WATER SERVICE CONTRACT

BETWEEN

OFFICE OF COLUMBIA RIVER
WASHINGTON DEPARTMENT OF ECOLOGY

AND

MERCER CANYONS, INC.

EXPLANATORY RECITALS:

Whereas, the following preliminary statements are made in explanation:

1. RCW 90.90.010 authorizes the Washington Department of Ecology's (Ecology) Office of Columbia River (OCR) to enter into water service contracts to recover all or a portion of the cost of developing water supplies.
2. Since 2004, OCR has partnered with the United States Bureau of Reclamation (Reclamation) on releasing additional water from Lake Roosevelt for new water supplies.
3. On December 21, 2010, Ecology issued Surface Water Certificate S3-30556 authorizing Reclamation to release 37,500 acre-feet of water from Lake Roosevelt for the purpose of instream flow purposes, with 25,000 acre-feet to be used as replacement water for out-of-stream municipal and industrial uses.
4. On December 21, 2010, Ecology issued Trust Water Certificate S3-30556, accepting 37,500 acre-feet of water into the Trust Water Rights Program.
5. OCR entered into a federal water service contract with Reclamation on August 2, 2011, Contract No. 11XX101734 (Reclamation Contract). The Reclamation Contract is attached hereto as Attachment A. The Reclamation Contract relates to the 37,500 acre-feet of water supply released for instream flows and new municipal and industrial permits. The Reclamation Contract has a term of 40 years, expiring on August 2, 2051, unless it is renewed pursuant to its terms.

Mercer Canyons, Inc. holds an application for a water right (Application No. S4-31148) that was filed with Ecology on February 2, 1992.

I. THIS WATER SERVICE CONTRACT (AGREEMENT) is made and entered into by and between the Washington Department of Ecology, hereinafter referred to as "ECOLOGY", and Mercer Canyons, Inc., hereinafter referred to as "APPLICANT".

II. IT IS THE PURPOSE OF THIS AGREEMENT to establish a contractual framework for the APPLICANT to reimburse the State of Washington through ECOLOGY an agreed upon annual sum to utilize permitted waters of the State of Washington under Water Right Permit No. S4-31148 (Attachment B) for beneficial use of that water. This Agreement is intended to describe the annual costs, the conditions to the Agreement and the term of service for the use of that water. This Agreement contains all the terms and conditions agreed upon by the parties. No other understandings, oral or otherwise, regarding the subject matter of this Agreement shall be deemed to exist or to bind any of the parties hereto.

III. STATEMENT OF PERFORMANCE: ECOLOGY has conducted a water right investigation and will issue a Report of Examination (ROE) approving the application after the APPLICANT signs this Agreement. After any appeal of the ROE is concluded, ECOLOGY will issue a permit (unless the ROE is vacated upon appeal). All provisions, conditions and limitations of water use identified in Attachment B are incorporated into this contract.

The supply of water authorized in Attachment B is a permanent authorization. However, it is mitigated by a non-permanent federal water service contract. In the future, either the Reclamation Contract will be renewed, or OCR will make best efforts to replace it with another water supply source that provides equal mitigation value.

IV. PERIOD OF PERFORMANCE: Subject to its other provisions, the period of performance of this Agreement shall commence on the date of permit issuance, and run as long as the APPLICANT receives water pursuant to Attachment B, unless amended or terminated sooner as provided herein.

V. TERMS OF PAYMENT: Cost recovery payments for this Agreement are based on costs incurred by ECOLOGY as a result of the Reclamation Contract, unless otherwise amended. The Reclamation Contract and its terms and conditions are incorporated by reference into this Agreement. Annual payments due by the APPLICANT to ECOLOGY are as follows:

APPLICANT shall pay ECOLOGY an annual sum of $35 per acre-foot per year based on the permitted or certificated quantity described in Attachment B. ECOLOGY may at its sole discretion adjust this rate if Reclamation exercises Provision 14(2)(b) of the Reclamation Contract, which provides for periodic review of payments for water service contracts under Federal Reclamation law. ECOLOGY shall not adjust its rate unless it provides APPLICANT with 90 days notice of said rate adjustment.

VI. BILLING PROCEDURE: Payment shall be based on the full permitted quantity in Attachment B. At such time as the permit is superseded, or perfected and replaced by a certificate, then the payment shall be based upon the superseding permit or certificated quantity. Payment shall be due by November 1st each year for the subsequent year's water use. ECOLOGY shall send a notice of payment due to the APPLICANT by September 15th of each year.

VII. AGREEMENT ALTERATIONS, AMENDMENTS, AND ASSIGNMENTS: This Agreement may be amended or assigned by mutual agreement of the parties. Such amendments or assignments shall not be binding unless they are in writing and signed by personnel authorized to bind each of the parties.

Exceptions to mutual agreement amendments and assignments:

1. When a certificate issues for the permit in Attachment B, said certificate shall automatically replace the permit and become the basis for this Agreement in Attachment B.
2. This Agreement is assignable if accompanied by an equivalent assignment of the subject permit. A superseding permit issued in such event will become the basis for this Agreement in Attachment B.
3. In the event a superseding permit issues based on an approved change decision by ECOLOGY, said superseding permit will become the basis for this Agreement in Attachment B. However, in addition to other applicable criteria and transfer statutes, a change application shall only be approved for the permit or certificate if the new use, point of withdrawal, or other proposed change is capable of being mitigated through the Reclamation Contract.
4. In the event a certificate has issued and the entire property to which the certificate is appurtenant is transferred to another party, this Agreement is assignable if agreed to by the current and proposed certificate holders.

VIII. TERMINATION: The APPLICANT may terminate this Agreement upon thirty (30) calendar days prior written notification to ECOLOGY. In that event, the subject permit shall be cancelled by ECOLOGY if still in effect. If a certificate is in effect, such termination shall constitute the certificate holder's intent to abandon the certificate and ECOLOGY shall promptly revoke same.

ECOLOGY shall not terminate this Agreement unless:

1. The Reclamation Contract is renewed and ECOLOGY is subjected to different or additional conditions for the water releases not covered by this ECOLOGY-APPLICANT Water Service Contract; or
2. The Reclamation Contract is terminated and ECOLOGY has secured alternate mitigation for the permit or certificate.
3. The Reclamation Contract is terminated and ECOLOGY has not secured alternate mitigation for the permit or certificate[1].
4. The APPLICANT fails to honor the terms of this Agreement, including payment.

Prior to terminating this Agreement as described in #1 and #2 above, ECOLOGY shall provide to the APPLICANT a new water service contract for review and execution at least ninety (90) calendar days prior to such termination. The goal of such notice is to provide informed and uninterrupted mitigation throughout the life of the permit or certificate. If ECOLOGY terminates this Agreement as described in #1 and #2 above, the APPLICANT may:

A. Accept the terms of the new water service contract; or
B. Abandon use of the permit or certificate and either:
    a. Cease beneficial use associated with said right (e.g. no longer divert or withdraw water); or
    b. Continue the beneficial use under another suitable water right.

ECOLOGY shall not terminate this Agreement as described in #4 above, unless it has taken the following steps:

I. ECOLOGY must provide notice to the APPLICANT of APPLICANT'S failure to comply with this Agreement and provide for 30 calendar days response by the APPLICANT. If the APPLICANT corrects such non-compliance within said 30 day period, ECOLOGY shall not terminate the Agreement. Except however, that if such non-compliance is due to failure to promptly provide annual payment as required herein, a late penalty of 5% shall be assessed.

II. If non-compliance persists beyond the 30 day notice period, ECOLOGY may initiate termination of the Agreement by providing a ninety (90) calendar day Notice of Intent to Terminate. If the APPLICANT corrects such non-compliance within said 90-day period, ECOLOGY shall not terminate the Agreement. Except however, that the APPLICANT shall be assessed a non-compliance penalty of 5%, said penalty being in addition to any penalty assessed in the 30-day notice period. If non-compliance persists beyond 90 days, ECOLOGY may terminate the Agreement and either cancel the permit or revoke the certificate as appropriate. Such cancellation or revocation shall be made by Departmental Order. In the event of such cancellation or revocation, the APPLICANT agrees to voluntarily abandon the permit or certificate.

In the event of termination by either party, all payments paid in advance for the coming calendar year shall remain with ECOLOGY without refund.

ECOLOGY and the APPLICANT are each responsible for their own respective costs and attorney's fees in connection with this Agreement and any dispute related to the proper interpretation or implementation of

[1] See the Reclamation Contract termination clause.

this Agreement. No damages, direct or indirect, may be awarded to the APPLICANT due to failure of ECOLOGY, or ECOLOGY's officers, agents, or employees, to perform any obligation under this Agreement.

The APPLICANT is not a third party beneficiary of the Reclamation Contract.

IX. GOVERNANCE: This Agreement is entered into pursuant to and under the authority granted by the laws of the state of Washington and any applicable federal laws. The provisions of this Agreement shall be construed to conform to those laws. In the event of an inconsistency in the terms of this Agreement, or between its terms and any applicable statue or rule, the inconsistency shall be resolved by giving precedence in the following order:

- Applicable state and federal statutes and rules;
- Any other provisions of the Agreement, including material incorporated by reference.

X. WAIVER: A failure by either party to exercise its rights under this Agreement shall not preclude that party from subsequent exercise of such rights and shall not constitute a waiver of any other rights under this Agreement unless stated to be such in writing signed by an authorized representative of the party and attached to the original Agreement.

XI. ALL WRITINGS CONTAINED HEREIN: This Agreement contains all the terms and conditions agreed upon by the parties. No other understandings, oral or otherwise, regarding the subject matter of this Agreement shall be deemed to exist or to bind any of the parties hereto.

XII. IN WITNESS WHEREOF, the parties have executed this Agreement

STATE OF WASHINGTON
DEPARTMENT OF ECOLOGY

9/28/12
Derek I. Sandison Date
Director, Office of Columbia River

APPLICANT

8/29/12
Rob Mercer Date
Mercer Canyons, Inc.

Approved as to form only.
Assistant Attorney General

ATTACHMENT A: RECLAMATION CONTRACT

ATTACHMENT B: WATER RIGHT AUTHORIZATION