

**STATE LAND DEPARTMENT
STATE OF ARIZONA**

WATER AGREEMENT

Agreement No. 21-106805

This Agreement between the State Land Department of the State of Arizona, acting through the Arizona State Land Commissioner (hereinafter called the "Department") and

PHELPS DODGE BAGDAD, INC., a Delaware corporation

(hereinafter called "Buyer") is made this 17th day of December, 2002.

The Buyer and the Department hereby agree as follows:

1. That the Department does hereby convey to Buyer the right to withdraw Ground Water using a well located on the lands described in Appendix A attached hereto, (hereinafter called "Premises") for the term and in consideration of rents and/or payments as set forth herein; the Buyer shall comply with provisions of the Groundwater Management Act (if applicable) and other applicable law, with the covenants and conditions contained herein, which Buyer hereby agrees to faithfully keep and perform, and with the terms set forth in the Notice of Sale published on October 10, 2002 in regard to the public auction of water held on December 17, 2002. If there is any conflict or inconsistency between the terms and provisions contained herein and the terms of public auction No. 21-106805, the terms of the public auction shall prevail.

2. **TERM AND AGREEMENT**

From the date hereof and until the 16th day of December, 2012, the Buyer shall have the right to extract, use, store, remove and dispose of ground water extracted using one or more wells located on the Premises, on the terms and conditions stated herein.

3. USE OF PREMISE AND IMPROVEMENTS THEREON

A. The Buyer shall, within 30 days from the date of this Agreement, apply to the Department for the proper surface lease, easement or permit allowing Buyer the right to use as much of the surface of the Premises as is reasonably necessary for the extraction, use, storage, removal and disposition of the water together with the right of ingress to and egress from the Premises across other State lands along designated routes previously approved by the Department and necessary to carry out the purpose of this Agreement. The buyer shall not extract water prior to obtaining the necessary surface lease, easement or permit from the Department, and no one other than the Buyer or its agents, officers and employees, or subcontractors of the Buyer approved by the Department in writing shall have the right to enter upon the Premises to use, extract, store, remove or dispose of the water therefrom. The buyer shall also be responsible for reimbursing any prior lessees for reimbursable improvements subject to Title 37 of the Arizona Revised Statutes.

B. The Buyer shall not, by virtue of this Agreement, be authorized to construct or install on the Premises any reimbursable improvements. Nothing in this provision, however, shall interfere with any rights to reimbursement for improvements which Buyer might have by virtue of its status as a lessee of the Department. Conditions for removal of improvements shall be covered under the surface lease, easement or permit.

C. The Buyer may use, with predetermined rental, any and all improvements existing on the Premises which are owned by the Department. The nature and extent of existing state-owned improvements on the Premises shall be determined by inventories or reports thereof in the files of the Department, including the Department's inspection and reports of the Premises after removal of improvements by a prior lessee, permittee or buyer.

4. ASSIGNMENT

The buyer may assign this Agreement only with the prior written approval of the Department.

5. CONDUCT OF OPERATIONS

The Buyer hereby agrees to conduct its operations on the Premises in accordance with the terms and provisions of the surface lease, easement or permit described in Section 3(A) above, and to protect the Premises and soils thereof. Furthermore, Buyer agrees to fence all dangerous workings and to take such measures as are reasonable to protect livestock, humans and property from harm as a result of the Buyer's use of the Premises.

6. RENTS AND PAYMENTS

A. In addition to the payments hereinafter provided, Buyer agrees to pay the Department annually in advance the sum of \$ N/A for rental of existing state-owned improvements on the Premises as described in Appendix A attached.

B. The Department offered the right to extract ground water from the Premises at public auction on the basis of a minimum advance payment of \$ 5,600.00 per year for the extraction of 80 acre feet of water per year for 10 years, and a minimum payment per acre foot of water as follows:

At the auction, Buyer bid the minimum annual payment of \$ 5,600.00 per year (\$ 70.00 per acre foot) which Buyer agrees to pay annually in advance on the anniversary date of the auction. The buyer paid the first annual minimum payment at the auction.

The Department and the Buyer agree that the advance payments shall be earned upon receipt; although such payments will be credited against payments due from Buyer pursuant to Section 6(B) hereof if the advance payments exceed the amount due from the Buyer pursuant to Section 6 (B) when this Agreement is terminated or expires, Buyer shall not be entitled to any refund or rebate of any portion of such payments. The buyer agrees that the advance payments shall be paid each year regardless of use or removal of water. Non-use of water during any year of this Agreement shall not entitle the Buyer to any credits for any succeeding year.

C. The Buyer has bid and agrees to pay the Department \$ 70.00 per acre foot for each additional acre foot of water withdrawn over the minimum amount. In no event shall the annual withdrawal exceed 645 acre feet.

7. REAPPRAISAL

At its sale option, the Department may increase the amount of the payments required for the rights granted by this Agreement based upon a reappraisal pursuant to Arizona Administrative Code (AAC) Rule 12-5-2007(F) or any applicable successor rule. After the Department has complied with the requirements of AAC 12-5-2007(F) and the administrative decision modifying the appraised value is final, the amounts payable by the Buyer pursuant to Section 6 shall be modified to provide for payment at the reappraised rate and this Agreement shall be deemed to be amended accordingly.

8. RELATED EXPENSES

There shall be a charge to the Buyer to cover contract administration/sales related expenses. This charge will be assessed pursuant to Arizona Administrative Code Rule 12-5-2007(G)(2) or any applicable successor rule.

9. WATER RECORDS METERING AND PRODUCTION REPORTING

A. Prior to the extraction of water, the Buyer shall install a metering device at the well head of each well or at a location other than the well head if approved by the Department. Metering devices must meet the approval of the Department prior to installation, and shall be accessible for inspection by agents, employees or officers of the Department during reasonable hours.

B. The Buyer shall keep accurate books and records showing all water extracted from Premises. The Department shall have the right to examine such books and records of Buyer during reasonable business hours, and Buyer shall maintain all such books and records for one (1) year after termination of this Agreement.

C. On or before the 15th day following each full month of this Agreement, the Buyer will report to the Department the total quantities in gallons or acre feet (325,851 gallons) of water extracted from the Premises during that immediately previous full month; such monthly report shall be made irrespective of the amount of the water use or extraction. At any time the minimum number of acre feet purchased is exceeded, the Department shall compute the payment due from Buyer and such payment shall be due and payable within thirty (30) days of the mailing of the statement by the Department.

D. The continued authorization to extract groundwater is contingent upon the purchaser submitting to the Department biannually, on or before the second anniversary of the date of sale, a Groundwater Level Monitoring Program Report, to include proof satisfactory to the Department, that the hydrologic and other impacts of the withdrawals do not exceed 50 percent of the initial water column height in the pumped wells as described in the supplemental report titled "Proposed Monitoring Program for Evaluation of Aquifer Conditions at Warm Springs and Urle Sites, Bagdad, Arizona: Arizona State Land Department Applications to Auction Water from State Land Nos. 21-106804 and 21-106805," by Errol L. Montgomery and Associates, Inc., dated August 22, 2002. Additionally, if such impacts exceed the 33% trigger criteria contained in the referenced report, the purchaser will, within 180 days, submit documentation to the Department that demonstrates actions designed to minimize such impacts.

10. DISPOSITION OF ADVANCE PAYMENT

If this Agreement is terminated, the Department shall be entitled to retain the entire amount of the advance payment and the Buyer shall not be entitled to any refund thereof. All rights of the Buyer pursuant to this Agreement shall be terminated.

11. WATER QUALITY

The Department makes no guarantee with respect to water quality or the suitability of the water for Buyer's purposes.

12. RIGHT TO LEASE RESERVED TO THE DEPARTMENT

The Department reserves the right to assign, lease and issue permits for the use of the Premises both surface and subsurface to other persons for any uses or purposes not inconsistent with Buyer's rights under this Agreement.

13. SUBJECT TO EMINENT DOMAIN OR CONDEMNATION PROCEEDINGS

If at any time during the duration of this Agreement, the whole or any part of the Premises shall be taken for any quasi-public or public purpose by any person, private or public corporation or by any governmental agency having authority to exercise the power of eminent domain or condemnation proceedings pursuant to any law, general, special or otherwise, this Agreement shall expire on the date when the Premises shall be taken or acquired, and all compensation and damages awarded for rights or interests in the Premises being condemned and all compensation and damages awarded for rights or interests in severance which may accrue to the remaining Premises shall be the sole property of the Department; however, in the event of such taking, advance payments prepared and unused by Buyer shall be returned to the Buyer to the extent, if any, that such taking makes it impossible for Buyer to enjoy the rights hereby purchased.

14. HOLD THE DEPARTMENT HARMLESS

The Buyer agrees to save, hold harmless and indemnify the Department and all of its agencies, officers and employees against any and all claims, costs, damages, expenses or charges arising out of, incidental to, or resulting in any way from Buyer's operations pursuant to or in violation of this Agreement. The buyer shall maintain such insurance as may be required by the Department in connection with Buyer's surface lease, easement or permit as described in Section 3.

15. TERMINATION AND RESTORATION

Upon termination of this Agreement for any reason, Buyer agrees to leave the surface of the Premises in a reasonably safe condition as close to original conditions as possible, in accordance with safety practices customary in the area in which the Premises are located.

Well closures, temporary or permanent abandonment of wells shall comply with rules and regulations established by the Department of Water Resources and any special stipulations agreed to by this Department and Buyer.

16. PAYMENT FOR LOSS OR DAMAGE

The Buyer shall promptly pay the Department (and lessees of the Department where applicable) for any loss to the Department or its lessees caused by the Buyer or by Buyer's servants, agents, employees or contractor to the Premises, its grasses, forage, crops and improvements.

17. TERMINATION BY THE DEPARTMENT

The Department shall have the right to terminate this Agreement upon thirty (30) days prior written notice to Buyer at any time for the failure or neglect of the Buyer to perform any of the provisions hereof. If Buyer fails to make payments when due or to report timely and accurately the Department shall be entitled to terminate this Agreement immediately, without notice.

18. NOTICE OF AUTHORITY TO CANCEL THIS CONTRACT

This contract is subject to cancellation pursuant to A.R.S. § 38-511.

19. ATTORNEYS' FEES AND COST

In the event a dispute between the Department and Buyer results in legal action, the prevailing party in such action shall have the right to recover reasonable attorneys' fees and costs incurred in the proceeding.

20. CROSS-DEFAULT

Any default by Buyer under this Agreement shall constitute an event of default under the Buyer's surface lease, easement or permit authorizing the Buyer's use of the Premises as described in Section 3, and any default in such lease, easement or permit shall be an event of default under this Agreement.

21. WATER RIGHTS

The Department's authorization for the Buyer to extract ground water pursuant to this Agreement, and to devote such water to beneficial use shall not entitle Buyer to assert any continuing right to extract such water, or to any water right separate and apart from the rights of the Department. This Agreement shall not affect any water rights already owned by the Buyer or acquired by the Buyer separately from and independent of this Agreement, and the Department shall not assert any interest in such rights by virtue of this Agreement.

22. OTHER PROVISIONS**ADDITIONAL CONDITIONS**

The Department reserves the right to relinquish to the United States land needed for irrigation works in connection with a government reclamation project and to grant or dispose of rights of way and sites for canals, reservoirs, dams, power or irrigation plants or works, railroads, tramways, transmission lines or any other purpose or use on or over the Premises.

THIS DOCUMENT is submitted for examination and shall have no binding effect on the parties unless and until executed by the Department (after execution by the Buyer), and a fully executed copy is delivered to the Buyer.

IN THE EVENT OF A DISPUTE between the parties to this Agreement, it is agreed to use arbitration to resolve the dispute but only to the extent required by A.R.S. § 12-1518; and, in no event shall arbitration be employed to resolve a dispute which is otherwise subject to administrative review by the Department pursuant to statute or Department Administrative Rule.

STATE OF ARIZONA LAND DEPARTMENT
1616 W. ADAMS
PHOENIX, AZ 85007

RUN DATE: 21-JAN-2003
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PAGE: 001

KE-LEASE#: 021-106805-00-000 APPTYPE: NEW
AMENDMENT#: 0

<u>LAND#</u>	<u>LEGAL DESCRIPTION</u>	<u>AUS</u>	<u>ACREAGE</u>
15.0-N-09.0-W-11-13-031-8003	SESESE	0.00	10.000
TOTALS:		0.00	10.000

IN WITNESS HEREOF, the parties hereto have signed this Water Agreement effective the day and year set forth previously herein.

John C. Galanini 17 MAR 03
Buyer Date

STATE OF ARIZONA,
Arizona State Land Commissioner

Buyer Date

Buyer Date

By Linda J. Walhelm 3/20/03
Date

PO Box 245
Address

(SEAL)

BAGDAD AZ 86321
City State Zip