFORNIA.

CONTAINING 12,750 S.F. MORE OR LESS

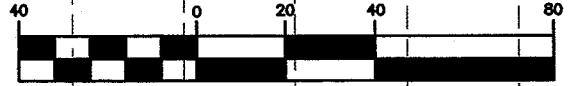
EFFECTS:

APN 011-243-002 AND A PORTION OF APN 011-243-006



ROUTE 1  
STATE OF CALIFORNIA

GRAPHIC SCALE



( IN FEET )

1 inch = 40 ft.

ELDER AVENUE

BLOCK 17

1 3 5 7 9 11 13 15 17 19

LAND PARCEL  
LEASE LINE

10.00'

150'

(1-CT+22)

85'

2 4 6 8 10 12 14 16 18 20

REY STREET

CITY OF SEASIDE  
CITY OF SAND CITY

SHASTA AVENUE



Creegan+D'Angelo

INFRASTRUCTURE  
ENGINEERS

225 Cannery Row, Suite H  
Monterey, CA 93940  
Tel (831) 373-1333  
Fax (831) 373-0733

www.cdengineers.com

**SCHEDULE 'A'**

**SAND CITY DESALINATION FACILITY**

**LANDS OF THE SAND CITY**

9/25/07 REDEVELOPMENT AGENCY 1"=40'  
707003 SHEET 2 OF 2

## SCHEDULE B

### Basic Rent

Lessee shall pay Basic Rent in the amount of \$765,000 per year to Lessor on the first day of each and every year during the Basic Term. Basic Rent payable to Lessor during the first year of the Basic Term shall be paid to Lessor within ten (10) days following the date Lessor gives notice to Lessee of Lessor's approval of the final design for that portion of the Project Improvements to be designed and constructed by CDM Constructors, Inc. Basic Rent payable to Lessor during the last year of the Basic Term shall be paid to Lessor within ten (10) days following the date Lessor gives notice to Lessee of delivery of the reverse osmosis equipment to the project site.

The parties acknowledge and agree that the capital cost of the Leasehold Improvements will be at least NINE MILLION DOLLARS (\$9,000,000). In the event the capital cost of the Leasehold Improvements exceed NINE MILLION DOLLARS (\$9,000,000), the parties agree that the amount of Basic Rent shall be increased to amortize eighty seven percent (87%) of such increase in capital cost over the Basic Term of the Lease in the manner allowed by FASB rules for a facility operating lease.

Lessee shall pay Basic Rent equal to the annual fair market rental value of the Leased Property and the assigned water rights to Lessor on the first day of each and every year during the Renewal Term. The fair market rental value of the Leased Property and the assigned water rights during the Renewal Term shall be determined by agreement between Lessor and Lessee made after Lessee has given notice of exercise of its option to extend the Lease for the Renewal Term under paragraph (b) of Article 2 of this Lease. In the event Lessor and Lessee cannot agree on the fair market rental value within sixty (60) days following the date Lessee gives such notice, each party shall appoint an appraiser who shall determine the fair market rental value by appraisal. In the event the two appraisers appointed by the parties cannot agree, they shall appoint a third appraiser whose decision shall be final and binding on the parties.