

MEMORANDUM OF UNDERSTANDING

1. Parties and Agreement. Tejon Ranchcorp ("TR") and the Antelope Valley East Kern Water Agency ("AVEK") shall be the parties ("Parties") to this Memorandum of Understanding and the Parties agree as follows:
2. General Intent and Purpose. TR purchased as a supplemental water asset, and its seller is holding for delivery in 2008, 8,393 acre feet of water ("Supplemental Water"). TR does not need to use the Supplemental Water in 2008, and does not anticipate needing to use the Supplemental Water until 2012 or later. AVEK needs to supplement its water supply in 2008. In an effort to assist in supplementing AVEK's water supply, TR shall transfer the Supplemental Water to AVEK to use in 2008, and AVEK shall return the Supplemental Water to TR, in accordance with the terms of this Memorandum of Understanding.
3. Term. The term of this Memorandum of Understanding shall commence on the Effective Date, defined below, and shall continue until December 31, 2020 unless AVEK requests and TR agrees, to defer the Call and return of the water as under Paragraph 7. Under this condition, the term of this Memorandum of Understanding shall be extended by a number of years equal to the total length of the deferment period(s). The target date for commencement of the term will be September 30, 2008, and that date is defined as the "Effective Date." Delivery of the Supplemental Water shall be completed by December 31, 2008.
4. Delivery Point: Responsibility for Delivery Costs to Delivery Point. TR shall cause the Supplemental Water to be delivered to AVEK at the Tupman Turnout, in Reach 12 of the California Aqueduct, ("Tupman Turnout") no later than the target date of December 31, 2008. TR shall be responsible for the delivery costs to the Tupman Turnout
5. Transfer to AVEK: Responsibility for Delivery Costs to AVEK. AVEK shall cause the Supplemental Water to be delivered from the Tupman Turnout to its service area using its Article 55 conveyance rights under its SWP contract. TR shall reimburse AVEK for 50% of AVEK's project variable costs, including variable and off-aqueduct, as billed to AVEK from DWR, to initially deliver the Supplemental Water to the AVEK service area.
6. Water Credit: Specific Intent. AVEK shall establish a water credit ("Credit") on its books and records in the name of and for the account of TR for the Supplemental Water, adjusted by the applicable Return Ratio. AVEK shall use, as a template for the Credit, the ledger system currently used by the Kern County Water Agency for the Kern Water Bank, or another system approved by TR. It is the Parties' specific intent that the Credit is in addition to, and not in substitute for, any allocation of SWP water from AVEK or water purchased from AVEK for the benefit of TR or its affiliates. AVEK acknowledges that it has the right to "repay" TR only with water, not cash or other consideration, unless otherwise specifically requested by TR and approved by AVEK. The quality of water returned to TR shall be the same as SWP water available in the year it is returned.
7. Return Ratios. At TR's written request, AVEK shall return the Supplemental Water to TR in accordance with the return schedule ("Return Schedule") in Paragraph 8, at the following return ratios ("Return Ratios"):

a. If TR requested return of the Supplemental Water in a wet or dry year (that is any year), the Return Ratio shall be 1.5 to 1, meaning that the total return under this scenario would be 12,589.5 acre feet, except as provided Paragraph 7.b.

b. If TR requested return of the Supplemental Water in a dry year, and AVEK requested, and TR agreed, to defer the Call and return of water until a wet year, the Return Ratio in the wet year shall be 2 to 1, meaning that the total return under this scenario would be 16,786 acre feet.

c. For the purposes of calculation of the Return Ratios, a wet year shall be a year in which the SWP allocation is 51% or more, and a dry year shall be a year in which the SWP allocation is less than 51%. The controlling allocation for the purpose of administering this Memorandum of Understanding shall be the allocation in place on March 1 of each year.

8. Return Schedule: Call by TR. Commencing on January 1, 2012, TR may, but shall not be obligated to, call ("Call") for return of the Supplemental Water according to the following Return Schedule:

a. The maximum Call in any calendar year shall be 20% of the original Credit, as adjusted upward by the applicable Return Ratio at the time of the Call. TR may make only one Call in any calendar year.

b. If the SWP allocation is 51% or more at the time of the Call, TR shall receive 100% of the Call, up to 20% of the original Credit, as adjusted upward by the applicable Return Ratio at the time of the Call.

c. If the SWP allocation is less than 51% at the time of the Call, TR shall receive a percentage of the Call equal to the Call amount times the SWP allocation, up to 20% of the original Credit, as adjusted upward by the applicable Return Ratio at the time of the Call.

d. No matter how many acre feet of water are returned to TR in any calendar year, TR may continue to make Calls, subject to the 20% limitation, until a minimum of 12,589.5 acre feet under Paragraph 7.a, up to a maximum of 16,786 acre feet under Paragraph 7.b, has been returned to TR.

e. As an example only, the year is 2013, it is a wet year, and TR makes its maximum 20% Call. 20% of the original Credit is 1,679 acre feet, and TR gets a 1.5 to 1 Return Ratio, or a return of 2,519 acre feet. If the SWP allocation that year is 51%, TR gets a 100% return, or 2,519 acre feet.

f. As another example only, the year is now 2016, it is a dry year, and TR makes a 15% Call. 15% of the original Credit is 1,259 acre feet, and TR gets a 1.5 to 1 Return Ratio, or a return of 1,889 acre feet. If the SWP allocation that year is 30%, TR gets a 30% return, or 567 acre feet.

g. As a final example only, the year is now 2020, it is another dry year, and TR makes a 10% Call. 10% of the original Credit is 839 acre feet, and TR gets a 1.5 to 1 Return Ratio, or a return of 1,259 acre feet. However, AVEK requests, and TR agrees, to defer the

Call and return of water until a wet year. TR gets a 2 to 1 Return Ratio, or a return of 1,678 acre feet in a subsequent year as a wet year Call.

9. Return Schedule; Put to TR. Notwithstanding any other provision of this Memorandum of Understanding, AVEK may, in its sole discretion, put ("Put"), that is require TR to accept a return of a maximum of 25% of the original 8,393 acre feet, as adjusted upward by the applicable Return Ratio, in any calendar year, commencing on January 1, 2012.
10. Responsibility for Return Delivery Costs. AVEK shall return the 8,393 acre feet, plus appropriate quantities as determined through application of the Return Ratio (a total quantity between 12,589.5 acre feet and 16,786 acre feet) from the Agency's Table A water supply. In each year, AVEK shall be responsible for the cost to return 50% of the water that is a component of the original 8,393 acre feet, and 100% of the cost of water returned based on the appropriate Return Ratio. Tejon shall reimburse AVEK for 50% of the water that is a component of the original 8,393 acre feet. The rate for the Tejon reimbursement shall be the Agency's Water Banking Rate, which is established at the beginning of each calendar year and is based on a projection of State Water Project delivery power costs. For example, the rate for 2008 is \$194.50/acre foot as indicated in Section 12 (c-2) of the Agency's Rules and Regulations for the Distribution of Water.
11. Mediation or Arbitration as Alternative to Litigation. If there is a dispute under this Memorandum of Understanding, the Parties shall make a good faith attempt to resolve the dispute through mediation or arbitration before resorting to litigation. Any mediation or arbitration shall be conducted by three mediators or arbitrators experienced in water use and transfer matters, mutually agreed to by the Parties.
12. Respective Approval by Boards of Directors. This Memorandum of Understanding shall be subject to execution by and delivery to the other Party, following the approval of TR's Board of Directors and the AVEK's Board of Directors. If this Memorandum of Understanding is not approved by both Boards by September 10, 2008, this Memorandum of Understanding shall automatically terminate and be of no further effect, unless a subsequent approval is accepted by both Parties.

The Parties have executed this Memorandum of Understanding to be effective as of September 23, 2008.

TEJON RANCHCORP, a California  
corporation

By *Dennis Altman*

*Vice President*  
Its \_\_\_\_\_

ANTELOPE VALLEY EAST KERN WATER  
AGENCY

By *Andy D. Rutledge*  
*Andy D. Rutledge*