

## COUNCIL AGENDA REPORT

**\*\*\*DOUBLE-CLICK THUMB TACK TO VIEW AGENDA RELATED MATERIAL PROVIDED TO A MAJORITY OF THE CITY COUNCIL AFTER DISTRIBUTION OF THE AGENDA PACKET.**

December 1, 2009

**TO:** City Council



**FROM:** City Manager

Prepared by Senior Assistant City Attorney/Utilities Counsel  
and Director of Utilities

**SUBJECT: ENVIRONMENTAL REVIEW OF THE WATERLINE INTERTIE PROJECT AND APPROVAL OF AN AGREEMENT WITH THE NIPOMO COMMUNITY SERVICES DISTRICT ON THE SALE AND DELIVERY OF SUPPLEMENTAL WATER**

### RECOMMENDATION:

That the City Council, acting as a Responsible Agency, approve a resolution to make findings under the California Environmental Quality Act for the Nipomo Community Services District Waterline Intertie Project and approve the Wholesale Water Supply Agreement with the Nipomo Community Services District.

### SUMMARY:

The Nipomo Community Services District (NCSD) needs to purchase supplemental water to offset groundwater overdraft. The Santa Maria Groundwater Litigation Stipulation requires the City of Santa Maria (City) seek to provide the Nipomo Management Area with 2,500 Acre Feet (AF) of supplemental water annually. The City has adequate water to fulfill this obligation. The NCSD and the City signed a Memorandum of Understanding (MOU) in 2004 to begin negotiations on a supplemental water sales agreement. The NCSD completed the preliminary design and certified an Environmental Impact Report for a Waterline Intertie Project to deliver the supplemental water to the community. They have also approved the Agreement with the City for the purchase of supplemental water. The City Council now is asked to consider the Environmental Impact Report and approve the Agreement.

The City has water of sufficient quality and quantity to supply supplemental water to Nipomo and therefore, there are no significant environmental impacts to the City. The sale of supplemental water to Nipomo will be a judicial use of fiscal assets and will help with groundwater restoration and preservation by assisting in the balance of the groundwater basin.

### BACKGROUND:

The NCSD provides water, sewer, and solid waste services within its boundaries to the community of Nipomo. The NCSD needs to secure a supplemental water supply to offset overdraft of the groundwater basin in the Nipomo Mesa Management Area. The City has sufficient water resources to meet the demands of its retail customers and the NCSD's water supply needs. Attachment "A" is Table 3-6 from the City 2005 Urban Water Management Plan, which identified the City's water resources at 49,910 AF in both normal and dry water years. This quantity of water greatly exceeds the City's

present usage of 14,700 AF annually. It also far exceeds the projected City water use of approximately 19,000 AF to support a population of 120,900 in the projected build-out year of 2022.

The City Council entered into an MOU with the NCS D on September 7, 2004 (Attachment "B"). The MOU set the basic terms under which the City and the NCS D would negotiate for the NCS D to purchase supplemental water, of certain quality and quantity, from the City of Santa Maria. The MOU details the following key points:

- NCS D would be the lead agency for preparation of the environmental study for the project.
- An intertie, between the two water systems, would be designed, constructed and financed by the NCS D.
- City would deliver to the NCS D supplemental water of the same pressure and quality as the City delivers to its retail customers.
- City would deliver to the NCS D 600 Acre Feet of supplemental water annually when the intertie is completed increasing to 1,260 Acre Feet annually in 2035.

The City and the NCS D are parties to a certain groundwater adjudication lawsuit commonly referred to as the Santa Maria Groundwater Litigation. On June 30, 2005, the court-ordered Settlement Stipulation was issued. The purpose of the Stipulation is to impose a physical solution establishing a legal and practical means for ensuring the basin's long-term sustainability. The Stipulation provides that "the NCS D and the City shall employ their best efforts to timely implement the Nipomo Supplement Water Project." The stipulation recognized the MOU between the City and the NCS D and requires a minimum of 2,500 Acre Feet of supplemental water be brought to the Nipomo Basin.

## **DISCUSSION:**

### **Project**

In order for the City to deliver water to the NCS D, a water delivery system must be constructed between the two existing water systems. The water delivery system, or Nipomo Waterline Intertie Project (Project), is made up of water lines, pump stations and the necessary infrastructure to deliver water from one location to another. Construction of the water delivery system is the responsibility of the NCS D. The location for joining of the two water systems in Santa Maria will be near the intersection of West Taylor Street and North Blosser Road. A pipeline extension would run north on Blosser Road to the levee, under the levee and the Santa Maria River and eventually to a connection in Nipomo (Attachment "C"). If the NCS D receives the necessary financing for the Project, the delivery system is scheduled to be completed by the NCS D in January 2012.

### **Environmental**

Environmental review of the Project is required under the California Environmental Quality Act (CEQA). The City received a Notice of Preparation of an Environmental Impact Report (EIR) for the Project in June 2008 and a notice of a public scoping meeting in July 2008. The NCS D certified the Final EIR on May 13, 2009.

The City acts as a "responsible agency" for the Project, under CEQA, because we are delivering supplemental water to the NCS D and a portion of the water infrastructure is

being built in the City. A responsible agency complies with CEQA by considering the EIR and reaching its own conclusions on whether and how to approve the project involved. Listed below are the steps required by CEQA for the City to consider the EIR:

- The City is to respond to the lead agency's request for consultation. *The City participated in the study session and scoping meeting for the project. The Director of Utilities reviewed and commented on specific sections of the administrative draft pertaining to City water supply, water quality impacts, and groundwater impacts. The City also provided assistance in responding to comments submitted by area residents.*
- The City is to designate representatives to attend meetings requested by the lead agency to discuss the scope and content of the environmental document. *A City representative attended initial scoping-type meetings for the intertie environmental impact report and reviewed specific sections of the document.*
- The City is to comment on draft environmental documents, focusing on any shortcomings within its area of expertise or which pertain to parts of the project it will carryout. *The City reviewed the draft EIR and commented on the delivery of water and the construction of water delivery infrastructure in the City.*
- The City is to consider the environmental impact report before reaching a decision on the project. *The City Council is now requested to consider the Final EIR for the Nipomo Waterline Intertie Project as approved by the NCSD.*
- The City is to mitigate or avoid significant environmental effects, if feasible, for the aspects of the project it will carryout. *The City does not incur any significant environmental effects from the project. There is sufficient water quantity and quality to allow the sale of supplemental water to the NCSD without having a negative environmental effect on the City.*
- The City is to make findings as legally required for each significant effect of the project. *A resolution containing recommended findings accompanies this staff report.*

There are no significant environmental effects on the City. The environmental findings can be found in Exhibit "A" of the environmental resolution.

### Agreement

In order for the City to comply with the MOU and Stipulation, an agreement is needed to formalize the terms and conditions by which the City will provide supplemental water to the NCSD. The City and the NCSD have worked out these terms and conditions in a Wholesale Water Supply Agreement (Agreement). The Agreement was approved by the NCSD Board on October 28, 2009. Key points of the Agreement are as follows:

### Terms:

The Agreement terms are from the effective date until June 30, 2085. After June 30, 2035, the Agreement shall be subject to the renewal of the contract between the City and Central Coast Water Authority for the State Water Project water. The City shall not be required to deliver supplemental water at a financial loss after June 30, 2035. If this were to occur, both parties are required to meet to renegotiate the Agreement in good

faith. The parties will meet in good faith in 2085 to determine whether to extend the terms of the Agreement.

#### Quantity:

The Agreement details the minimum amount of supplemental water that the City shall deliver and the NCSD shall purchase as follows:

Years 1 through 10	- 2,000 Acre Feet per year
Years 11 through 19	- 2,500 Acre Feet per year
Years 20 through end of Term	- 3,000 Acre Feet per year

The NCSD may request up to an additional 3,200 Acre Feet per year per the Agreement.

#### Quality:

The City shall deliver supplemental water to the NCSD from the sources used to provide water to the City's retail customers per the Agreement. Currently, there are two sources of water for Santa Maria; high-quality State water and groundwater. State water is blended with groundwater supplies to provide a relatively consistent water quality throughout the service area.

High-quality water delivery is a high priority goal of the City. The City is implementing conservation measures to conserve high-quality State water for delivery to our customers and investigating new sources of high-quality water as follows:

#### Conservation:

- Leakwatch Real-Time Radio Metering Program. The City is implementing a new water meter reading program that will give the City the ability to achieve real-time data to determine where customer-related leaks may be occurring. Identifying customer's leaks early and proactively working with customers to fix leaks saves an estimated 264 Acre Feet of the City's water in the first year after program implementation and provides the ratepayers and City potential cost savings.
- Secondary Water System Project. This project is the construction of a water system that delivers only groundwater to irrigation systems with large amounts of landscaping such as parks and schools. This enables the City to apply groundwater to its most appropriate use – landscaping. By watering plants with lower quality groundwater, the City is able to preserve high-quality State water to our customers for domestic and commercial use.

#### New sources of high-quality water:

- State Water Acquisition. The City is in discussions with the County of Santa Barbara, Central Coast Water Authority, and other local agencies in the attempt to acquire more high-quality State water.
- Groundwater Treatment. State water deliveries can fluctuate due to climate and environmental issues. The City is investigating groundwater treatment (reverse osmosis) as a method to keep our water supply high-quality during years of low delivery of State water.

### Purchase Price:

The purchase price for the supplemental water delivered to the NCSD shall be based on Tier 1 of the City's Water Consumption Rate. This is the rate the City charges retail customers for water. In fiscal year 2008-2009 the Tier 1 Rate was \$1,063.37 per Acre Feet of water or \$2.441 per hundred cubic feet. The Tier 1 Rate is scheduled to increase five percent on July 1, 2010 and again on July 1, 2011 to keep up with inflation in the operation of the water system, retire bonds, and implement capital improvements.

### Alternatives:

Do not approve the Wholesale Water Supply Agreement with the NCSD. This alternative is not recommended for the following reasons:

- This Agreement follows the intent and object of the approved MOU between the City of Santa Maria and the NCSD.
- This Agreement abides by the Stipulation that provides for "the NCSD and the City shall employ their best efforts to timely implement the Nipomo Supplement Water Project".
- NCSD has approved the Agreement.
- The City has sufficient water of quality and quantity to meet the requirements of the Agreement.
- The Agreement will be fiscally prudent for the City.

### Fiscal Considerations:

Based on our fiscal projections, the sale of supplemental water to the NCSD will be revenue neutral in the worst case scenario and generate revenue under most scenarios. This follows the City's longstanding judicial use of fiscal assets.

### Impact to the Community:

The sale of supplemental water to the NCSD will be a positive impact to the community by implementing groundwater restoration and preservation and by improving the groundwater basin balance.

There would be traffic impacts to the community during construction of the Waterline Intertie Project. Motorist on North Blosser Road may experience detours and delays during construction of the project. To minimize any impact, the Utilities Department will work with the NCSD and the contractor to ensure sufficient public notification and signage is used before and during construction.

### Other Agency Review:

The Final EIR and Wholesale Water Supply Agreement were approved by the NCSD.

  
RICHARD G. SWEET, P.E.  
Director of Utilities

### ATTACHMENTS:

- Attachment "A" - Table 3-6
- Attachment "B" - Memorandum of Understanding
- Attachment "C" - Intertie Map

Table 3-6  
**Supply Reliability for the City of Santa Maria for Year 2030**

Source	Normal Water Year	Single-Dry Water Year	Multiple-Dry Water Years		
			Year 1	Year 2	Year 3
Imported Water from SWP <sup>(2)</sup>	13,706	890	5,874	5,874	5,874
Groundwater Available from Twitchell Yield <sup>(3)</sup>	14,300	14,300	14,300	14,300	14,300
Groundwater <sup>(6)</sup>	12,795	25,611	20,627	21,645	22,663
Return flows from SWP water <sup>(4,5)</sup>	8,909	8,909	8,909	7,891	6,873
Recycled water	0	0	0	0	0
<b>Total</b>	<b>49,710</b>	<b>49,710</b>	<b>49,710</b>	<b>49,710</b>	<b>49,710</b>
Percent of Normal		100	100	100	100

Attachment "A"

**MEMORANDUM OF UNDERSTANDING BY AND BETWEEN  
THE CITY OF SANTA MARIA AND  
NIPOMO COMMUNITY SERVICES DISTRICT**

This MEMORANDUM OF UNDERSTANDING ("MOU") is dated and effective as of the 1<sup>st</sup> day of September, 2004, by and between the CITY OF SANTA MARIA (the "City"), a California municipal corporation, and NIPOMO COMMUNITY SERVICES DISTRICT ("NCSD"), an independent special district formed under and pursuant to Section 61000, *et seq.* of the California Government Code. City and NCSD are sometimes individually referred to herein as a "Party" and collectively as the "Parties". This MOU shall constitute the binding agreement of the Parties, subject to the terms, conditions and contingencies set forth herein.

**RECITALS**

This MOU is based on the following facts, understandings and intentions of the Parties:

A. NCSD provides water, sewer and solid waste service and limited street lighting and drainage service within the NCSD boundary, located in the southern portion of San Luis Obispo County. NCSD's major water supply is comprised of groundwater from the Nipomo Hydrologic Sub-Area of the greater Santa Maria Groundwater Basin (the "NHSA") as described in a draft report by SAIC entitled Water Resources Evaluation, Nipomo Mesa Management Area, and dated June 10, 2002. Due to current supply conditions and anticipated growth demands, NCSD needs to secure supplemental water supplies.

B. City serves water in the Santa Maria Valley, in northern Santa Barbara County. City has a contract with Central Coast Water Authority to receive water from the State Water Project ("SWP") and also pumps groundwater from the Santa Maria Basin. City has sufficient water resources, to meet the demands of its retail water customers and to meet NCSD's water supply needs.

C. NCSD seeks to acquire a supplemental water supply of up to three thousand (3,000) acre-feet per year to protect the NHSA from further degradation and to meet current needs and projected growth demands (the "Program"); and City is willing to sell to NCSD, on a wholesale long-term basis, the desired water supply (the "Supplemental Water").

D. The Parties desire to enter into a wholesale water supply agreement (the "Agreement") to formalize the terms and conditions by which City will provide the Supplemental Water to NCSD.

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E. As set forth below, City and NCSD each have established certain conditions precedent to the delivery of the Supplemental Water and desire to enter into this MOU to identify certain key terms and conditions that will be the subject of the Agreement and certain contingencies that must be satisfied prior to any delivery of the Supplemental Water.

**TERMS AND CONDITIONS**

NOW, THEREFORE, in consideration of the mutual covenants, representations and other provisions contained herein, and for other valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the Parties hereby agree as follows:

**ARTICLE 1: GENERAL**

**1.1 Purpose.**

(a) The purpose of this MOU is to acknowledge the agreement of the Parties with respect to certain basic terms and conditions of a proposed transaction, which basic terms and conditions shall form the basis upon which the Parties will negotiate in good faith the Agreement. With respect to the negotiation of the Agreement, this MOU is a statement of intent only and does not grant NCSD any rights in and to the Supplemental Water, nor shall the City have any obligation to NCSD to reserve or deliver the Supplemental Water until the Agreement has been executed by the Parties, provided, however, that the City acknowledges that this MOU represents the negotiations of the Parties with respect to the value of the Supplemental Water, which will be incorporated into the Agreement as the annual rate.

(b) Notwithstanding Subparagraph (a) above, this MOU further sets forth certain binding terms and conditions upon which the City agrees to reserve the right of NCSD to take delivery of certain Supplemental Water pending the negotiation of the Agreement and the satisfaction of certain contingencies set forth herein, as well as the allocation of certain costs and risks between the City and NCSD. These provisions are binding on the City and NCSD.

**1.2 Wholesale Water Supply Agreement.** The Agreement will supersede this MOU and will more specifically identify the Parties' rights and obligations regarding the delivery of water by City to NCSD. The terms of the Agreement shall not be limited by this MOU if, in the course of good faith negotiations, the Parties agree to modifications.

**1.3 Contract Date.** The Parties specifically recognize that the transaction contemplated by the Agreement is subject to review pursuant to California Public Resources Code Sections 21000, et seq. ("CEQA"). NCSD will serve as the CEQA lead agency and will make environmental determinations regarding the Project which includes the delivery of the Supplemental Water and the construction of facilities to deliver Supplemental Water from the interconnection to NCSD. Nothing contained in this MOU shall be construed to mean that NCSD will certify the environmental determinations, or will make such findings as may be



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required to develop the Project. NCSO, as the CEQA lead agency, is responsible for determining whether the Project and the Project's environmental determinations comply with CEQA. It is the intent of both Parties that the Agreement shall be signed no later than thirty-five (35) days from the date NCSO certifies the environmental determinations and/or challenges, if any, are resolved regarding the Project. The actual date of execution by the last Party to sign the Agreement shall be considered the "Contract Date."

**1.4 Term of MOU.** This MOU shall be and remain in effect from the date first set forth above until the Contract Date, unless earlier terminated by the Parties as provided for in Section 1.5.

**1.5 Termination of MOU.**

(a) NCSO shall have the right to terminate its obligations under this MOU at any time without cause. To effect termination, NCSO shall provide written notice to the City as provided for in Section 9.6 hereof.

(b) In addition to any other termination right provided in this MOU, City shall have the right to terminate this Agreement if NCSO does not comply with the CEQA time schedule established in Section 5.1 (c). To effect termination, City shall provide written notice to NCSO as provided for in Section 9.6 hereof.

(c) Upon termination of this Agreement by either Party, neither Party shall have any further rights or obligations hereunder, except for the obligations set forth in Section 1.8 and Article 7, which shall survive the termination of this Agreement.

**1.6 Reservation of Water.** Upon execution of this MOU and until the Contract Date, and thereafter upon the closing of the acquisition of the Supplemental Water contemplated by this MOU, unless terminated, City will not enter into any agreement with any other corporation, government entity or other person with respect to the ownership, operation, rights or use of its water that would prevent City from (i) carrying out its obligations under this MOU; or (ii) delivering Supplemental Water to NCSO as contemplated by the Agreement. NCSO shall compensate City for the foregoing obligations to reserve water for NCSO as provided for in Section 3.1 of this MOU. Further, for the term of the Agreement, City shall not supply water to any other person or entity for use or distribution, in whole or in part, in the NHSA for a price or on any term or condition more favorable than that price and those terms and conditions provided for in the Agreement. The initial reservation payment of thirty seven thousand five hundred dollars (\$37,500) shall be paid upon execution of this MOU and shall be non-refundable to NCSO notwithstanding any termination of this MOU.

**1.7 Cooperation.** City agrees to provide the resources of City personnel to reasonably cooperate with and assist NCSO, without charge, in completing all necessary due diligence with respect to the calculation of anticipated supplemental water supplies and the identification of potential regulatory or environmental requirements or hurdles to the Agreement.

**1.8 Indemnity under MOU.**

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(a) NCS D agrees to indemnify and hold City harmless from any claims arising out of any action taken by NCS D with respect to implementation of this MOU, including any claims related to the construction of the interconnection. The foregoing indemnity obligations of NCS D shall be governed by the terms of Article 4, provided that the exclusion of regulatory claims in Section 4.1 shall not apply.

(b) City agrees to indemnify NCS D and to hold NCS D harmless from any claims arising out of any action taken by City with respect to implementation of this MOU, including any claims related to City's construction of any facilities necessary to implement the interconnection. The foregoing indemnity obligations of City shall be governed by the provisions of Article 4 hereof prescribing the conduct of the obligor whenever the same are reasonably applicable.

**ARTICLE 2: PRINCIPAL TERMS OF AGREEMENT**

**2.1 Description.** City will provide NCS D with wholesale water service from sources available to City's retail customers upon a mutually determined delivery schedule. In order to effectuate delivery of the Supplemental Water, the Parties acknowledge that certain infrastructure must be completed by NCS D. In exchange for payment of a reservation fee as provided for in Section 3.1 of this MOU, City will reserve for NCS D an exclusive right to the Supplemental Water until such time as NCS D has completed the necessary infrastructure and is able to take delivery of the Supplemental Water. Thereafter, City shall provide the Supplemental Water to NCS D as provided in the Agreement.

**2.2 Term of Reservation.** The "Reservation Term" shall commence on the actual date of execution by the last party to sign this MOU and shall continue until, and as long as, this MOU or the Agreement is not terminated as provided herein. The initial physical delivery of water ("Initial Delivery") to NCS D is anticipated by the Parties to occur on or before the expiration of two years subsequent to the Contract Date (the "Effective Date").

**2.3 Term of Agreement.** The term of the Agreement shall commence on the *Effective Date and end on June 30, 2065 (the "Term")*. Notwithstanding said Term, should the provisions applicable to City's extension of its contract for State Water Project water with the Central Coast Water Authority past June 30, 2035 render any term or terms of the Agreement substantially financially burdensome to City, the parties will then renegotiate the provisions of the Agreement in good faith and employ their best efforts to equitably amend the Agreement so that it remains in full force and effect during the entirety of the Term.

**2.4 Early Termination of Agreement.** NCS D shall have the right to terminate the Agreement (i) if City is found to be in material breach of its obligations to deliver the Supplemental Water as set forth in the Agreement; or (ii) upon five years' prior written notice to City.

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**2.5 Right to Acquire Water.** Subject to the terms and conditions of the Agreement, City hereby grants to NCSD the right to purchase and take delivery of Supplemental Water from City, beginning on the Effective Date and each year for the remainder of the Term of the Agreement. NCSD's right to acquire water from City shall not exceed a maximum of two hundred and fifty (250) acre-feet per month or four point two (4.2) cubic feet per second.

**2.6 Minimum Delivery.** NCSD agrees to acquire the following minimum quantity of Supplemental Water after initial water deliveries in the given periods (each period measuring twelve months) as follows:

<b>Period</b>	<b>Quantity in AF</b>
First	600
Second	685
Third	770
Fourth	855
Fifth	940
Sixth	1,025
Seventh	1,072
Eight	1,119
Ninth	1,166
Tenth	1,213
Eleventh thru 2035	1,260

**2.7 Supply.** City shall deliver the Supplemental Water to NCSD from sources used to provide water to City's retail customers.

**2.8 Source Flexibility.** During the term of the Agreement or any renewal, City may substitute or combine new or additional replacement sources of water for the source of Supplemental Water. Any substitute, combined or additional sources must be at least equal in deliverability, reliability, quality, pressure, and environmental impacts to the source being replaced.

**2.9 Water Quality.** City shall be responsible for ensuring that the quality of the Supplemental Water delivered to NCSD is of the same pressure and quality of water that City delivers to its residential customers and shall meet all federal, state, and local laws and regulations as amended from time to time. City agrees to indemnify and hold NCSD harmless from any claims arising out of any action taken by City with respect to water quality.

**2.10 Delivery Mechanism.** NCSD shall be responsible for constructing and operating an interconnection with City's retail distribution system. The location, plans and specifications of such connection shall be subject to prior approval by City, which approval shall not unreasonably be withheld or delayed. City shall provide easements on its property at no charge to NCSD and waive normal permit fees. NCSD shall also be responsible for obtaining any and

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all regulatory and environmental permits, licenses or other approvals necessary to construct and operate the interconnection. City will deliver the Supplemental Water to NCSD at the interconnection upon a mutually agreeable delivery schedule, subject to the provisions of Section 2.5. NCSD assumes all responsibility for delivery of the water from the interconnection.

**ARTICLE 3: PAYMENT PROVISIONS**

**3.1 Reservation Fee.** In consideration for the City's reservation of water for NCSD as provided for in Sections 1.6 and 2.1 of this MOU and to reserve capacity within City's distribution system from the date of this MOU until the Effective Date, NCSD shall pay City a reservation fee (the "Reservation Fee") of seven hundred and fifty thousand dollars (\$750,000). The Reservation Fee will be paid in four installments as follows:

<b>Installment</b>	<b>Amount</b>
1) MOU Date	\$37,500
2) Contract Date: Final and Beyond Challenge	\$187,500
3) Completion of Construction	\$225,000
4) First 300 AF Delivered @ \$1,000/AF	\$300,000

The Reservation Fee is non-refundable. The Reservation Fee will be credited against the transaction and reduce the Annual Fixed Rate (as described in Section 3.2) at the rate of fifty dollars (\$50.00) per acre-foot for the first fifteen thousand (15,000) acre-feet of Supplemental Water purchased by NCSD. City has the right to terminate the Agreement if any of the installments under the Reservation Fee are not paid on or before the due date. City shall use the Reservation Fee to cover any costs incurred under this MOU and the Agreement.

**3.2 Payment for Supplemental Water.**

(a) NCSD shall pay City either an Annual Fixed Rate for the Supplemental Water in the amount of one thousand two hundred and fifty dollars (\$1,250.00) per acre-foot or an Annual Variable Rate in the amount of eight hundred and ninety five dollars (\$895.00) per acre-foot adjusted each year from Initial Delivery through the end of the Term by three percent (3.0%) annually. NCSD shall choose one such rate prior to accepting the initial delivery of Supplemental Water hereunder and that rate then shall apply for the entirety of the Term, provided that the parties agree to renegotiate the rates stated herein for the period commencing with the year 2036 through the end of the Term, consistent with Section 2.3.

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(b) For water remarketed by NCSD into NHSA, City shall charge either the Annual Fixed Rate or the Annual Variable Rate stated in subsection 3.2 (a) at the choice of the end user made prior to that end user accepting the initial delivery of Supplemental Water from NCSD. That rate shall then apply for the entirety of the Term, provided that the rate is subject to renegotiation for the period commencing with the year 2036 through the end of the Term, consistent with Section 2.3. NCSD shall measure and report all deliveries of Supplemental Water remarketed by it to end users on a quarterly basis consistent with the payments due pursuant to subsection 3.4.

**3.3 Remarketing of Supplemental Water.** NCSD shall be free to remarket the Supplemental Water to other parties who either use or serve water within the NHSA, without restriction as to price and terms.

**3.4 Payment Schedule.** City shall bill NCSD on a quarterly basis in arrears for Supplemental Water delivered to NCSD's interconnection during the previous quarter. The amount payable by NCSD to City shall be based on the total quantity in acre-feet of Supplemental Water delivered during the quarter just ended multiplied by the then-current Annual Fixed Rate and Annual Variable Rate. The first invoice to NCSD will be dated within three months of the Initial Delivery and continue each calendar quarter (January 1, April 1, July 1, and October 1) through the end of the Term. The invoice shall apply to the previous quarter of actual Supplemental Water deliveries.

**3.5 Construction, Regulatory/ Permit and Other Costs.** NCSD shall be solely responsible for all costs related to the construction and operation of the interconnection with City's retail distribution system. NCSD shall also be solely responsible for all regulatory and/or permit compliance and costs with respect to the interconnection. Except as otherwise provided for in this Article 3, the Parties shall be responsible for their own fees and costs related to the completion of this MOU and the Agreement.

**ARTICLE 4: DIVISION OF RISK RESPONSIBILITIES**

**4.1 Indemnity.** NCSD, its successors and assigns, shall hold harmless, defend and indemnify City, its officials, employees, agents, successors and assigns (all of which are herein referred to as the "City Indemnified Parties") from and against all liabilities, obligations, claims, damages, losses, actions, judgments, suits, costs and expenses, including but not limited to reasonable attorneys' fees (collectively, "Damages"), which may be imposed on, incurred by, or asserted against City Indemnified Parties as a result of (i) a breach of NCSD's obligations; or (ii) the conduct of NCSD's operations associated with the interconnection to City's retail distribution system and the subsequent delivery of Supplemental Water to NCSD's customers. Notwithstanding the foregoing, in no event shall NCSD be liable to indemnify a City Indemnified Party for (i) any Damages resulting from the negligence or the gross negligence or willful misconduct of City; (ii) any third party claim brought in connection with regulatory approvals; or (iii) any claim brought in connection with the quality of the Supplemental Water as provided in Section 2.3 above. This indemnification shall survive termination of the Agreement.

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**4.2 Third Party Claims.** Promptly following notice of any "Third Party Claim" for which City is indemnified hereunder, City shall notify NCS D of such claim in writing. NCS D shall have a period of thirty (30) days following the receipt of such notice to notify City of whether NCS D elects to assume the defense thereof. If NCS D so notifies City that it elects to assume the defense, NCS D thereafter shall defend (with counsel approved by City), indemnify and hold City harmless from and against, and shall reimburse City for, the Third Party Claim.

NCS D shall not consent to entry of judgment or enter into any settlement agreement, without the consent of City, which does not include a complete and unconditional release of City or which imposes injunctive or other equitable relief against City. City shall be entitled to participate in, but not control, the defense thereof, with counsel of its choice and at its own expense.

If NCS D does not give the requisite notice, or fails to assume and diligently pursue the defense of such Third Party Claim, City may defend against such Third Party Claim in such manner as it may deem appropriate, at NCS D's expense, including without limitation settlement thereof on such terms as City may deem appropriate, and to pursue such remedies as may be available to City against NCS D. Notwithstanding the foregoing, City shall not consent to entry of a judgment or enter into any settlement agreement, without the consent of NCS D, which does not include a complete and unconditional release of NCS D.

**4.3 Force Majeure.** If by reason of acts of God, earthquakes, droughts, floods, storms, explosion, fires, labor troubles, strikes, insurrection, riots, acts of the public enemy, or federal, state, or local law, order, rule, or regulation, the City is prevented from delivering, in whole or in part, Supplemental Water to NCS D, as provided herein, then City may reduce delivery of Supplemental Water up to the same percentage the City reduces water delivery to its retail customers.

**4.4 Suspension.** The delivery of water may be suspended or curtailed during any period of public emergency or disaster that is declared by City. For the purposes of this MOU, a public emergency or disaster shall not include ordinary measures taken during periods of drought or water shortage. Should such a suspension or curtailment occur, the resulting deficit in water deliveries shall be offered to be offset by the City through excess water deliveries as soon as is practicable.

**4.4 Notice of Claims.** The Parties shall promptly notify each other within ten (10) days of City or NCS D becoming aware of: (1) any claims or suits brought against City or NCS D for which they seek indemnification from the other Party, (2) any Third Party Claims, and (3) any force majeure event. Any such notice shall conform to the requirements specified in Section 9.6 of this MOU.

**ARTICLE 5: CONDITIONS PRECEDENT**

**5.1 Conditions Precedent.** NCS D's obligation to consummate the transaction contemplated under this MOU and the Agreement (other than the payment of the Reservation

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Fee on the MOU Date) will be subject to the satisfaction of the following conditions (the "Conditions Precedent").

(a) General Feasibility. City will deliver to NCSD, as soon as possible following the execution of this MOU, such further documents, plans, maps, studies, reports, records, permits, licenses and contracts relating to the Supplemental Water that NCSD may deem necessary or desirable in order to assess the viability and feasibility of the Supplemental Water for NCSD's intended use. NCSD will have until the proposed Contract Date to review and approve or disapprove the same.

Additionally, during the term of the MOU, NCSD shall investigate the costs and general feasibility of constructing and operating an interconnection with City's retail distribution system. City shall provide reasonable assistance to NCSD in conducting this feasibility investigation.

(b) Due Diligence. City agrees to cooperate with NCSD's due diligence investigation of City, and to provide NCSD and its representatives with prompt and reasonable access to key employees and to books, records, contracts and other information pertaining to the Supplemental Water and that portion of City's retail distribution system affected by the contemplated transaction (the "Due Diligence Information").

(c) CEQA Compliance. NCSD will diligently pursue CEQA compliance for the delivery of the Supplemental Water and the facilities necessary to transport the Supplemental Water from City to NCSD. NCSD agrees to the following time line:

- (i) To develop a project description for the Supplemental Water Agreement contemplated in this MOU no later than one hundred and twenty (120) days from the date upon which NCSD's Board of Directors approves this MOU; and
- (ii) To retain environmental consultants within one hundred and twenty (120) days from the date upon which NCSD's Board of Directors approves this MOU; and
- (iii) To use reasonable efforts to complete all associated CEQA studies and reports.

**5.2 Pre-Closing Covenants.** The Agreement shall contain customary representations and warranties, including good and marketable title to the Supplemental Water. City shall further provide appropriate documentation to enable NCSD to verify City's ability to provide Supplemental Water as contemplated herein.

**5.3 Conditions to Obligation.** The Parties are not obligated to consummate the acquisition of the Supplemental Water contemplated hereby unless and until the Parties have reached agreement as to all of the essential terms of the acquisition, which shall be reflected in the Agreement. In addition, the Parties will not be obligated to consummate the acquisition of the Supplemental Water unless NCSD has obtained all certificates, permits and approvals that

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are required in connection with the construction and operation of the interconnection and the delivery and use of the Supplemental Water, and NCS D satisfactorily completes its due diligence investigation as described in Section 5.1 of this MOU.

**ARTICLE 6: BEST EFFORTS**

**6.1 Best Efforts.** The Parties agree to negotiate in good faith, and to use their reasonable best efforts to reach and tentatively approve the Agreement with respect to the acquisition of the Supplemental Water on or before December 31, 2004, and to close the transaction, by formal execution of the Agreement, as soon as it is reasonably practicable. In the event any Party violates the covenants contained in this Article 6 (the "Breaching Party"), the other Party may seek recovery from the Breaching Party of its actual costs and expenses incurred in connection with this MOU in reliance on the good faith of the Breaching Party. The foregoing remedy shall be the sole and exclusive remedy for a breach of this Article 6 and neither Party shall be liable to the other for any claim of lost profits or consequential damages.

**ARTICLE 7: CONFIDENTIALITY**

**7.1 Confidentiality.** NCS D shall use the Due Diligence Information solely for the purpose of investigation of the Supplemental Water and the feasibility of constructing and operating the required interconnection; and, unless and until the Parties consummate the acquisition of the Supplemental Water, NCS D, its affiliates, directors, officers, employees, advisers and agents (the "NCS D Representatives") will keep the Due Diligence Information confidential. NCS D will disclose the Due Diligence Information only to those Representatives of NCS D who need to know such information for the purpose of consummating the acquisition. NCS D agrees to be responsible for any breach of this Section 7.1 by any of the NCS D Representatives. In the event the acquisition is not consummated, NCS D will return to City any materials containing Due Diligence Information, or will certify in writing that all such materials or copies of such materials have been destroyed.

The Parties hereto agree that any information provided them in connection with the transactions contemplated by this MOU will be kept confidential by them and their respective officers, directors, employees, agents, representatives and advisors; provided, however, that disclosure of such information may be made:

(a) To the extent the same shall be or have otherwise become publicly available other than as a result of the Parties hereto, and

(b) If, in the reasonable opinion of counsel to the disclosing Party, such disclosure is required to be disclosed by law or during the course of or in connection with any litigation or proceeding, provided that the Party so disclosing notifies the other Party of its obligations to provide such confidential information and fully cooperates with the other Party to protect the confidentiality of such information.



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**ARTICLE 8: REPRESENTATIONS OR WARRANTIES**

**8.1 Representations or Warranties of City.** City makes the following representations, warranties and covenants to NCSD:

(a) Power and Authority to Execute and Perform this MOU. City has the power and authority to enter into this MOU and to perform its obligations, and all necessary approvals and authorizations have been obtained.

(b) Enforceability. This MOU constitutes a legal, valid and binding obligation of City, and is enforceable against City in accordance with its terms.

**8.2. Representations or Warranties of NCSD.** NCSD makes the following representations, warranties and covenants to City:

(a) Power and Authority to Execute and Perform this MOU. NCSD has the power and authority to enter into this MOU and to perform its obligations, and all necessary approvals and authorizations have been obtained.

(b) Enforceability. This MOU constitutes a legal, valid and binding obligation of NCSD, enforceable against NCSD in accordance with its terms.

**ARTICLE 9: MISCELLANEOUS PROVISIONS**

**9.1 Remedies Not Exclusive.** Except as provided in Article 6, remedies provided in this MOU and the Agreement for enforcement of its terms are intended and shall be construed as cumulative rather than exclusive and shall not be deemed to deprive the Party using the same from also using any other remedies provided by this MOU or the Agreement or by law.

**9.2 No Transfer of Rights.** The rights granted to NCSD hereunder constitute the right to take delivery of water only and shall not be interpreted as a sale, transfer, or assignment of City's water rights with respect to its SWP contract, the Santa Maria Basin, or other water sources as may be available from time to time.

**9.3 Subject to Applicable Law.** NCSD and City acknowledge and agree that this MOU and the rights and obligations of the Parties hereunder shall be subject to the laws governing municipal corporations as they now exists and as they may be hereafter amended or codified by the Legislature of the State of California.

**9.4 Entire Agreement.** This MOU contains the entire understanding between City and NCSD with respect to its subject matter, and supersedes all prior agreements, oral or written, and all prior or contemporaneous discussions or negotiations between City and NCSD. This MOU cannot be amended except in writing signed by both Parties.

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**9.5 No Waiver.** Any failure or delay on the part either Party to exercise any right under this MOU shall not constitute a waiver of the right, and shall not preclude such Party from exercising or enforcing the right, or any other provision of this MOU, on any subsequent occasion.

**9.6 Notices.** All notices or other communications required or desired to be given pursuant to this MOU shall be in writing and shall be hand-delivered, or mailed by certified mail, return receipt requested, or sent by a reputable overnight courier service providing delivery confirmation. Each such notice or communication shall be deemed to be duly given when hand-delivered, or three (3) days after being mailed in any depository maintained by the United States Postal Service, with prepaid postage, certified, return receipt requested or one (1) day after being deposited for next day delivery with Federal Express or other reputable courier. Each such notice or communication shall be addressed to the Parties at their respective addresses set forth next to their signatures below, or such other address as a Party notifies the other in writing.

**9.7 Headings; Section References.** Captions and headings appearing in this MOU are inserted solely as reference aids for the ease and convenience; they shall not be deemed to define or limit the scope or substance of the provisions they introduce, nor shall they be used in construing the intent or effect of such provisions.

**9.8 Severability.** If any provision of this MOU is finally determined by a court to be invalid or unenforceable as written, the provision shall, if possible, be enforced to the extent reasonable under the circumstances and otherwise shall be deemed deleted from this MOU. The other provisions of this MOU shall remain in full force and effect so long as the material purposes of the MOU and understandings of the Parties are not impaired.

**9.9 Binding Effect Assignment.** This MOU shall be binding on and inure to the benefit of the Parties, and their respective successors and permitted assigns. Neither Party shall assign this MOU in whole or in part without first receiving the prior written approval of the other Party, which approval shall not be withheld unreasonably, provided that the City shall be deemed to approve NCS D's assignment of its rights and obligations hereunder, in whole or in part, to a public utility, mutual water company, or public entity supplying water to customers located in the NHSA. Any unauthorized attempt to assign this MOU shall be null and void.

**9.10 Attorneys Fees.** In the event that any action or proceeding is brought to enforce one or more of the terms of this MOU, to restrain an alleged violation of this MOU, or to determine the validity of this MOU or any part thereof, the prevailing Party in any such action or proceeding shall be entitled to recover from the other its reasonable costs and attorneys' fees, in addition to any other remedies available to it in law or equity. If both Parties are successful in one or more causes of action during any such proceeding, the costs and fees shall be apportioned as determined by the court.

**9.11 Governing Law and Venue.** This MOU is a contract governed in accordance with the laws of the State of California.

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IN WITNESS WHEREOF, the Parties have executed this agreement as of the date first written above.

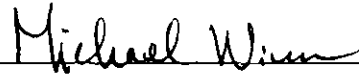
CITY:

NCSD:

City of Santa Maria  
a California municipal corporation

Nipomo Community Services District  
a California independent special district

By:   
Name: Tim Ness  
Title: City Manager

By:   
Name: MICHAEL WINN  
Title: President, NCSD

Address: 110 E. Cook Street  
Santa Maria, CA 93454

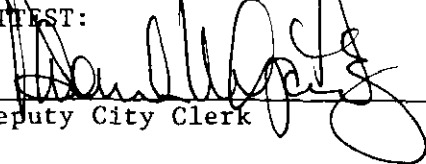
Address: 148 S. Wilson St.  
Nipomo, CA 93444

Fax: (805) 349-0657

Fax: 929-1932


Phone: (805) 925-0951

Phone: 929-1133

ATTEST:  
  
Deputy City Clerk

APPROVED AS TO FORM:

Best Best & Krieger LLP

By:   
Eric Garner, Partner

