Table of Contents

As filed with the Securities and Exchange Commission on April 1, 2008

Registration No. 333-

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM S-1

REGISTRATION STATEMENT
Under
The Securities Act of 1933

Energy Recovery, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware	3559	01-0616867
(State or Other Jurisdiction of Incorporation or Organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

1908 Doolittle Drive
San Leandro, CA 94577
(510) 483-7370
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

G.G. Pique
President and Chief Executive Officer
1908 Doolittle Drive
San Leandro, CA 94577
(510) 483-7370
(Name, address, including zip code, and telephone number, including area code, of agent for service)

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Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act, as amended, check the following box. ☐

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐	Accelerated filer ☐	Non-accelerated filer ☑ (Do not check if a smaller reporting company)	Smaller reporting company ☐

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Proposed Maximum Aggregate Offering Price(1)(2)	Amount of Registration Fee
Common Stock, $0.001 par value	$175,000,000	$6,877.50

(1) Estimated solely for the purpose of computing the amount of the registration fee pursuant to Rule 457(o) under the Securities Act.
(2) Includes additional shares that the underwriters have the option to purchase.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment that specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to such Section 8(a), may determine.

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchanges Commission is effective. This prospectus is not an offer to sell these securities and we are not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED APRIL 1, 2008

Shares

Energy Recovery, Inc.

Common Stock

This is the initial public offering of our common stock. We are selling shares of common stock, and the selling stockholders named in this prospectus are selling shares of common stock. We will not receive any proceeds from the shares of common stock sold by the selling stockholders. Prior to this offering, there has been no public market for our common stock. The initial public offering price of our common stock is expected to be between $ and $ per share. We intend to apply to list our common stock on the NASDAQ Global Market under the symbol "ERII."

The underwriters have an option to purchase a maximum of additional shares to cover over-allotments of shares.

Investing in our common stock involves risks. See "Risk Factors" beginning on page 7.

	Per Share	Total
Price to Public	$	$
Underwriting Discounts and Commissions	$	$
Proceeds to ERI	$	$
Proceeds to Selling Stockholders	$	$

The underwriters expect to deliver the shares to purchasers on or about , 2008.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

Citi **Credit Suisse**

The date of this prospectus is , 2008

Table of Contents

TABLE OF CONTENTS

You should rely only on the information contained in this document or to which we have referred you. We have not authorized anyone to provide you with information that is different. This document may only be used where it is legal to sell these securities. The information in this document may only be accurate on the date of this document.

Corporate Information

We incorporated in Virginia in April 1992 and reincorporated in Delaware in March 2001. Our principal executive offices are located at 1908 Doolittle Drive, San Leandro, California 94577. Our telephone number is (510) 483-7370. Our website address is www.energyrecovery.com. Information contained on our website is not incorporated by reference into this prospectus, and you should not consider information contained on our website to be part of this prospectus.

"ERI," the ERI logo, "Making Desalination Affordable," "PX Pressure Exchanger," "PX" and other trademarks or service marks of ERI appearing in this prospectus are the property of ERI. This prospectus contains additional trade names, trademarks and service marks of other companies. We do not intend our use or display of other companies' trade names, trademarks or service marks to imply a relationship with, or endorsement or sponsorship of us by, these other companies.

Industry and Market Data

This prospectus includes market and industry data and forecasts that we obtained from internal research, publicly available information and industry publications and surveys. Industry publications and surveys generally state that the information contained therein has been obtained from sources believed to be reliable. Unless otherwise noted, statements as to our market position relative to our competitors are approximated and based on the above-mentioned third-party data and internal analysis and estimates as of the date of this prospectus. Although we believe the industry and market data and statements as to market position to be reliable as of the date of this prospectus, we have not independently verified this information and it could prove inaccurate. Industry and market data could be wrong because of the method by which sources obtained their data and because information cannot always be verified with certainty due to the limits on the availability and reliability of raw data, the voluntary nature of the data gathering process and other limitations and uncertainties. In addition, we do not know all of the assumptions regarding general economic conditions or growth that were used in preparing the forecasts from sources cited herein.

Dealer Prospectus Delivery Obligation

Until , 2008 (25 days after the date of this prospectus) all dealers that effect transactions in these securities, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealer's obligation to deliver a prospectus when acting as an underwriter and with respect to unsold allotments or subscriptions.

PROSPECTUS SUMMARY

This summary highlights information contained elsewhere in this prospectus. You should read the following summary together with the more detailed information appearing in this prospectus, including our consolidated financial statements and the related notes, and our risk factors beginning on page 7, before deciding whether to purchase shares of our common stock. Unless the context otherwise requires, the terms "ERI," "the Company," "we," "us" and "our" in this prospectus refer to Energy Recovery, Inc. and its consolidated subsidiaries.

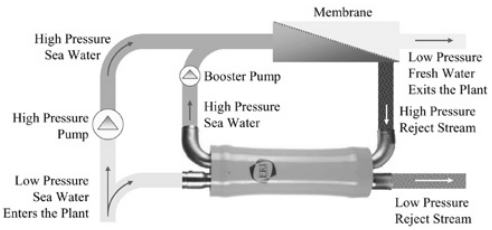
Our Business

We are a leading global developer and manufacturer of highly efficient energy recovery devices utilized in the rapidly growing water desalination industry. We operate primarily in the sea water reverse osmosis, or SWRO, segment of the industry. In the SWRO process, high pressure is used to drive sea water through filtering membranes to produce fresh water. Energy recovery devices have increased the cost-competitiveness of SWRO desalination compared to other means of fresh water supply and have enabled the ongoing rapid growth of the SWRO segment of the desalination industry worldwide. Our primary product, the PX Pressure Exchanger, or PX, helps optimize the energy intensive SWRO process by recapturing and recycling up to 98% of the energy in the high pressure reject stream, thereby reducing SWRO energy consumption by an estimated 60% as compared to the same process without any energy recovery devices.

We believe that the proven benefits of our proprietary technology have made us a leader in the SWRO energy recovery market due to the following:

- up to 98% energy recovery efficiency;
- proprietary design employing only one moving part;
- corrosion resistant, highly durable ceramic composition;
- smaller footprint, modular design and system redundancy; and
- lower life cycle cost versus competitors.

The PX device uses a corrosion resistant ceramic rotor to recapture and recycle the energy that otherwise would have been lost in the reject stream of the SWRO process and applies it to the low pressure incoming sea water. The PX device has been installed in over 300 desalination plants and specified in plant designs by over 60 original equipment manufacturers, or OEMs, and engineering, procurement and construction, or EPC, firms worldwide. We estimate that PX devices shipped as of December 31, 2007 reduce electricity consumption in SWRO desalination plants in the aggregate by approximately 300 megawatts relative to comparable plants with no energy recovery devices. Assuming a rate of $0.08 per kilowatt-hour, the deployment of PX devices in these plants would result in annual electricity cost savings of approximately $210 million in the aggregate, which would equate to a reduction in carbon dioxide emissions of approximately 1.5 million tons per year.



As of December 31, 2007, we had shipped over 4,000 PX devices to desalination plants worldwide, including in China, Europe, India, Australia, Africa, the Middle East, North America and the Caribbean. Our net revenue grew from $4.0 million in 2003 to $35.4 million in 2007.

We design, manufacture and sell various models of the PX device to serve a range of SWRO process flow rates for various plant designs and sizes. With respect to large desalination plants (greater than 50,000 cubic meters, or 13.2 million gallons, per day capacity), we sell our products to international EPCs, and with respect to smaller desalination facilities (fewer than 50,000 cubic meters per day capacity) we sell our products to OEMs for installation in hotels, power plants and municipal facilities. Our successful market penetration has resulted in a rapidly increasing installed base of PX devices globally, which we expect to lead to aftermarket part replacement and service opportunities. We also manufacture a line of booster pumps for use in conjunction with some models of the PX device.

Our research, development and manufacturing facility is located in the San Francisco Bay technology corridor, and we have direct sales offices and technical support centers in many key desalination markets, including Madrid, Dubai, Shanghai and Fort Lauderdale.

Industry Opportunity

The demand for fresh water continues to grow, driven by the need for drinking water to satisfy the world's growing population, changing weather patterns, an increasing need for water for agriculture and industry and the concentration of populations in urban areas that lack sufficient fresh water resources. The United Nations Population Fund expects the global consumption of water to double every 20 years. A study conducted by the International Water Management Institute projects that by 2025, 33% of the population of the developing world will face severe water shortages. The uneven geographic distribution of fresh water supplies compounds this problem.

The two basic processes used to desalinate sea water are thermal, or distillation, and more recently, SWRO. The most significant operating cost component for either process is energy consumption. Thermal desalination technology is highly energy inefficient and is mainly used in the Middle East where energy costs are low. Until approximately 15 years ago SWRO was also energy inefficient, in part because of the loss of energy associated with the high-pressure reject stream. Today, however, the energy cost of the SWRO process is 50% less than that of the traditional thermal desalination process due to the incorporation of energy recovery devices, including our PX device, and improved membranes.

The significant reduction in operating costs related to energy has made the SWRO desalination industry in which we compete the fastest growing segment of the desalination industry. According to Global Water Intelligence, or GWI, due to the use of SWRO technology, the cost of producing a cubic meter of fresh water from sea water, which averaged approximately $10 per cubic meter in the mid-1960's, had dropped to as low as $0.46 per cubic meter by 2005. As a result, the share of total new contracted sea water desalination capacity using SWRO has increased from 42% in 1999 to approximately 71% in 2006.

Desalination has become an economically attractive alternative in many coastal regions or other locations near a salt water source where fresh water sources are becoming increasingly stressed. According to the February/March 2008 issue of International Desalination & Water Reuse Quarterly, there are approximately 14,000 desalination plants worldwide. GWI estimates that as of December 31, 2005, there were 39.9 million cubic meters per day of installed capacity, and that the growth in the market for new total desalination capacity should increase by approximately 13% per year from 2005 to 2015. We expect SWRO's share of new total desalination capacity to grow in excess of the overall industry growth rate, particularly due to higher energy costs experienced over the past few years.

We are active in the fastest growing markets for desalination, which include China, Algeria, Australia and India. According to GWI projections, these markets are expected to grow at least 20% per year from 2005 to 2015. Other significant markets include the Middle East, North America, the Caribbean and Europe. Additionally, our PX device is currently specified in the pilot test facility for the proposed Carlsbad, California plant, which, if constructed, is expected to be the largest SWRO plant in the United States.

Our Strengths

- ***Unique and efficient product.*** We manufacture the only commercially available rotary isobaric energy recovery device, which we believe is more effective at recovering and recycling energy than any other commercially available energy recovery device. The PX device incorporates highly-engineered corrosion resistant ceramic parts that require minimal maintenance, and a modular design that allows for system redundancy resulting in minimal plant shutdowns. Our rotary device has only one moving part and a continuous flow design, which complements the continuous flow of the SWRO process. We believe these unique benefits lead to lower life cycle costs than competing products.

- ***Leading position in a rapidly growing industry.*** The combination of decreasing fresh water supplies, increasing fresh water demand and declining SWRO desalination costs is driving growth in the SWRO desalination industry. We believe we are the largest global supplier of energy recovery devices for SWRO, the fastest growing segment of the desalination market. For example, in the last five years we believe that our PX product was selected for a significant majority of new SWRO plants commissioned in China, one of the fastest growing desalination markets.
- ***Rapid growth.*** Our net revenue increased from $4.0 million in 2003 to $35.4 million in 2007, representing a compound annual growth rate of 72%, driven by the rapid growth of the SWRO desalination industry and our increased penetration of this market. Our sales growth has enabled us to leverage our existing manufacturing cost base in order to achieve cost synergies and improved utilization, and to develop new products to provide additional cost and performance advantages.
- ***High barriers to entry.*** Historically, there has been a slow adoption rate for new technologies in the desalination industry. We have spent the last 11 years penetrating the market and establishing our company and products with major industry participants. We also have U.S. and international patents covering specific design features of the PX device, and have developed significant know-how related to ceramic processing methods essential to the manufacturing, reliability and performance of the PX device.
- ***Diversified international blue chip customer base.*** Currently, most of our revenue is generated by sales to large EPCs. As of December 31, 2007, we were specified in plant designs by over 60 OEMs and EPCs worldwide and have sold PX devices to approximately 250 other customers, including small and mid-tier OEMs, hotel operators, power plants and municipalities.
- ***Strong, experienced management team.*** Our senior management team has significant industry experience in the design, construction and operation of SWRO desalination plants and the filtration industry. Our chief executive officer, G.G. Pique, joined us in 2000 after serving for seven years as the group vice president Latin America of US Filter Corporation (subsequently acquired by Vivendi) and has over 30 years of experience in the water treatment industry.

Our Strategy

- ***Increase market penetration.*** We actively work with EPCs and OEMs to specify the PX device in the designs of their SWRO desalination plants. To further our market penetration, we are also expanding our existing sales channels through new strategic hires and by increasing our product offerings, and are continuing to increase the awareness of our technology through technical papers, trade shows, industry publications and trade association memberships.
- ***Continue to broaden our product portfolio.*** We are developing new products that we expect will continue to grow our market share and meet the increasing demands of our clients. As the SWRO market moves towards increasingly larger desalination plants, we are developing products such as the PX-1200 Titan, which are designed to address these larger volume plants. For customers who are more sensitive to up-front costs and who operate smaller plants, we are developing the Comp PX. We also intend to expand our product portfolio to include additional circulation/booster pumps and a bundled, turnkey energy recovery system solution that would include both a PX device and pump.
- ***Increase our aftermarket sales.*** Over time, components of our PX device will need to be repaired or replaced. Thus, as our installed base of PX devices ages and the number of installed units increases, we expect aftermarket sales of replacement PX parts and services to increase.
- ***Capitalize on growth opportunities in alternative power and other emerging sectors.*** We are diversifying our energy recovery offerings to capitalize on growth opportunities in emerging sectors. For example, osmotic power generation will utilize a process similar to that of SWRO and is a clean, alternate source of power currently under development. We are currently in discussions with a European utility company that is designing an osmotic power pilot test facility that may use our PX technology. In addition, our PX device could potentially be applied in any process that has a high-pressure waste stream.

Risk Factors

You should carefully consider the risks described under “Risk Factors” and elsewhere in this prospectus. These risks could materially and adversely impact our business, financial condition, operating results and cash flow, which could cause the trading price of our common stock to decline and could result in a partial or total loss of your investment.

THE OFFERING

Common stock offered by ERI	shares
Common stock offered by the selling stockholders	shares
Common stock to be outstanding after this offering	shares
Use of proceeds by us	We intend to use the net proceeds to us of $ million from this offering for working capital and other general corporate purposes. We may also use a portion of the net proceeds to acquire other businesses, products or technologies. However, we do not have agreements or commitments for any specific acquisitions at this time.
Risk factors	You should read the "Risk Factors" section of this prospectus for a discussion of factors that you should consider carefully before deciding to invest in shares of our common stock.
Proposed NASDAQ Global Market symbol	ERII

The number of shares of our common stock to be outstanding after this offering is based on 39,777,446 shares of our common stock outstanding as of December 31, 2007, and excludes:

- 1,280,608 shares of common stock issuable upon exercise of options outstanding as of December 31, 2007, at a weighted average exercise price of $2.38 per share;
- 2,074,122 shares of common stock issuable upon the exercise of warrants outstanding as of December 31, 2007, at a weighted average exercise price of $0.52 per share;
- 56,879 shares of common stock that have been exercised pursuant to options but not yet vested as of December 31, 2007;
- 5,625 shares of common stock reserved as of December 31, 2007 for future grant under our 2002 Stock Option/Stock Issuance Plan;
- 8,709 shares of common stock reserved as of December 31, 2007 for future grant under our 2004 Stock Option/Stock Issuance Plan;
- 39,017 shares of common stock reserved as of December 31, 2007 for future grant under our 2006 Stock Option/Stock Issuance Plan; and
- 1,000,000 shares of common stock reserved for future issuance under our 2008 Equity Incentive Plan which will become effective on the date of the completion of this offering.

Unless otherwise indicated, this prospectus reflects and assumes the following:

- the filing of our amended and restated certificate of incorporation immediately prior to the completion of this offering; and
- no exercise by the underwriters of their option to purchase additional shares.

SUMMARY CONSOLIDATED FINANCIAL DATA

The following tables summarize the consolidated financial data for our business. You should read this summary consolidated financial data in conjunction with the sections titled "Selected Consolidated Financial Data" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes, all included elsewhere in this prospectus. The summary financial data in this section is not intended to replace the consolidated financial statements and is qualified in its entirety by the consolidated financial statements and related notes included in this prospectus. The summary consolidated statements of operations data for each of the three years in the periods ended December 31, 2007, 2006 and 2005 is derived from our audited consolidated financial statements and related notes included elsewhere in this prospectus. Our historical results are not necessarily indicative of the results that should be expected in the future.

	Years ended December 31,		
	2007(1)	2006(1)	2005
	(in thousands, except per share data)		
Consolidated Statement of Operations Data:			
Net revenue	$ 35,414	$ 20,058	$ 10,689
Cost of revenue(2)	14,852	8,131	4,685
Gross profit	20,562	11,927	6,004
Operating expenses:			
Sales and marketing(2)	5,230	3,648	1,779
General and administrative(2)	4,299	3,372	2,458
Research and development(2)	1,705	1,267	630
Total operating expenses	11,234	8,287	4,867
Income from operations	9,328	3,640	1,137
Other income (expense):			
Interest expense	(105)	(77)	(216)
Interest and other income	517	58	35
Income before provision for income taxes	9,740	3,621	956
Provision for income taxes	3,947	1,239	62
Net income	$ 5,793	$ 2,382	$ 894
Earnings per share—basic	$ 0.15	$ 0.06	$ 0.02
Earnings per share—diluted	$ 0.14	$ 0.06	$ 0.02
Number of shares used in per share calculations:			
Basic	39,060	38,018	36,790
Diluted	41,433	40,244	38,454

	As of December 31, 2007	
	Actual	As Adjusted(3)
	(in thousands)	
Consolidated Balance Sheet Data:		
Cash, cash equivalents and short-term investments	$ 240	
Total assets	27,304	
Long-term liabilities	620	
Total liabilities	7,243	
Total stockholders' equity	20,061	

(1) Effective January 1, 2006, we adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, or SFAS 123(R), using the prospective transition method, which requires the application of the provisions of SFAS 123(R) only to share-based payment awards granted, modified, repurchased or cancelled on or after the modification date. Under this method, we recognize stock-based compensation expense for all share-based payment awards granted after December 31, 2005 in accordance with SFAS 123(R).

(2) Includes employee stock-based compensation as follows:

	Years ended December 31,		
	2007	2006	2005
		(in thousands)	
Cost of revenue	$ 117	$ 143	$ 88
Sales and marketing	349	310	86
General and administrative	383	425	731
Research and development	159	183	98
Total stock-based compensation	$ 1,008	$ 1,061	$ 1,003

(3) As adjusted to reflect the issuance of shares of common stock in this offering at an assumed initial public offering price of $ per share, which is the mid-point of the price range listed on the cover page of this prospectus. Each $1.00 increase or decrease in the assumed initial public offering price of $ per share would increase or decrease, as applicable, the amount of cash, cash equivalents and short-term investments, total assets and total stockholders' equity by approximately $ million, assuming the number of shares offered by us, as set forth on the cover page of this prospectus, remains the same and after deducting the underwriting discounts and commissions and estimated offering expenses payable by us.

RISK FACTORS

Investing in our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below before making a decision to buy our common stock. If any of the following risks materializes, our business, financial condition and results of operations could be harmed. Consequently, the trading price of our common stock could decline, and you may lose all or part of your investment. Before deciding to purchase any shares of our common stock, you should also refer to the other information contained in this prospectus, including "Forward-Looking Statements" and our consolidated financial statements and the related notes.

Risks Related to Our Business and Industry

We have relied and expect to continue to rely on sales of our PX devices for almost all of our revenue and a decline in sales of these products will cause our revenue to decline.

Our primary product is the PX device, and sales of our PX device historically have accounted for almost 100% of our revenue. While we sell a variety of models of the PX device depending on the design of the desalination plant and its desired output, all of our models rely on the same basic technology we have developed over the past 11 years. We expect that the revenue from our PX devices will continue to account for most of our revenue for the foreseeable future. Any factors adversely affecting the demand for the PX device, including competition, customer spending and industry regulations, would cause a significant decline in our revenue. Some of the factors that may affect sales of our PX device may be out of our control.

We depend on the construction of new desalination plants for revenue, and as a result, our operating results have experienced, and may continue to experience, significant variability due to volatility in capital spending and other factors affecting the water desalination industry.

The demand for our products may decrease if the construction of desalination plants declines. We derive substantially all of our revenue from the sale of products and services, directly or indirectly, to the municipal water supply, hotel and resort, and agricultural industries. Construction of desalination plants and subsequent installation of our products may be deferred or cancelled as a result of many factors, including changing governmental regulations, energy costs and reduced energy conservation capital spending. For instance, desalination projects on islands are often delayed due to unpredictable weather patterns. In addition, a significant amount of revenue generated by our original equipment manufacturer, or OEM, customers is dependent on long-term relationships, which are not always supported by long-term contracts. This revenue is particularly susceptible to variability based on changes in the spending patterns of such OEM customers. We have experienced and may in the future experience significant variability in our revenue, on both an annual and a quarterly basis, as a result of these factors. Pronounced variability or an extended period of reduction in spending by our customers and construction of desalination plants could negatively impact our business and make it difficult for us to accurately forecast our future sales, which could lead to increased spending by us that is not matched with equivalent or higher revenue.

New planned sea water reverse osmosis, or SWRO, projects can be cancelled and/or delayed, and cancellations and/or delays may negatively impact our revenue.

Due to delays in, or failure to obtain the approval of or permitting for, plant construction because of political factors, adverse financing conditions or other factors, especially in countries with political unrest, planned SWRO projects can be cancelled or delayed. Even though we may have a signed contract to produce a certain number of PX devices by a certain date, if a customer requests a delay of shipment and we accordingly delay shipment of our PX devices, our results of operations and revenue will be negatively impacted.

We rely on a limited number of engineering, procurement and construction, or EPC, customers for a large portion of our revenue. If our EPC customers cancel their commitments or do not purchase our products in connection with future projects, our revenue could significantly decrease, which would adversely affect our financial condition and future growth.

A limited number of our EPC customers accounts for a substantial portion of our net revenue. In 2007, three EPC customers, including their affiliated entities, accounted for 56% of our net revenue, and in 2006, two EPC customers, including their affiliated entities, accounted for 29% of our net revenue. Specifically, Acciona Water, Geida and its affiliated entities and Doosan Heavy Industries represented approximately 20%, 23% and 13% of our net revenue in 2007, respectively, and GE Ionics and Geida and its affiliated entities accounted for approximately 18% and 11% of our net revenue in 2006, respectively. We do not have long-term contracts with our EPC customers and instead sell to them on a

purchase order basis or under individual stand alone contracts. If our EPC customers reduce their purchases, our projected revenue will significantly decrease, which will adversely affect our financial condition and future growth. If one of our EPC customers delays or cancels one or more of its projects or if it fails to pay amounts due to us or delays its payments, our revenue or operating results could be negatively affected. There is a limited number of EPCs who are involved in the desalination industry. Thus, if one of our EPC customers decides not to continue to use our energy recovery devices in its future projects, we may not be able replace such a lost customer with another EPC customer and our net revenue would be negatively affected.

Our operating results may fluctuate significantly, which makes our future operating results difficult to predict and could cause our operating results to fall below expectations or our guidance.

Our operating results may fluctuate due to a variety of factors, many of which are outside of our control. Due to the fact that a single order for our PX devices for a particular desalination plant may represent significant revenue, we have experienced significant fluctuations in revenue from quarter to quarter, and we expect such fluctuations to continue. As a result, comparing our operating results on a period-to-period basis may not be meaningful. You should not rely on our past results as an indication of our future performance. If our revenue or operating results fall below the expectations of investors or securities analysts or below any guidance we may provide to the market, the price of our common stock would likely decline substantially.

In addition, factors that may affect our operating results include, among others:

- fluctuations in demand, adoption, sales cycles and pricing levels for our products and services;
- the cyclical nature of SWRO plant construction, which typically reflects a seasonal increase in shipments of PX devices in the fourth quarter;
- changes in customers' budgets for desalination plants and the timing of their purchasing decisions;
- delays or postponements in the construction of desalination plants;
- our ability to develop, introduce and ship in a timely manner new products and product enhancements that meet customer demand, certification requirements and technical requirements;
- the ability of our customers to obtain other key components of a plant such as high pressure pumps or membranes;
- our ability to implement scalable internal systems for reporting, order processing, product delivery, purchasing, billing and general accounting, among other functions;
- unpredictability of governmental regulations and political decision-making as to the approval or building of a desalination plant;
- our ability to control costs, including our operating expenses;
- our ability to purchase key PX components, principally ceramics, from third party suppliers;
- our ability to compete against other companies that offer energy recovery solutions;
- our ability to attract and retain highly skilled employees, particularly those with relevant industry experience; and
- general economic conditions in our domestic and international markets.

If we are unable to collect unbilled receivables, our operating results will be adversely affected.

Our customer contracts generally contain holdback provisions pursuant to which the final installments to be paid under such sales contracts are due up to 36 months after the product has been shipped to the customer and revenue has been recognized. Typically, between 10 and 20 percent, and in some instances up to 30 percent, of the revenue we receive pursuant to our customer contracts are subject to such holdback provisions and are accounted for as unbilled receivables until we deliver invoices for payment. As of December 31, 2007, we had approximately $1.7 million of current unbilled receivables and approximately $2.3 million of non-current unbilled receivables. If we are unable to invoice and collect, or if our customers fail to make payments due under our sales contracts, our results of operations will be adversely affected.

If we lose key personnel upon whom we are dependent, we may not be able to execute our strategies. Our ability to increase our revenue will depend on hiring highly skilled professionals with industry-specific experience, particularly given the unique and complex nature of our devices.

Given the specialized nature of our business, we must hire highly skilled professionals with industry-specific experience. Our ability to successfully grow depends on recruiting skilled and experienced employees. We often compete with larger, better known companies for talented employees. Also, retention of key employees, such as our chief executive officer, who has over 30 years of experience in the water treatment industry, is vital to the successful execution of our growth strategies. Our failure to retain existing or attract future key personnel could harm our business.

The success of our business depends in part on our ability to develop new products and services and increase the functionality of our current products.

Since 2004, we have invested over $3 million in research and development costs associated with our PX products. From time to time, our customers have expressed a need for greater processing efficiency. In response, and as part of our strategy to enhance our energy recovery solutions and grow our business, we plan to continue to make substantial investments in the research and development of new technologies. For instance, we are in the process of developing the PX-1200 Titan as a product for use in increasingly larger desalination plants. While this product has the potential to provide greater capacity, it will be priced higher and may not perform as well as our other PX devices. It is possible that potential customers may not accept the new pricing structure. It is also possible that the release of this product may be delayed if testing reveals unexpected flaws. Our future success will depend in part on our ability to continue to design and manufacture new products, to enhance our existing products and to provide new value-added services. We may experience unforeseen problems in the performance of our existing and new technologies or products. Furthermore, we may not achieve market acceptance of our new products and solutions. If we are unable to develop competitive new products, or if the market does not accept such products, our business and results of operations will be adversely affected.

Our revenue and growth model depend upon the continued viability and growth of the SWRO industry using current technology.

If there is a downturn in the SWRO industry, our sales would be directly and adversely impacted. In addition, changes in SWRO technology could reduce the demand for our devices. For example, a reduction in the operating pressure used in SWRO plants could reduce the need for and viability of our energy recovery devices. Membrane manufacturers are actively working on lower pressure membranes for SWRO that could potentially be used on a large scale to desalinate sea water at a much lower pressure than is currently necessary. Similarly, an increase in the recovery rate would reduce the number of energy recovery devices required and would reduce the demand for our product. Any of these changes would adversely impact our revenue and growth.

The durable nature of the PX device may reduce potential aftermarket revenue opportunities.

Our PX devices utilize ceramic components that have to date demonstrated high durability, high corrosion resistance and long life in SWRO applications. Because most of our PX devices have only been installed for several years, it is difficult to accurately predict their performance or endurance over a longer period of time. Accordingly, our value proposition to customers may not be fulfilled and our opportunity to sell replacement components or units may be limited.

Our sales cycle can be long and unpredictable, and our sales efforts require considerable time and expense. As a result, our sales are difficult to predict and may vary substantially from quarter to quarter, which may cause our operating results to fluctuate.

Our sales efforts involve substantial education of our current and prospective customers about the use and benefits of our PX products. This education process can be extremely time consuming and typically involves a significant product evaluation process. While the sales cycle for our OEM customers, who are involved with smaller desalination plants, averages one to three months, the average sales cycle for our international EPC customers, who are involved with larger desalination plants, ranges from six to 16 months and has, in some cases, extended up to 36 months. Most of our EPC customers are located internationally or are themselves governmental entities. In addition, these customers generally must make a significant commitment of resources to test and evaluate our technologies. As a result, our sales process involving these customers is often subject to delays associated with lengthy approval processes that typically accompany the design, testing and adoption of new, technologically complex products. This long sales cycle makes quarter-by-quarter revenue predictions difficult and results in our investing significant resources well in advance of orders for our products.

Since a significant portion of our annual sales typically occurs during the fourth quarter, any delays could affect our annual revenue and operating results.

A significant portion of our annual sales typically occurs during the fourth quarter, which we believe generally reflects EPC customer buying patterns. Any delays or cancellation of expected sales during the fourth quarter would reduce our quarterly and annual revenue from what we anticipated. Such a reduction might cause our quarterly and annual revenue or quarterly and annual operating results to fall below the expectations of investors or securities analysts or below any guidance we may provide to the market, causing the price of our common stock to decline.

We depend on three vendors for our supply of ceramics, which is a key component of our products. If any of our ceramics vendors cancels its commitments or is unable to meet our demand and/or requirements, our business could be harmed.

We rely on a limited number of vendors to produce the ceramics used in our products. For the years ended December 31, 2007, 2006 and 2005, our three ceramics suppliers represented approximately 66%, 71% and 62%, respectively, of our total purchases. From time to time our demand has grown faster than the supply capabilities of these vendors. If any of our suppliers were to cancel or materially change its commitment with us or fail to meet the quality or delivery requirements needed to satisfy customer orders for our products, we could lose customer orders, be unable to develop or sell our products cost-effectively or on a timely basis, if at all, and have significantly decreased revenue, which would harm our business, operating results and financial condition. We are currently in the process of qualifying a fourth supplier of ceramics. However, our qualification process is rigorous and there is no assurance that such additional supplier will be approved as a qualifying supplier. If we are unable to qualify this additional supplier, we may be exposed to increased risk of supply chain disruption and capacity shortages.

We depend on a single supplier for our supply of stainless steel castings. If our supplier is not able to meet our demand and/or requirements, it could harm our business.

We rely on a single foundry to produce all of our stainless steel castings for use in our PX products. Our reliance on a single manufacturer of stainless steel castings involves a number of significant risks, including reduced control over delivery schedules, quality assurance, manufacturing yields, production costs and lack of guaranteed production capacity or product supply. We do not have a long term supply agreement with our supplier and instead secure manufacturing availability on a purchase order basis. Our supplier has no obligation to supply products to us for any specific period, in any specific quantity or at any specific price, except as set forth in a particular purchase order. Our requirements represent a small portion of the total production capacities of our supplier and our supplier may reallocate capacity to other customers, even during periods of high demand for our products. We have in the past experienced and may in the future experience quality control issues and delivery delays with our supplier due to factors such as high industry demand or the inability of our vendor to consistently meet our quality or delivery requirements. If our supplier were to cancel or materially change its commitment with us or fail to meet the quality or delivery requirements needed to satisfy customer orders for our products, we could lose time-sensitive customer orders, be unable to develop or sell our products cost-effectively or on a timely basis, if at all, and have significantly decreased revenue, which would harm our business, operating results and financial condition. We may qualify additional suppliers in the future which would require time and resources. If we do not qualify additional suppliers, we may be exposed to increased risk of capacity shortages due to our complete dependence on our current supplier.

We face competition from a number of companies that offers competing energy recovery solutions. If any of these companies produces superior technology or offers more cost effective products, our competitive position in the market could be harmed and our profits may decline.

The market for energy recovery devices for desalination plants is competitive and continually evolving. The PX device competes with slow cycle isobarics, Pelton wheels and hydraulic turbochargers. Our three primary competitors are Calder AG, Fluid Equipment Development Company and Pump Engineering Incorporated. We expect competition to persist and intensify as the desalination market opportunity grows. Many of our current and potential competitors may have significantly greater financial, technical, marketing and other resources than we do and may be able to devote greater resources to the development, promotion, sale and support of their products. Also, our competitors may have more extensive customer bases and broader customer relationships than we do, including long-standing relationships or exclusive contracts with our current or potential customers. For instance, we have had difficulties penetrating some of the Caribbean markets because Consolidated Water Co. Ltd., a major builder of SWRO desalination plants in that area, has an exclusive license with Calder AG to use Calder's technology. In addition, these companies may have longer operating histories and greater name recognition than we do. Our competitors may be in a stronger position to respond quickly to new technologies and may be able to market and sell their products more effectively. Moreover, if one or more of our competitors were to merge

or partner with another of our competitors or with current or potential customers, the change in the competitive landscape could adversely affect our ability to compete effectively.

We are subject to risks related to product defects, which could lead to warranty claims in excess of our warranty provisions or result in a large number of warranty claims in any given year.

We warrant our products for up to five years. We test our products in our manufacturing facilities through a variety of means. However, there can be no assurance that our testing will reveal latent defects in our products, which may not become apparent until after the products have been sold into the market. Accordingly, there is a risk that warranty claims may be filed due to product defects. We may incur additional operating expenses if our warranty provisions do not reflect the actual cost of resolving issues related to defects in our products. If these additional expenses are significant, they could adversely affect our business, financial condition and results of operations. While the number of warranty claims has not been significant to date, we are in the initial stages of offering such warranties to our customers. Accordingly, we cannot quantify the error rate of our products and cannot assure that a large number of warranty claims will not be filed in a given year. As a result, our operating expenses may increase if a large number of warranty claims are filed in any specific year, particularly towards the end of any given warranty period.

If we are unable to protect or enforce our intellectual property rights, our competitive position could be harmed and we could be required to incur significant expenses to enforce our rights.

We depend on our ability to protect our proprietary technology. We rely on trade secrets, patent, copyright and trademark laws and confidentiality agreements with employees and third parties, all of which offer only limited protection. We hold five United States patents and nine counterpart international patents relating to specific proprietary design features of our PX technology. The terms of these patents will begin to expire in 2011, at which time we could become more vulnerable to increased competition. In addition, we have applied for two new United States patents and 14 international counterpart patents covering our current and anticipated future PX designs. We do not hold patents in many of the countries into which we sell our PX devices, including Saudi Arabia, Algeria and China, and accordingly, the protection of our intellectual property in those countries may be limited. We also do not know whether any of our pending patent applications will result in the issuance of patents or whether the examination process will require us to narrow our claims, and even if patents are issued, they may be contested, circumvented or invalidated. Moreover, while we believe our remaining issued patents are essential to the protection of the PX technology, the rights granted under any of our issued patents or patents that may be issued in the future may not provide us with proprietary protection or competitive advantages, and, as with any technology, competitors may be able to develop similar or superior technologies to our own now or in the future. In addition, our granted patents may not prevent misappropriation of our technology, particularly in foreign countries where intellectual property laws may not protect our proprietary rights as fully as those in the United States. This may render our patents impaired or useless and ultimately expose us to currently unanticipated competition. Protecting against the unauthorized use of our products, trademarks and other proprietary rights is expensive, difficult and, in some cases, impossible. Litigation may be necessary in the future to enforce or defend our intellectual property rights or to determine the validity and scope of the proprietary rights of others. This litigation could result in substantial costs and diversion of management resources, either of which could harm our business.

Claims by others that we infringe their proprietary rights could harm our business.

Third parties could claim that our technology infringes their proprietary rights. In addition, we may be contacted by third parties suggesting that we obtain a license to certain of their intellectual property rights they may believe we are infringing. We expect that infringement claims against us may increase as the number of products and competitors in our market increases and overlaps occur. In addition, to the extent that we gain greater visibility, we believe that we will face a higher risk of being the subject of intellectual property infringement claims. Any claim of infringement by a third party, even those without merit, could cause us to incur substantial costs defending against the claim, and could distract our management from our business. Furthermore, a party making such a claim, if successful, could secure a judgment that requires us to pay substantial damages. A judgment against us could also include an injunction or other court order that could prevent us from offering our products. In addition, we might be required to seek a license for the use of such intellectual property, which may not be available on commercially reasonable terms, or at all. Alternatively, we may be required to develop non-infringing technology, which could require significant effort and expense and may ultimately not be successful. Any of these events could seriously harm our business. Third parties may also assert infringement claims against our customers and OEMs. Because we generally indemnify our customers and OEMs if our products infringe the proprietary rights of third parties, any such claims would require us to initiate or defend protracted and costly litigation on their behalf, regardless of the merits of these claims. If any of these claims succeeds, we may be forced to pay damages on behalf of our customers and OEMs.

If we fail to expand our manufacturing facilities to meet our future growth, our operating results could be adversely affected.

Our existing manufacturing facilities are capable of meeting current demand and demand for the foreseeable future. However, the future growth of our business depends on our ability to successfully expand our manufacturing, research and development and technical testing facilities. Larger products currently under development will require the design and construction of new manufacturing capacity. We intend to add new facilities or expand existing facilities as the demand for our devices increases. However, we cannot ensure that suitable additional or substitute space will be available to accommodate any such expansion of our operations.

If we need additional capital to fund future growth, it may not be available on favorable terms, or at all.

We have historically relied on outside financing to fund our operations, capital expenditures and expansion. We may require additional capital from equity or debt financing in the future to fund our operations, or respond to competitive pressures or strategic opportunities. We may not be able to secure such additional financing on favorable terms, or at all. The terms of additional financing may place limits on our financial and operating flexibility. If we raise additional funds through further issuances of equity, convertible debt securities or other securities convertible into equity, our existing stockholders could suffer significant dilution in their percentage ownership of our company, and any new securities we issue could have rights, preferences or privileges senior to those of existing or future holders of our common stock, including shares of common stock sold in this offering. If we are unable to obtain necessary financing on terms satisfactory to us, if and when we require it, our ability to grow or support our business and to respond to business challenges could be significantly limited.

If foreign and local governments no longer subsidize or are willing to engage in the construction and maintenance of desalination plants and projects, the demand for our products would decline and adversely affect our business.

Our products are used in SWRO desalination plants which are often times constructed and maintained through government subsidies. The rate of construction of desalination plants depends on each government's willingness and ability to allocate funds for such projects. For instance, some desalination projects in the Middle East and North Africa are funded by budget surpluses driven by high crude oil and natural gas prices. If governments divert funds allocated for such projects to other projects or do not have budget surpluses, the demand for our products could decline and negatively affect our revenue base, which could harm the overall profitability of our business.

In addition, various water management agencies could alter demand for fresh water by investing in water reuse initiatives or limiting the use of water for certain agricultural purposes. Certain uses of water considered to be wasteful could be curtailed, resulting in more available water and less demand for alternative solutions such as desalination.

Our products are highly technical and may contain undetected flaws or defects which could harm our business and our reputation and adversely affect our financial condition.

The manufacture of our products is highly technical, and our products may contain latent defects or flaws. We test our products prior to commercial release and during such testing have discovered and may in the future discover flaws and defects that need to be resolved prior to release. Resolving these flaws and defects can take a significant amount of time and prevent our technical personnel from working on other important tasks. In addition, our products have contained and may in the future contain one or more flaws that were not detected prior to commercial release to our customers. Some flaws in our products may only be discovered after a product has been installed and used by customers. Any flaws or defects discovered in our products after commercial release could result in loss of revenue or delay in revenue recognition, loss of customers and increased service and warranty cost, any of which could adversely affect our business, operating results and financial condition. In addition, we could face claims for product liability, tort or breach of warranty. Our contracts with our customers contain provisions relating to warranty disclaimers and liability limitations, which may not be upheld. Defending a lawsuit, regardless of its merit, is costly and may divert management's attention and adversely affect the market's perception of us and our products. In addition, if our business liability insurance coverage proves inadequate or future coverage is unavailable on acceptable terms or at all, our business, operating results and financial condition could be harmed.

Our international sales and operations subject us to additional risks that may adversely affect our operating results.

Historically, we have derived a significant portion of our revenue from customers whose SWRO facilities utilizing the PX device are outside the United States. Many of such customers' projects are in emerging growth countries with relatively young and unstable market economies and volatile political environments. We also have sales and technical support personnel stationed in Africa, Asia and the Middle East, among other regions, and we expect to continue to add personnel in additional countries. As a result, any governmental changes or reforms or disruptions in the business, regulatory or political

environment in the countries in which we operate or sell our products could have a material adverse effect on our business, financial condition and results of operations.

Sales of our products have to date been denominated principally in U.S. dollars. Over the last several years, the U.S. dollar has weakened against most other currencies. Future increases in the value of the U.S. dollar, if any, would increase the price of our products in the currency of the countries in which our customers are located. This may result in our customers seeking lower-priced suppliers, which could adversely impact our operating results. A larger portion of our international revenue may be denominated in foreign currencies in the future, which would subject us to increased risks associated with fluctuations in foreign exchange rates.

Our international contracts and operations subject us to a variety of additional risks, including:

- political and economic uncertainties;
- reduced protection for intellectual property rights;
- trade barriers and other regulatory or contractual limitations on our ability to sell and service our products in certain foreign markets;
- difficulties in enforcing contracts, beginning operations as scheduled and collecting accounts receivable, especially in emerging markets;
- increased travel, infrastructure and legal compliance costs associated with multiple international locations;
- competing with non-U.S. companies not subject to the U.S. Foreign Corrupt Practices Act; and
- difficulty in attracting, hiring and retaining qualified personnel.

As we continue to expand our business globally, our success will depend, in large part, on our ability to anticipate and effectively manage these and other risks associated with our international operations. Our failure to manage any of these risks successfully could harm our international operations and reduce our international sales, which in turn could adversely affect our business, operating results and financial condition.

If we fail to manage future growth effectively, our business would be harmed.

Future growth in our business, if it occurs, will place significant demands on our management, infrastructure and other resources. To manage any future growth, we will need to hire, integrate and retain highly skilled and motivated employees. We will also need to continue to improve our financial and management controls, reporting and operational systems and procedures. If we do not effectively manage our growth, our business, operating results and financial condition would be adversely affected.

Our failure to achieve or maintain adequate internal control over financial reporting in accordance with U.S. Securities and Exchange Commission, or SEC, rules or prevent or detect material misstatements in our annual or interim consolidated financial statements in the future could materially harm our business and cause our stock price to decline.

As a public company, SEC rules require that we maintain internal control over financial reporting that provides reasonable assurance regarding the reliability of financial reporting and preparation of published financial statements in accordance with generally accepted accounting principles. Accordingly, we will be required to document and test our internal controls and procedures to assess the effectiveness of our internal control over financial reporting. In addition, our independent registered public accounting firm will be required to report on the effectiveness of our internal control over financial reporting. In the future, we may identify material weaknesses and deficiencies which we may not be able to remediate in a timely manner. Material weaknesses may exist when we report on the effectiveness of our internal control over financial reporting for purposes of our attestation required by reporting requirements under the Securities Exchange Act of 1934 after this offering, with our first reporting obligation being in our Annual Report on Form 10-K for the year ending December 31, 2009. If we fail to achieve or maintain effective internal control over financial reporting, we will not be able to conclude that we have maintained effective internal control over financial reporting or our independent registered public accounting firm may not be able to issue an unqualified report on the effectiveness of our internal control over financial reporting. As a result our ability to report our financial results on a timely and accurate basis may be adversely affected and investors may lose confidence in our financial information, which in turn could cause the market price of our common stock to decrease. We may also be required to restate our financial statements from prior periods. In addition, testing and maintaining internal control will require increased management time and resources. Any failure to maintain effective internal control over financial reporting could impair the success of our business and harm our financial results, and you could lose

all or a significant portion of your investment. If we have material weaknesses in our internal control over financial reporting, the accuracy and timing of our financial reporting may be adversely affected.

Changes to financial accounting standards may affect our results of operations and cause us to change our business practices.

We prepare our financial statements to conform with generally accepted accounting principles, or GAAP, in the United States. These accounting principles are subject to interpretation by the SEC and various other bodies. A change in those policies can have a significant effect on our reported results and may affect our reporting of transactions completed before a change is announced. Changes to those rules or the interpretation of our current practices may adversely affect our reported financial results or the way we conduct our business.

We may engage in future acquisitions that could disrupt our business, cause dilution to our stockholders and harm our financial condition and operating results.

In the future, we may acquire companies or assets that we believe may enhance our market position. We may not be able to find suitable acquisition candidates and we may not be able to complete acquisitions on favorable terms, if at all. If we do complete acquisitions, we cannot assure you that they will ultimately strengthen our competitive position or that they will not be viewed negatively by customers, financial markets or investors. In addition, any acquisitions that we make could lead to difficulties in integrating personnel and operations from the acquired businesses and in retaining and motivating key personnel from these businesses. Acquisitions may disrupt our ongoing operations, divert management from day-to-day responsibilities, increase our expenses and harm our operating results or financial condition. Future acquisitions may reduce our cash available for operations and other uses and could result in an increase in amortization expense related to identifiable assets acquired, potentially dilutive issuances of equity securities or the incurrence of debt, any of which could harm our business, operating results and financial condition.

Risks Related to this Offering

We will incur significant increased costs as a result of operating as a public company, and our management will be required to devote substantial time to compliance requirements.

As a public company, we will incur significant legal, accounting and other expenses that we did not incur as a private company. In addition, the Sarbanes-Oxley Act of 2002, or Sarbanes-Oxley, as well as rules subsequently implemented by the SEC and the NASDAQ Global Market, or NASDAQ, have imposed various requirements on public companies, including requiring changes in corporate governance practices. Our management and other personnel will need to devote a substantial amount of time to these compliance requirements. Moreover, these rules and regulations will increase our legal and financial compliance costs and will make some activities more time-consuming and costly. For example, we expect these rules and regulations to make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur substantial costs to maintain the same or similar coverage. These rules and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, our board committees or as executive officers.

The trading price of our common stock may be volatile, and you might not be able to sell your shares at or above the initial public offering price.

There are no directly comparable U.S. companies known to us whose securities are currently being publicly traded in the U.S. stock market. Additionally, our common stock has no prior trading history. Factors affecting the trading price of our common stock will include:

- factors discussed in this risk factors section and elsewhere in this prospectus;
- variations in our operating results;
- announcements of technological innovations, new or enhanced products, or significant agreements by us or by our competitors;
- gain or loss of significant customers;
- recruitment or departure of our key personnel;
- changes in the estimates of our operating results or changes in recommendations by any securities analysts who elect to follow our common stock;

- market conditions in our industry, the industries of our customers and the economy as a whole; and
- adoption or modification of regulations, policies, procedures or programs applicable to our business.

In addition, if the market for stocks of companies in industries related or similar to ours, or the stock market in general, experiences loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business. The trading price of our common stock might also decline as a result of events that affect other companies in our industry even if these events do not directly affect us. Some companies that have had volatile market prices for their securities have had securities class actions filed against them. If a suit were filed against us, regardless of its merits or outcome, it could result in substantial costs and divert management's attention and resources. This could harm our business, operating results and financial condition.

There has been no prior market for our common stock and our stock price may decline after this offering.

Prior to this offering, there has been no public market for shares of our common stock. Although we expect to apply to list our common stock on NASDAQ, an active public trading market for our common stock may not develop or, if it develops, may not be maintained after this offering. Our company and the representatives of the underwriters will negotiate to determine the initial public offering price. The initial public offering price may be higher than the trading price of our common stock following this offering. As a result, you could lose all or part of your investment.

Future sales of shares by our existing stockholders could cause our stock price to decline.

If our existing stockholders sell, or indicate an intention to sell, substantial amounts of our common stock in the public market after the lock-up agreements and other legal restrictions on resale discussed in this prospectus lapse, the trading price of our common stock could decline. See "Shares Eligible for Future Sale" below. Based upon shares outstanding as of , 2008, we will have outstanding a total of shares of common stock upon completion of this offering, an increase of % from the number of shares outstanding prior to this offering. Of these shares, only the shares of common stock sold in this offering will be freely tradeable, without restriction, in the public market. Our underwriters, however, may, in their sole discretion, permit our officers, directors and other current stockholders who are subject to the contractual lock-up to sell shares prior to the expiration of the lock-up agreements.

The lock-up agreements pertaining to this offering will expire 180 days from the date of this prospectus, although those lock-up agreements may be extended under certain circumstances. After the lock-up agreements expire, up to an additional shares of common stock will be eligible for sale in the public market, based upon shares outstanding as of , 2008, of which are held by our directors, executive officers and other affiliates and will be subject to volume limitations under Rule 144 under the Securities Act and various vesting agreements. In addition, as of , 2008, the shares of common stock that are either subject to outstanding warrants or options or reserved for future issuance under our employee benefit plans will become eligible for sale in the public market to the extent permitted by the provisions of various vesting agreements, the lock-up agreements and Rules 144 and 701 under the Securities Act. If these additional shares are sold, or if it is perceived that they will be sold, in the public market, the trading price of our common stock could decline.

If securities or industry analysts do not publish research or publish inaccurate or unfavorable research about us or our business, or publish projections for our business that exceed our actual results, our stock price and trading volume could decline.

The trading market for our common stock may be affected by the research and reports that securities or industry analysts publish about us or our business. We do not currently have, and may never obtain, research coverage by securities and industry analysts. If no securities or industry analysts commence coverage of our company, the trading price for our stock and the trading volume could decline. In the event we obtain securities or industry analyst coverage, if one or more of the analysts who covers us downgrades our stock or publishes inaccurate or unfavorable research about our business, our stock price could decline. In addition, if we obtain analyst coverage, the analysts' projections may have little or no relationship to the results we actually achieve and could cause our stock price to decline if we fail to meet their projections. If one or more of these analysts ceases coverage of our company or fails to publish reports on us regularly our stock price or trading volume could decline.

Insiders will continue to have substantial control over us after this offering and will be able to influence corporate matters.

Upon completion of this offering, our directors and executive officers and their affiliates will beneficially own, in the aggregate, approximately % of our outstanding common stock, assuming no exercise of the underwriters' option to

purchase additional shares, compared to % represented by the shares sold in this offering, assuming no exercise of the underwriters' option to purchase additional shares. As a result, these stockholders will be able to exercise significant influence over all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, such as a merger or other sale of our company or its assets. This concentration of ownership will limit your ability to influence corporate matters and may have the effect of delaying or preventing a third party from acquiring control over us. For more information regarding the ownership of our outstanding stock by our executive officers and directors and their affiliates, please see the section titled "Security Ownership of Certain Beneficial Owners and Management" below.

As a new investor, you will experience substantial dilution as a result of this offering and future equity issuances.

The initial public offering price per share will be substantially higher than the net tangible book value per share of our common stock outstanding prior to this offering. As a result, investors purchasing common stock in this offering will experience immediate dilution of $ per share. In addition, we have issued options and warrants to acquire common stock at prices significantly below the initial public offering price. To the extent outstanding options are ultimately exercised, there will be further dilution to investors in this offering. This dilution is due in large part to the fact that our earlier investors paid substantially less than the initial public offering price when they purchased their shares of our stock. In addition, if the underwriters exercise their option to purchase additional shares, if outstanding warrants to purchase our common stock are exercised or if we issue additional equity securities, you will experience additional dilution.

We will have broad discretion to determine how to use the proceeds raised in this offering, and we may use the proceeds in ways that may not enhance our operating results or the price of our common stock.

We could spend the proceeds from this offering in ways our stockholders may not agree with or that do not yield a favorable return. We intend to use the net proceeds from this offering for general corporate purposes, which may include expansion of our sales and marketing and research and development efforts, capital expenditures, and potential acquisitions of, or investments in, complementary businesses, products and technologies. However, we do not have more specific plans for the net proceeds from this offering and will have broad discretion in how we use the net proceeds of this offering. If we do not invest or apply the proceeds of this offering in ways that improve our operating results, we may fail to achieve expected financial results, which could cause our stock price to decline.

After the completion of this offering, we do not expect to declare any dividends in the foreseeable future.

After the completion of this offering, we do not anticipate declaring any cash dividends to holders of our common stock in the foreseeable future. Consequently, investors must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investment. Investors seeking cash dividends should not purchase our common stock.

Anti-takeover provisions in our charter documents and under Delaware law could discourage, delay or prevent a change in control of our company and may affect the trading price of our common stock.

Provisions in our certificate of incorporation and bylaws, as amended and restated upon the closing of this offering, may have the effect of delaying or preventing a change of control or changes in our management. Our amended and restated certificate of incorporation and amended and restated bylaws to become effective upon completion of this offering include provisions that:

- authorize our board of directors to issue, without further action by the stockholders, up to 10,000,000 shares of undesignated preferred stock;
- require that any action to be taken by our stockholders be effected at a duly called annual or special meeting and not by written consent;
- specify that special meetings of our stockholders can be called only by our board of directors, the chairman of the board, the chief executive officer or the president;
- establish an advance notice procedure for stockholder approvals to be brought before an annual meeting of our stockholders, including proposed nominations of persons for election to our board of directors;
- establish that our board of directors is divided into three classes, Class I, Class II and Class III, with each class serving staggered terms;
- provide that our directors may be removed only for cause;

- provide that vacancies on our board of directors may be filled only by a majority of directors then in office, even though less than a quorum;
- specify that no stockholder is permitted to cumulate votes at any election of directors; and
- require a super-majority of votes to amend certain of the above-mentioned provisions.

In addition, we are subject to the provisions of Section 203 of the Delaware General Corporation Law regulating corporate takeovers. Section 203 generally prohibits us from engaging in a business combination with an interested stockholder subject to certain exceptions.

For information regarding these and other provisions, please see the section titled "Description of Capital Stock" below.

FORWARD-LOOKING STATEMENTS

This prospectus includes forward-looking statements that relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ materially from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. Words such as "believe," "expect," "anticipate," "estimate," "intend," "plan," "likely," "will," "would," "could" and similar expressions or phrases identify these forward-looking statements.

All forward-looking statements involve risks and uncertainties. The occurrence of the events described, and the achievement of the expected results, depend on many events, some or all of which are not predictable or within our control. Actual results may differ materially from expected results.

Factors that may cause actual results to differ from expected results include:

- fluctuations in demand, adoption, sales cycles and pricing levels for our products and services;
- the cyclical nature of SWRO plant construction, which typically reflects a seasonal increase in shipments of PX devices in the fourth quarter;
- changes in customers' budgets for desalination plants and the timing of their purchasing decisions;
- delays or postponements in the construction of desalination plants;
- our ability to develop, introduce and ship in a timely manner new products and product enhancements that meet customer demand, certification requirements and technical requirements;
- the ability of our customers to obtain other key components of a plant such as high pressure pumps or membranes;
- our ability to implement scalable internal systems for reporting, order processing, product delivery, purchasing, billing and general accounting, among other functions;
- unpredictability of governmental regulations and political decision-making as to the approval or building of a desalination plant;
- our ability to control costs, including our operating expenses;
- our ability to purchase key PX components, principally ceramics, from third party suppliers;
- our ability to compete against companies that offer energy recovery solutions;
- our ability to attract and retain highly skilled employees, particularly those with relevant industry experience; and
- general economic conditions in our domestic and international markets.

See the section above titled "Risk Factors" for a more complete discussion of these risks and uncertainties and for other risks and uncertainties. These factors and the other risk factors described in this prospectus are not necessarily all of the important factors that could cause our actual results to differ materially from those expressed in any of our forward-looking statements. Other unknown or unpredictable factors also could harm our results. Consequently, actual results or developments anticipated by us may not be realized or, even if substantially realized, may not have the expected consequences to, or effects on, us. Given these uncertainties, we caution you not to place undue reliance on such forward-looking statements.

All future written and verbal forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. We undertake no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this prospectus might not occur.

USE OF PROCEEDS

We estimate that our net proceeds from this offering will be approximately $ million, assuming an initial public offering price of $ per share, which is the midpoint of the range set forth on the cover page of this prospectus, and after deducting underwriting discounts and commissions and estimated offering expenses. Each $1.00 increase or decrease in the assumed initial public offering price of $ per share would increase or decrease, as applicable, the net proceeds to us by approximately $ million, assuming the number of shares offered by us, as set forth on the cover page of this prospectus, remains the same and after deducting the underwriting discounts and commissions payable to us. If the underwriters' option to purchase additional shares in this offering is exercised in full, we estimate that our net proceeds will be approximately $ million. We will not receive any proceeds from the sale of shares of our common stock by the selling stockholders.

We intend to use the net proceeds to us from this offering for working capital and other general corporate purposes, including to finance our growth, develop new products and fund capital expenditures. Additionally, we may expand our current business through acquisitions of other businesses, products or technologies. However, we do not have agreements or commitments for any specific acquisitions at this time.

Pending our use of the net proceeds from this offering, we intend to invest the proceeds in short-term, investment-grade interest-bearing instruments.

DIVIDEND POLICY

We have never declared nor paid cash dividends on our common stock. We currently intend to retain all available funds and any future earnings for use in the operation of our business and do not anticipate paying any dividends on our common stock in the foreseeable future. Any future determination to declare dividends will be made at the discretion of our board of directors and will depend on our financial condition, operating results, capital requirements, general business conditions and other factors that our board of directors may deem relevant.

CAPITALIZATION

The following table sets forth our cash, cash equivalents and short-term investments and capitalization as of December 31, 2007:

- on an actual basis; and
- on an as adjusted basis to reflect the issuance of shares of common stock in this offering at an assumed initial public offering price of $ per share, which is the mid-point of the price range listed on the cover page of this prospectus.

The information set forth in the table should be read together with the information set forth under "Management's Discussion and Analysis of Financial Condition and Results of Operations," and our consolidated financial statements and accompanying notes, each appearing elsewhere in this prospectus.

	As of December 31, 2007	
	Actual	As Adjusted(1)
	(in thousands, except share data)	
Cash, cash equivalents and short-term investments	$ 240	$
Total debt, including current portion		
Total borrowings	729	
Capital lease obligations	101	
Total debt	$ 830	$
Stockholders' equity (deficit):		
Common stock, par value $0.001 per share; 45,000,000 shares authorized; 39,777,446 shares issued and outstanding, actual; shares authorized and shares issued and outstanding, as adjusted	40	
Additional paid-in capital	20,762	
Notes receivable from stockholders	(835)	
Accumulated other comprehensive loss	(5)	
Retained earnings (accumulated deficit)	99	
Total stockholders' equity	20,061	
Total capitalization	$ 20,891	$

(1) Each $1.00 increase or decrease in the assumed initial public offering price of $ per share would increase or decrease, as applicable, the amount of additional paid-in capital, total stockholders' equity and total capitalization by approximately $ million, assuming the number of shares offered by us, as set forth on the cover page of this prospectus, remains the same and after deducting the underwriting discounts and commissions and estimated offering expenses payable by us.

The share information set forth in the table above is based on 39,777,446 shares of common stock outstanding as of December 31, 2007, and excludes:

- 1,280,608 shares of common stock issuable upon exercise of options outstanding as of December 31, 2007, at a weighted average exercise price of $2.38 per share;
- 2,074,122 shares of common stock issuable upon the exercise of warrants outstanding as of December 31, 2007, at a weighted average exercise price of $0.52 per share;
- 56,879 shares of common stock that have been exercised pursuant to options but not yet vested as of December 31, 2007.
- 5,625 shares of common stock reserved as of December 31, 2007 for future issuance under our 2002 Stock Option/Issuance Plan;

- 8,709 shares of common stock reserved as of December 31, 2007 for future issuance under our 2004 Stock Option/Issuance Plan;
- 39,017 shares of common stock reserved as of December 31, 2007 for future issuance under our 2006 Stock Option/Issuance Plan; and
- 1,000,000 shares of common stock reserved for future issuance under our new 2008 Equity Incentive Plan, which will become effective on the date of the completion of this offering.

DILUTION

Our net tangible book value as of December 31, 2007 was $19.7 million, or approximately $0.50 per share. Net tangible book value per share represents the amount of total tangible assets, less our total liabilities, divided by 39,777,446 shares of common stock outstanding.

Net tangible book value dilution per share to new investors represents the difference between the amount per share paid by purchasers of shares of common stock in this offering and the as adjusted net tangible book value per share of common stock immediately after completion of this offering. After giving effect to our sale of shares of common stock in this offering at an assumed initial public offering price of $ per share, which is the midpoint of the range listed on the cover page of this prospectus, and after deducting the underwriting discounts and commissions and estimated offering expenses, our net tangible book value as of December 31, 2007 would have been $ million, or $ per share. This represents an immediate increase in net tangible book value of $ per share to existing stockholders and an immediate decrease in net tangible book value of $ per share to purchasers of common stock in this offering, as illustrated in the following table:

Assumed initial public offering price per share		$
Net tangible book value per share as of December 31, 2007	$ 0.50	
Increase in net tangible book value per share attributable to new investors		
As adjusted net tangible book value per share after this offering		
Decrease in as adjusted net tangible book value per share to new investors in this offering		$

A $1.00 increase or decrease in the assumed initial public offering price of $ would increase or decrease, as applicable, our as adjusted net tangible book value per share after this offering by $ per share and the decrease in as adjusted net tangible book value per share to new investors in this offering by $ per share, assuming the number of shares offered by us, as set forth on the cover of this prospectus, remains the same and after deducting the estimated underwriting discounts and commissions and offering expenses payable by us.

If the underwriters exercise their option to purchase additional shares of our common stock in full in this offering, the net tangible book value per share after this offering would be $ per share, the increase in net tangible book value per share to existing stockholders would be $ per share and the decrease in net tangible book value per share to new investors purchasing shares in this offering would be $ per share.

The following table presents as of December 31, 2007 the differences between the existing stockholders and the purchasers of shares in this offering with respect to the number of shares purchased from us, the total consideration paid and the average price paid per share:

	Shares Purchased		Total Consideration		Average Price Per Share
	Number	Percent	Amount	Percent	
Existing stockholders		%	$	%	$
New investors					
Total		100.0%		100.0%	

The above discussion and tables assume no exercise of 1,280,608 shares of common stock issuable upon the exercise of stock options outstanding as of December 31, 2007 with a weighted average exercise price of $2.38 per share and 2,074,122 shares of common stock issuable upon the exercise of warrants outstanding as of December 31, 2007 with a weighted average exercise price of $0.52 per share. If all of these options and warrants were exercised, then as adjusted net tangible book value per share would increase from $ to $, resulting in a reduction in the decrease in as adjusted net tangible book value per share to new investors in this offering of $ per share.

SELECTED CONSOLIDATED FINANCIAL DATA

You should read the following selected consolidated historical financial data below in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements, related notes and other financial information included in this prospectus. The selected financial data in this section is not intended to replace the consolidated financial statements and is qualified in its entirety by the consolidated financial statements and related notes included in this prospectus.

The selected consolidated statements of operations data for each of the three years in the periods ended December 31, 2007, 2006 and 2005 and the consolidated balance sheet data as of December 31, 2007 and 2006 are derived from our audited consolidated financial statements and related notes included elsewhere in this prospectus, and the selected consolidated statements of operations data for each of the two years ended December 31, 2004 and 2003 and the consolidated balance sheet data as of December 31, 2005, 2004 and 2003 are derived from our audited consolidated financial statements and related notes not included in this prospectus. Our historical results are not necessarily indicative of the results that should be expected in the future.

	Years ended December 31,				
	2007(1)	2006(1)	2005	2004	2003
	(in thousands except per share data)				
Consolidated Statement of Operations Data:					
Net revenue	$ 35,414	$ 20,058	$ 10,689	$ 4,047	$ 4,045
Cost of revenue(2)	14,852	8,131	4,685	2,015	2,012
Gross profit	20,562	11,927	6,004	2,032	2,033
Operating expenses:					
Sales and marketing(2)	5,230	3,648	1,779	1,037	915
General and administrative(2)	4,299	3,372	2,458	1,055	892
Research and development(2)	1,705	1,267	630	340	25
Total operating expenses	11,234	8,287	4,867	2,432	1,832(4)
Income from operations	9,328	3,640	1,137	(400)	201
Other income (expense):					
Interest expense	(105)	(77)	(216)	(54)	(38)
Interest and other income	517	58	35	1	—
Income before provision for income taxes	9,740	3,621	956	(453)	163
Provision for income taxes	3,947	1,239	62	53	(11)
Net income (loss)	$ 5,793	$ 2,382	$ 894	$ (506)	$ 174
Earnings per share-basic(4)	$ 0.15	$ 0.06	$ 0.02	$ (0.02)	$ 0.01
Earnings per share-diluted(4)	$ 0.14	$ 0.06	$ 0.02	$ (0.02)	$ 0.01
Number of shares used in per share calculations:					
Basic	39,060	38,018	36,790	32,161	30,279
Diluted	41,433	40,244	38,454	32,161	32,936

	As of December 31,				
	2007	2006	2005	2004	2003
			(in thousands)		
Consolidated Balance Sheet Data:					
Cash, cash equivalents and short-term investments	$ 240	$ 42	$ 261	$ 140	$ 251
Total assets	27,304	13,539	8,496	3,054	2,445
Long-term liabilities	620	234	306	11	32
Total liabilities	7,243	5,412	3,795	2,061	1,210
Total stockholders' equity	20,061	8,127	4,701	993	1,235

(1) Effective January 1, 2006, we adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, or SFAS 123(R), using the prospective transition method, which requires the application of the provisions of SFAS 123(R) only to share-based payment awards granted, modified, repurchased or cancelled on or after the modification date. Under this method, we recognize stock-based compensation expense for all share-based payment awards granted after December 31, 2005 in accordance with SFAS 123(R).

(2) Includes employee stock-based compensation as follows:

	Years ended December 31,				
	2007	2006	2005	2004(3)	2003(3)
			(in thousands)		
Cost of revenue	$ 117	$ 143	$ 88	—	—
Sales and marketing	349	310	86	—	—
General and administrative	383	425	731	—	—
Research and development	159	183	98	—	—
Total stock-based compensation	$ 1,008	$ 1,061	$ 1,003	—	—

(3) No stock-based compensation expense was recognized as we used the intrinsic method of accounting and the options were granted with an exercise price equal to the fair market value.

(4) Earnings per share calculations for 2004 and 2003 are not audited.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this prospectus. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those discussed below. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled "Risk Factors" included elsewhere in this prospectus.

Overview

We were founded in 1992 and are in the business of designing, developing and manufacturing energy recovery devices for sea water reverse osmosis, or SWRO, desalination plants. In early 1997, we introduced the initial version of our energy recovery device, the PX. In November 1997, we introduced and marketed our first ceramic-based PX device. As of December 31, 2007, we had shipped over 4,000 PX devices to desalination plants worldwide, including in China, Europe, India, Australia, Africa, the Middle East, North America and the Caribbean.

A majority of our net revenue has been generated by sales to large engineering, procurement and construction firms, or EPCs, who are involved with the design and construction of larger desalination plants. Sales to EPCs often involve a long sales cycle, or the time between the initial project tender and the time the PX device is shipped to the client, which can range from six to 16 months. A single EPC desalination project can generate an order for numerous PX devices and generally represents an opportunity for significant revenue. We also sell PX devices to original equipment manufacturers, or OEMs, which commission smaller desalination plants, order fewer PX devices per plant and have shorter sales cycles.

Due to the fact that a single order for PX devices by an EPC for a particular plant may represent significant revenue, we often experience significant fluctuations in net revenue from quarter to quarter. In addition, our EPC customers tend to order a significant amount of equipment for delivery in the fourth quarter and, as a consequence, a significant portion of our annual sales typically occurs during that quarter.

In 2007, three customers represented approximately 56% of our net revenue, and in 2006, two customers represented approximately 29% of our net revenue. Specifically, Acciona Water, Geida and its affiliates and Doosan Heavy Industries represented 20%, 23% and 13% of our total sales in 2007, respectively, and GE Ionics and Geida and its affiliates accounted for 18% and 11% of our total sales in 2006, respectively. We do not have long-term contracts with our EPC or our OEM customers and instead sell to them on a purchase order basis or under individual stand alone contracts. Orders may be postponed or delayed by our customers on short or no notice.

In 2007 and 2006, most of our revenue was attributable to sales outside of the United States. We expect sales outside of the United States to remain a significant portion of our revenue for the foreseeable future.

Our revenue is principally derived from the sales of our PX devices. We receive a small amount of revenue from the sale of booster pumps, which we manufacture and sell in connection with PX devices to smaller desalination plants. We also receive incidental revenue from services, such as product support, that we provide to our PX customers.

Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States, or GAAP. These accounting principles require us to make estimates and judgments that can affect the reported amounts of assets and liabilities as of the date of the consolidated financial statements as well as the reported amounts of revenue and expense during the periods presented. We believe that the estimates and judgments upon which we rely are reasonable based upon information available to us at the time that we make these estimates and judgments. To the extent there are material differences between these estimates and actual results, our consolidated financial results will be affected. The accounting policies that reflect our more significant estimates and judgments and which we believe are the most critical to aid in fully understanding and evaluating our reported financial results are revenue recognition, warranty costs, stock-based compensation, inventory valuation, allowances for doubtful accounts and income taxes.

Revenue Recognition

We recognize revenue in accordance with SEC Staff Accounting Bulletin No. 104, *Revenue Recognition*. Revenue is recognized when the earnings process is complete, as evidenced by an agreement with the customer, transfer of title occurs, fixed pricing is determinable and collection is probable. Transfer of title typically occurs upon shipment of the equipment pursuant to a written purchase order or contract. Emerging Issues Task Force No. 00-21, *Revenue Arrangements with Multiple Deliverables* requires us to allocate the purchase price between the device and the value of the undelivered services

by applying the residual value method. Under this method, revenue allocated to undelivered elements is based on vendor-specific objective evidence of fair value of such undelivered elements, and the residual revenue is allocated to the delivered elements. Vendor specific objective evidence of fair value for such undelivered elements is based upon the price we charge for such product or service when it is sold separately. We may modify our pricing practices in the future, which could result in changes to our vendor specific objective evidence of fair value for such undelivered elements. Our purchase agreements typically provide for the provision by us of field services and training for commissioning of a desalination plant. Recognition of the revenue in respect of those services is deferred until provision of those services is complete. The services element of our contracts represent an incidental portion of the total contract price.

Under our revenue recognition policy, evidence of an arrangement has been met when we have an executed purchase order or a standalone contract. Typically, our smaller projects utilize purchase orders that conform to our standard terms and conditions that require the customer to remit payment generally within 30 to 90 days from product delivery. In some cases, if credit worthiness cannot be determined, prepayment is required from the smaller customers.

For our large projects, standalone contracts are utilized. For these contracts, consistent with industry practice, the customers typically require their suppliers, including our company, to accept contractual holdback provisions whereby the final amounts due under the sales contract are remitted over extended periods of time. These retention payments typically range between 10% and 20%, and in some instances up to 30%, of the total contract amount and are due and payable when the customer is satisfied that certain specified product performance criteria have been met upon commissioning of the desalinization plant, which in the case of our PX device may be 12 months to 24 months, and in some instances up to 36 months, from the date of product delivery as described further below.

The specified product performance criteria for our PX device generally pertains to the ability of our products to meet our published performance specifications and warranty provisions, which our products have demonstrated on a consistent basis. This factor, combined with our historical performance metrics measured over the past 10 years, provides us with a reasonable basis to conclude that the PX device will perform satisfactorily upon commissioning of the plant. To help ensure this successful product performance, we provide service, consisting principally of supervision of customer personnel, and training to the customers during the commissioning of the plant. The installation of the PX device is relatively simple, requires no customization and is performed by the customer under the supervision of our personnel. We defer the fair value of the service and training component of the contract and recognize such revenue as services are rendered. Based on these factors, we have concluded that delivery and performance have been completed when the product has been delivered (title transfers) to the customer.

We perform an evaluation of credit worthiness on an individual contract basis to assess whether collectibility is reasonably assured. As part of this evaluation, we consider many factors about the individual customer, including the underlying financial strength of the customer and/or partnership consortium and our prior history or industry specific knowledge about the customer and its supplier relationships. To date, we have been able to conclude that collectibility was reasonably assured on our sales contracts at the time the product was delivered and title has transferred; however, to the extent that we conclude that we are unable to determine that collectibility is reasonably assured at the time of product delivery, we will defer all or a portion of the contract amount based on the specific facts and circumstances of the contract and the customer.

Under the stand-alone contracts, the usual payment arrangements are summarized as follows:

- An advance payment, typically 10% to 20% of the total contract amount, is due upon execution of the contract;
- A payment upon delivery of the product, typically in the range of 50% to 70% of the total contract amount, is due on average between 120 and 150 days from product delivery, and in some cases up to 180 days;
- A retention payment, typically in the range of 10% to 20%, and in some cases up to 30%, of the total contract amount is due subsequent to product delivery as described further below.

Under the terms of the retention payment component, we are generally required to issue to the customer a product performance guarantee in the form of a collateralized letter of credit, which is issued to the customer approximately 12 to 24 months after the product delivery date. The letter of credit is collateralized by restricted cash on deposit with our financial institution (see Restricted Cash under “Summary of Significant Accounting Policies”). The letter of credit remains in place for the performance period as specified in the contract, which is generally 24 months and which runs concurrent with our standard product warranty period. Once the letter of credit has been put in place, we invoice the customer for this final retention payment under the sales contract. During the time between the product delivery and the issuance of the letter of credit, the amount of the final retention is classified on the balance sheet as unbilled receivable, of which a portion may be classified as long term to the extent that the billable period extends beyond one year. Once the letter of credit is issued, we

invoice the customer and reclassify the retention amount from unbilled receivable to accounts receivable where it remains until payment, typically 120 to 150 days after invoicing (see Note 3—Balance Sheet Information: Unbilled Receivables).

Shipping and handling charges billed to customers are included in sales. The cost of shipping to customers is included in cost of revenue.

We do not provide our customers with a right to return our products. However, we accept returns of products that are deemed to be damaged or defective when delivered, subject to the provisions of the product warranty. Historically, product returns have not been significant.

We sell our products to EPC companies that are not subject to sales tax. Accordingly, the adoption of EITF Issue No. 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation)*, does not have an impact on our consolidated financial statements.

Warranty Costs

We sell products with a limited warranty for a period of one to two years. In August 2007, we modified the warranty to offer a five-year term on the ceramic components for new sales agreements executed after August 7, 2007. We accrue for warranty costs based on estimated product failure rates, historical activity and expectations of future costs. We periodically evaluate and adjust the warranty costs to the extent actual warranty costs vary from the original estimates.

We may offer extended warranties on an exception basis and these are accounted for in accordance with Financial Accounting Standards Board Technical Bulletin 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts for Sales of Extended Warranties.*

Stock-Based Compensation

Prior to January 1, 2006, we accounted for stock-based employee compensation arrangements in accordance with the provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, or APB 25, and FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation*, an Interpretation of APB Opinion No. 25, or FIN 44, and had adopted the disclosure provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation*, or SFAS 123, and SFAS No. 148, *Accounting for Share-Based Compensation—Transition and Disclosure*, or SFAS 148.

In February 2005, we offered to each of our employees the option to borrow from us an amount equal to the aggregate exercise price for all of their outstanding options pursuant to full recourse promissory notes at 3.76% interest, which are due in February 2010. The interest rate on the notes was deemed to be below market rate, resulting in a change in the deemed exercise price for the options. As a result, we are accounting for these options as variable option awards. For 2007, 2006 and 2005, we recorded $783,000, $1.1 million and $1.0 million, respectively, of stock-based compensation related to the options exercised with promissory notes. All of our executive officers and directors have subsequently repaid their notes.

Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payment*, using the prospective transition method, which requires us to apply the provisions of SFAS 123(R) only to awards granted, modified, repurchased or cancelled after the adoption date. Upon adoption of SFAS 123(R), we selected the Black-Scholes option pricing model as the most appropriate method for determining the estimated fair value for stock-based awards. The Black-Scholes model requires the use of highly subjective and complex assumptions to determine the fair value of stock-based awards, including the option's expected term and the price volatility of the underlying stock. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite vesting period on a straight-line basis in our consolidated statements of operations and the expense is reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. For the years ended December 31, 2007 and 2006 we recognized stock-based compensation under SFAS 123(R) of $251,000 and $13,000, respectively.

To determine the inputs for the Black-Scholes option pricing model, we are required to develop several assumptions, which are highly subjective. These assumptions include:

- the length of our options' lives, which is based on anticipated future exercises;
- our common stock's volatility;
- the number of shares of common stock pursuant to which options will ultimately be forfeited;
- the risk-free rate of return; and

- future dividends.

We use comparable public company data to determine volatility, as our common stock has not yet been publicly traded. We use a weighted average calculation to estimate the time our options will be outstanding as prescribed by Staff Accounting Bulletin No. 107, *Share-Based Payment*. We estimate the number of options that are expected to be forfeited based on our historical experience and expected future forfeiture patterns. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for the estimated life of the option. We use our judgment and expectations in setting future dividend rates, which is currently expected to be zero.

The absence of an active market for our common stock also requires our management and board of directors to estimate the fair value of our common stock for purposes of granting options and for determining stock-based compensation expense. In response to these requirements, our management and board of directors estimate the fair market value of common stock on an annual basis, based on factors such as the price of the most recent common stock sales to investors, the valuations of comparable companies, the status of our development and sales efforts, our cash and working capital amounts, revenue growth and additional objective and subjective factors relating to our business.

The following table shows the stock option grants during 2007:

Grants Made During the Quarter Ended,	Number of Options	Exercise Price
March 31, 2007	—	—
June 30, 2007	69,200	$ 5.00
September 30, 2007	—	—
December 31, 2007	112,700	$ 5.00

In 2007, our board of directors determined that the fair market value of common stock for options granted that year was $5.00 per share. The fair value of the common stock for options granted was estimated by our board of directors with input from management and by reference to our stock price in conjunction with the prior sale of securities in private placements to third parties.

For options granted during 2007, we determined the fair value at date of grant using the Black-Scholes option pricing model. The following table summarizes the assumptions used in determining the fair value of stock options granted.

	Year Ended December 31, 2007
Risk-free interest rate	3.45%
Expected term	5 years
Dividend yield	0%
Expected volatility	50%

We account for equity instruments issued in exchange for the receipt of goods or services from non-employees in accordance with the consensus reached by the Emerging Issues Task Force, or EITF, in Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*. Costs are measured at the fair market value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. The value of equity instruments issued for consideration other than employee services is determined on the earlier of the date on which there first exists a firm commitment for performance by the provider of goods or services or on the date performance is complete, using the Black-Scholes pricing model.

Inventories

Inventories are stated at the lower of cost (using the weighted average cost method) or market. We calculate inventory reserve for excess and obsolete inventories based on estimated future demand of the products and spare parts. Cost of inventory is determined in accordance with Statement of Financial Accounting Standards No. 151, *Inventory Costs*, an amendment of ARB No. 43, Chapter 4, or SFAS 151.

Allowances for Doubtful Accounts

We record a provision for doubtful accounts based on our historical experience and a detailed assessment of the collectability of our accounts receivable. In estimating the allowance for doubtful accounts, our management considers, among other factors, (1) the aging of the accounts receivable, (2) our historical write-offs, (3) the credit worthiness of each

customer and (4) general economic conditions. Our allowance for doubtful accounts was $121,000, $230,000 and $150,000 at December 31, 2007, 2006 and 2005, respectively. If we were to experience unanticipated collections issues, it could have an adverse affect on our operating results in future periods.

Income Taxes

We account for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*, or SFAS 109, issued by the Financial Accounting Standards Board, or FASB. SFAS 109 requires an entity to recognize deferred tax liabilities and assets. Deferred tax assets and liabilities are recognized for the future tax consequence attributable to the difference between the tax bases of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets and liabilities are measured using the enacted tax rate expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that included the enactment date. Valuation allowances are provided if, based upon the available evidence, management believes it is more likely than not that some or all of the deferred assets will not be realized or the use of prior years' net operating losses may be limited.

On July 13, 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109*, or FIN 48. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in any entity's financial statements in accordance with SFAS 109 and prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Under FIN 48, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more likely than not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Additionally, FIN 48 provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. We adopted the provisions of FIN 48 on January 1, 2007. Measurement under FIN 48 is based on judgment regarding the largest amount that is greater than 50% likely of being realized upon ultimate settlement with a taxing authority. The total amount of unrecognized tax benefits as of the date of adoption was immaterial. As a result of the implementation of FIN 48, there was no change to our tax liability.

We adopted the accounting policy that interest recognized in accordance with Paragraph 15 of FIN 48 and penalty recognized in accordance with Paragraph 16 of FIN 48 are classified as part of income taxes. The amounts of interest and penalty recognized in the statement of operations and statement of financial position for 2007 were insignificant.

Our operations are subject to income and transaction taxes in the United States and in foreign jurisdictions. Significant estimates and judgments are required in determining our worldwide provision for income taxes. Some of these estimates are based on interpretations of existing tax laws or regulations. The ultimate amount of tax liability may be uncertain as a result.

We are subject to taxation in the U.S. and various states and foreign jurisdictions. There are no ongoing examinations by taxing authorities at this time. Our various tax years from 1997 through 2007 remain open in various taxing jurisdictions.

Results of Operations

The following table sets forth certain data from our historical operating results as a percentage of revenue for the years indicated:

	Years ended December 31,		
	2007	**2006**	**2005**
Results of Operations (as a % of Net Revenue*):			
Net revenue	100%	100%	100%
Cost of revenue	42	41	44
Gross profit	58	59	56
Operating expenses:			
Sales and marketing	15	18	17
General and administrative	12	17	23
Research and development	5	6	6
Total operating expenses	32	41	46
Income from operations	26	18	11
Other income (expense):			
Interest expense	—	—	(2)
Interest and other income	2	0	0
Income before provision for income taxes	28	18	9
Provision for income taxes	11	6	1
Net income	16%	12%	8%

* Percentages may not add up to 100% due to rounding.

2007 Compared to 2006 and 2005

Net Revenue

Net revenue is reported net of volume discounts. We derive our revenue principally from sales of our PX devices. Our net revenue increased by $15.4 million, or 77%, to $35.4 million in 2007 from $20.1 million in 2006, and by $9.4 million in 2006, or 88%, from $10.7 million in 2005. These increases were principally due to higher sales of our PX-220 device, which resulted primarily from increased market acceptance of the device and the overall growth of the desalination market. Prices were relatively constant for our PX devices in 2007, 2006 and 2005. In 2007, the sales of PX devices accounted for approximately 96% of our revenue increase with pump sales accounting for approximately 4% of the increase. In 2006, the sales of PX devices accounted for approximately 92% of the increase, with pump sales accounting for approximately 4% of the increase and spare parts and services accounting for the remainder of the increase.

The following geographic information includes net revenue to our domestic and international customers based on the customers' requested delivery locations, except for certain cases in which the customer directed us to deliver our products to a location that differs from the known ultimate location of use. In such cases, the ultimate location of use is reflected in the table below instead of the delivery location.

	Years Ended December 31, (in thousands)		
	2007	2006	2005
Domestic net revenue	$ 2,125	$ 1,003	$ 1,710
International net revenue	33,289	19,055	8,979
Total net revenue	$ 35,414	$ 20,058	$ 10,689
Revenue by country:			
Spain	35%	9%	5%
Saudi Arabia	13	*	*
Algeria	12	30	18
United States	6	5	16
United Arab Emirates	2	10	9
China	8	5	14
Australia	*	9	17
Others	24	32	21
Total	100%	100%	100%

* Less than 1%.

Gross Profit

Gross profit represents our net revenue less our cost of revenue. Our cost of revenue consists primarily of raw materials, personnel costs (including stock-based compensation), manufacturing overhead, warranty costs, capital costs, excess and obsolete inventory expense, and manufactured components. The largest component of our cost of revenue is raw materials, principally ceramic materials, which we obtain from several suppliers. Gross profit, as a percentage of net revenue, remained relatively constant at 58% in 2007 as compared to 59% in 2006 and 56% in 2005. Stock compensation expense included in cost of revenue was $117,000 in 2007, $143,000 in 2006 and $88,000 in 2005.

Sales and Marketing Expense

Sales and marketing expense consists primarily of personnel costs (including stock-based compensation), sales commissions, marketing programs and facilities cost associated with sales and marketing activities. Sales and marketing expense increased by $1.6 million, or 43%, to $5.2 million in 2007 from $3.6 million in 2006, and by $1.9 million in 2006, or 105%, from $1.8 million in 2005. These increases were primarily related to growth in our sales that resulted in higher headcount with sales and marketing employees increasing to seven at December 31, 2007 from six at December 31, 2006 and four at December 31, 2005. In addition, our sales team is compensated in part by commissions, resulting in increased sales expense as our sales levels increase.

As a percentage of our net revenue, sales and marketing expense decreased to 15% in 2007 from 18% in 2006 and 17% in 2005. The decrease in 2007 was attributable principally to the significant increase in our net revenue that year, which grew at a greater rate than our sales and marketing expenses.

With respect to the $1.6 million increase in sales and marketing expenses in 2007, $734,000 of such increase related to compensation and employee related benefits, $259,000 related to consultant fees, $248,000 related to travel and related expenses, $151,000 related to increased occupancy costs and $135,000 related to sales and marketing efforts. From 2005 to 2006, $1.1 million of the $1.9 million increase related to compensation and employee related benefits, while the remaining increase was primarily comprised of $645,000 related to outside marketing costs and $89,000 in increased lease facilities. Stock-based compensation expense included in sales and marketing expense was $349,000 in 2007, $310,000 in 2006 and $86,000 in 2005.

We plan to continue to invest heavily in sales and marketing by increasing the number of our sales personnel and we expect sales and marketing expenses in absolute dollars to increase in future periods. Our sales personnel are not immediately productive and therefore the increase in sales expense that we incur when we add new sales personnel is not immediately offset by increased revenue and may never result in increased revenue. The timing of our hiring of new sales

personnel and the rate at which they generate incremental revenue could therefore affect our future period-to-period financial performance.

General and Administrative Expense

General and administrative expense consists primarily of personnel (including stock-based compensation) and facilities costs related to our executive, finance and human resources organizations, as well as fees for professional services. Professional services consist of fees for outside legal and audit services and preparation for operating as a public company.

General and administrative expense increased by $927,000, or 27%, to $4.3 million in 2007 from $3.4 million in 2006, and by $914,000 in 2006, or 37%, from $2.5 million in 2005. These increases reflected in part the increase in general and administrative employees to 13 at December 31, 2007 from eight at December 31, 2006 and from six at December 31, 2005.

As a percentage of our net revenue, general and administrative expense was 12% in 2007, 17% in 2006 and 23% in 2005. The decrease of general and administrative expense as a percentage of net revenue was attributable principally to the significant increases in our net revenue.

The primary reason for the increase in general and administrative expenses was the growth in our operations that resulted in higher headcount including the recruitment of an officer, renting of additional facility space, increased travel and increased bank fees. With respect to the $927,000 increase in such expenses in 2007, $513,000 related to compensation, employee-related benefits and professional services fees, $139,000 related to bank charges, $105,000 related to office supplies and equipment, $89,000 related to occupancy costs, and $54,000 related to bad debt. With respect to the $914,000 increase in 2006, $870,000 related to compensation, employee-related benefits and professional service fees. Stock based compensation expense included in general and administrative expense was $383,000 in 2007, $425,000 in 2006 and $731,000 in 2005.

We expect to incur significant additional accounting and legal costs after this offering related to compliance with rules and regulations implemented by the SEC and NASDAQ, as well as additional insurance, investor relations and other costs associated with being a public company. Consequently, we expect general and administrative expenses in absolute dollars to increase in future periods.

Research and Development Expense

Research and development expenses include costs associated with the design, development, testing and enhancement of our products. Research and development expenses include employee compensation (including stock-based compensation), supplies and materials, consulting expenses, travel and facilities overhead. All research and development expenses are expensed as incurred.

Research and development expense increased by $438,000, or 35%, to $1.7 million in 2007 from $1.3 million in 2006, and by $637,000 in 2006, or 101%, from $630,000 in 2005. As a percentage of our net revenue, research and development expense decreased to 5% in 2007, from 6% in 2006 and in 2005.

Compensation, employee-related benefits, consulting services and depreciation of development equipment accounted for $151,000 of the $438,000 increase from 2006 to 2007. The remainder of the increase in 2007 was primarily attributable to $173,000 in product development costs and $98,000 in travel expense. Compensation, employee-related benefits, consulting services and depreciation of development equipment accounted for $413,000 of the $637,000 increase from 2005 to 2006. Stock-based compensation expense included in research and development expense was $159,000 in 2007, $183,000 in 2006 and $98,000 in 2005.

We believe that continued spending on research and development to develop new PX devices and other products is critical to our success and, consequently, we expect to increase research and development expenses in absolute dollars in future periods.

Other Income (Expense), Net

Other income (expense), net includes interest income on cash balances and short-term investments, and losses or gains on conversion of non-United States dollar transactions into United States dollars. Our losses or gains on currency conversions have not been material to date because our international sales have been denominated principally in United States dollars, and our foreign currency exposure risk has been limited to expense incurred in our overseas operations. If we are successful in increasing our international sales we may be subject to currency conversion risks because some of the

international sales could be denominated in foreign currencies. We have historically invested our available cash balances in money market funds, short-term United States Treasury obligations and commercial paper.

Other income (expense), net increased by $431,000 to $412,000 in 2007 from $(19,000) in 2006, and decreased by $162,000 to $(19,000) in 2006 from $(181,000) in 2005. The increase in net interest and other income from 2006 to 2007 was primarily attributable to gains on foreign currency transactions of $355,000 in 2007 and higher average cash balances, which resulted in higher interest income in 2007. The decrease in net interest expense from 2005 to 2006 was primarily attributable to a reduction in the use of the line of credit and associated interest expense due to increased profitability.

Quarterly Results of Operations

The following table sets forth our unaudited quarterly consolidated statement of operations data for each of our eight fiscal quarters in the period ended December 31, 2007. The quarterly data have been prepared on the same basis as the audited consolidated financial statements included elsewhere in this prospectus, and reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of this information. Our results for these quarterly periods are not necessarily indicative of the operating results for a full year or any future period.

	Three Months Ended,				Three Months Ended,			
	Dec. 31, 2007	Sept. 30, 2007	June 30, 2007	March 31, 2007	Dec. 31, 2006	Sept. 30, 2006	June 30, 2006	March 31, 2006
	(in thousands)							
Quarterly Results of Operations*								
Net revenue	$ 13,845	$ 10,978	$ 3,452	$ 7,139	$ 9,277	$ 1,314	$ 4,559	$ 4,908
Gross profit	7,517	6,882	1,878	4,285	5,643	568	2,735	2,981
Operating expenses:								
Sales and marketing	1,443	1,372	1,224	1,191	1,348	836	772	692
General administrative	1,513	1,053	960	773	1,376	677	727	592
Research and development	484	392	440	389	540	224	270	233
Total operating expenses	3,440	2,817	2,624	2,353	3,264	1,737	1,769	1,517
Income (loss) from operations	4,077	4,065	(746)	1,932	2,379	(1,169)	966	1,464
Net income (loss)	$ 2,701	$ 2,397	$ (424)	$ 1,119	$ 1,557	$ (782)	$ 648	$ 959
Net income per common share:								
Basic	$ 0.07	$ 0.06	$ (0.01)	$ 0.03	$ 0.04	$ (0.02)	$ 0.02	$ 0.02
Diluted	$ 0.06	$ 0.06	$ (0.01)	$ 0.03	$ 0.04	$ (0.02)	$ 0.02	$ 0.02

* Quarterly results may not add up to annual results due to rounding.

The following table sets forth our historical quarterly operating results as a percentage of net revenue for the periods indicated:

	Three Months Ended,				Three Months Ended,			
	Dec. 31, 2007	Sept. 30, 2007	June 30, 2007	March 31, 2007	Dec. 31, 2006	Sept. 30, 2006	June 30, 2006	March 31, 2006
	(as a % of Net Revenue*)							
Quarterly Income Summary								
Net revenue	100%	100%	100%	100%	100%	100%	100%	100%
Gross profit	54	63	54	60	61	43	60	61
Operating expenses:								
Sales and marketing	10	13	35	17	14	64	17	14
General administrative	11	10	28	11	15	51	16	12
Research and development	4	4	13	5	6	17	6	5
Total operating expenses	25	26	76	33	35	132	39	31
Income (loss) from operations	30	37	(22)	27	26	(89)	21	30
Net income (loss)	20%	22%	(12)%	16%	17%	(60)%	14%	20%

* Percentages may not add up to 100% due to rounding.

Net Revenue. Although annual net revenue increased by $15.3 million, or 77%, to $35.4 million in 2007 from $20.1 million in 2006, there were significant fluctuations in quarterly revenue in 2007 and 2006. Such fluctuations are due to the fact that a particular order from an EPC customer can represent significant revenue and that the postponement or cancellation of a large order can have a significant impact. In addition, as a result of EPC buying patterns, a higher proportion of our sales occurs in the fourth quarter compared to other quarters of the year.

Gross Profit. The quarterly changes in gross profit were mainly a result of the fluctuations in net revenue. From quarter to quarter, our fixed costs have generally remained constant, and thus changes to revenue caused corresponding

changes to our gross profit. Some of the more significant components of our fixed costs are salaries, manufacturing overhead and insurance. Because our variable costs make up a significant percentage of our cost of revenue, the largest components of which are materials, incremental labor costs and overtime, our variable costs mitigated somewhat the effects of revenue fluctuations on our gross profit.

Sales and Marketing Expenses. Sales and marketing expenses generally grew incrementally as a result of growth in our sales organization. Due to commissions, such expenses are generally highest in the fourth quarter as sales are typically greatest in that quarter.

Fluctuations in Quarterly Results. Our quarterly results of operation have fluctuated significantly in the past and are expected to fluctuate significantly in the future due to a number of factors, many of which are not in our control. We believe period to period comparisons are not necessarily meaningful and should not be relied upon as indicative of future results. See "Risk Factors—Our operating results may fluctuate significantly, which makes our future operating results difficult to predict and could cause our operating results to fall below expectations or our guidance."

Liquidity and Capital Resources

As of December 31, 2007, our principal sources of liquidity consisted of cash, cash equivalents and short-term investments of $240,000 and accounts receivable of $14.8 million. Our cash equivalents and short-term investments are invested primarily in money market funds, short-term United States Treasury obligations and commercial paper.

Our primary source of cash historically has been proceeds from the issuance of common stock and customer payments for our products and services. From January 1, 2005 through December 31, 2007, we issued common stock for aggregate net proceeds of $6.6 million. The proceeds from the sales of common stock have been used to fund our operations and capital expenditures.

On December 1, 2005, we entered into an agreement with a financial institution for a $2.0 million revolving note, or revolving note, and a $222,000 fixed rate-installment note, or fixed note, with maturity dates of December 1, 2006, subsequently extended to March 1, 2007, and December 15, 2010, respectively. The revolving note bears interest of base rate or LIBOR-based rate as elected by us. The interest rate was amended on April 26, 2006 to modify the definition of base rate and increase the rate to base rate plus 1% or LIBOR plus 2.5%. The fixed note bears an annual interest rate of 10%. These notes are secured by our accounts receivable, inventories, property, equipment and other general intangibles except for intellectual property.

On April 26, 2006, we also entered into a loan and security agreement with the financial institution for an additional $2.0 million credit facility with a maturity date of December 1, 2006, subsequently extended to March 1, 2007. The credit facility advances bear interest rates of base rate plus 1% or LIBOR plus 2.5%. The credit facility is secured by our cash and cash equivalents, accounts receivable, inventory, property and other general intangibles except for intellectual property.

On December 7, 2006, the revolving note was amended to increase the face amount of the note to $3.5 million.

On March 1, 2007, we renewed the revolving note and the loan and security agreement, or the first modification, to a maturity date of March 31, 2008. Additional amended terms under the first modification were an interest rate change to base rate or LIBOR plus 2.5%, limitation of advances to a borrowing base, various reporting requirements and our satisfaction of certain financial ratios and covenants.

On March 28, 2007, we modified the loan and security agreement, or the second modification, to add a $1.0 million equipment promissory note. The equipment promissory note bears an interest rate of cost of funds plus 3% and matures August 31, 2012. Additional amended terms under the second modification were changes to the financial ratios and covenants that we are required to maintain.

As of December 31, 2006, borrowings outstanding on the revolving note and the fixed note were $438,000 and $178,000, respectively. There were no borrowings under the credit facility. The interest rate for the revolving note elected by us was the base rate at 9.25%. We were in compliance with all covenants under the loan and security agreement.

As of December 31, 2007 there were no borrowings under the revolving note and the credit facility. The amounts outstanding on the fixed note and the equipment promissory note were $133,000 and $596,000, respectively at December 31, 2007. The interest rate for the equipment promissory note at December 31, 2007 was 7.81%. We were in compliance with all covenants under the loan and security agreement.

On March 28, 2008, we entered into a new credit agreement with our existing financial institution that replaced the $2.0 million credit facility and the $3.5 million revolving note. The new credit facility allows borrowings of up to

$9.0 million on a revolving basis at LIBOR plus 2.75%. This new credit facility expires on September 30, 2008 and is secured by our accounts receivable, inventories, property, equipment and other intangibles except intellectual property.

During 2007, 2006 and 2005, we provided certain customers with irrevocable standby letters of credit to secure our obligations for the delivery of products in accordance with sales arrangements. These letters of credit were issued under our revolving note credit facility and generally terminate within eight months from issuance. At December 31, 2007 the amounts outstanding on the letters of credit totaled approximately $2.2 million.

We have unbilled receivables pertaining to customer contractual holdback provisions, whereby we invoice the final installment due under a sales contract six to 24 months (and in some cases up to 36 months) after the product has been shipped to the customer and revenue has been recognized. Long-term unbilled receivables as of December 31, 2007 and 2006 consisted of unbilled receivables from customers due more than one year subsequent to period end. The customer holdbacks represent amounts intended to provide a form of security for the customer rather than a form of long-term financing; accordingly, these receivables have not been discounted to present value. At December 31, 2007, we had $1.7 million of current unbilled receivables and $2.3 million of non-current unbilled receivables.

Cash Flows from Operating Activities

Net cash provided by (used in) operating activities was $(2.8) million and $822,000 in 2007 and 2006, respectively. The $3.7 million increase in net cash used in operating activities from 2006 to 2007 was primarily attributable to increases in accounts and unbilled receivables.

Within changes in assets and liabilities, changes in accounts and unbilled receivables used $(9.2) million in cash in 2007 compared to $(3.2) million used in 2006 due to the timing of invoices for large projects at the end of 2007, along with a 77%, or $15.4 million, increase in net sales for the year. Changes in inventory used $(2.0) million in cash in 2007 compared to $(960,000) in 2006 primarily as a result of the growth of our business. Changes in accounts payable provided $583,000 in 2007 compared to $270,000 in 2006 due to the timing of payments. Changes in accrued liabilities provided $214,000 in 2007 compared to $1.0 million in 2006, primarily due to timing of payments. Changes in deferred revenue provided $343,000 in 2007 compared to $115,000 in 2006, primarily due to increased sales.

Net cash provided by (used in) operating activities was $822,000 in 2006 and $(694,000) in 2005. The $1.5 million decrease in net cash used in operating activities from 2005 to 2006 was primarily attributable to a $1.5 million increase in net income.

Within changes in assets and liabilities, changes in accounts and unbilled receivables used $(3.2) million in cash in 2006 compared to $(3.1) million in 2005. Changes in inventory used $(960,000) in cash in 2006 compared to $(901,000) in 2005 primarily as a result of the growth of our business. Changes in accounts payable provided $270,000 in cash in 2006 compared to $346,000 in 2005 due to the timing of payments. Changes in accrued liabilities provided $1.0 million in cash in 2006 compared to $(23,000) in 2005, primarily due to increased accrued bonuses and deferred revenue. Changes in deferred revenue provided $115,000 in cash in 2006 compared to $30,000 in 2005, primarily due to increased business. These changes in deferred revenue were offset in part by $46,000 in deferred tax liability in 2006.

Cash Flows from Investing Activities

Cash flows from investing activities primarily relate to capital expenditures to support our growth, as well as increases in our restricted cash used to collateralize our letters of credit.

Net cash provided by (used in) investing activities was $(2.0) million in 2007, $511,000 in 2006 and $(1.0) million in 2005. $1.0 million of the increase in net cash used in investing activities from 2006 to 2007 was attributable to the increase in restricted cash balances along with $918,000 used for the purchase of property and equipment. The decrease in net cash used in investing activities from 2005 to 2006 was primarily attributable to fewer purchases of property, plant and equipment.

Cash Flows from Financing Activities

Net cash provided by financing activities was $5.1 million in 2007 and net cash used was $(530,000) in 2006. Net cash provided by financing activities was $1.9 million in 2005. The increase in net cash provided by financing activities in 2007 was primarily attributable to our issuance of common stock in a private placement.

We believe that our existing cash balances, together with the anticipated net proceeds from this offering and cash generated from our operations, will be sufficient to meet our anticipated capital requirements for at least the next 12 months. However, we may need to raise additional capital or incur additional indebtedness to continue to fund our operations in the future. Our future capital requirements will depend on many factors, including our rate of revenue growth, if any, the expansion of our sales and marketing and research and development activities, the timing and extent of our expansion into new geographic territories, the timing of introductions of new products and the continuing market acceptance of our products. Although we currently are not a party to any agreement or letter of intent with respect to potential material investments in, or acquisitions of, complementary businesses, services or technologies, we may enter into these types of arrangements in the future, which could also require us to seek additional equity or debt financing. Additional funds may not be available on terms favorable to us or at all.

Contractual Obligations

The following is a summary of our contractual obligations as of December 31, 2007 (in thousands):

	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Notes payable	$ 729	$ 172	$ 472	$ 85	$ —
Operating lease obligations	862	411	451	—	—
Capital lease obligations (including interest)*	120	50	70	—	—
Total	$1,691	$ 633	$ 993	$ 85	$ —

* Present value of net minimum capital lease payments is $101, as reflected on the balance sheet.

In the course of our normal operations, we also entered into purchase commitments with our suppliers for various key raw materials and component parts. The purchase commitments covered by these arrangements are subject to change based on our sales forecasts for future deliveries. As of December 31, 2007 purchase commitments with our suppliers were approximately $8.1 million.

This table excludes agreements with guarantees or indemnity provisions that we have entered into with, among others, customers and OEMs in the ordinary course of business. Based on our historical experience and information known to us as of December 31, 2007, we believe that our exposure related to these guarantees and indemnities as of December 31, 2007 was not material.

Supplier Concentration

Certain of the raw materials and components that we use in the manufacturing of our products are available from a limited number of suppliers. Shortages could occur in these essential materials and components due to an interruption of supply or increased demand in the industry. If we are unable to procure certain of such materials or components, we would be required to reduce our manufacturing operations, which could have a material adverse effect on our results of operations.

For the years ended December 31, 2007, 2006 and 2005, three suppliers represented approximately 66%, 71% and 62%, respectively, of our total purchases. As of December 31, 2007 and 2006, approximately 60% and 77%, respectively, of our accounts payable were due to these suppliers.

Off-Balance Sheet Arrangements

During the periods presented, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purpose.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, or SFAS 157. SFAS 157 defines fair value, establishes a framework for measuring fair value, and enhances fair value measurement disclosure. In February 2008, the FASB issued FASB Staff Position 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement

under Statement 13, or FSP 157-1, and FSP 157-2, Effective Date of FASB Statement No. 157, or FSP 157-2. FSP 157-1 amends SFAS 157 to remove certain leasing transactions from its scope. FSP 157-2 delays the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until the beginning of the first quarter of 2009. The measurement and disclosure requirements related to financial assets and financial liabilities are effective for us beginning in the first quarter of 2008. The adoption of SFAS 157 for financial assets and financial liabilities will not have a significant impact on our consolidated financial statements. However, the resulting fair values calculated under SFAS 157 after adoption may be different from the fair values that would have been calculated under previous guidance. We are currently evaluating the impact that SFAS 157 will have on our consolidated financial statements when it is applied to non-financial assets and non-financial liabilities beginning in the first quarter of 2009.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, or SFAS 159. SFAS 159 permits companies to choose to measure certain financial instruments and other items at fair value. The standard requires that unrealized gains and losses are reported in earnings for items measured using the fair value option. SFAS 159 is effective for us beginning in the first quarter of 2008. The adoption of SFAS 159 is not expected to have a significant impact on our consolidated financial statements. SFAS 159 is effective for us beginning in the first quarter of 2008. The adoption of SFAS 159 is not expected to have a significant impact on our consolidated financial statements.

In June 2007, the FASB ratified EITF Issue No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities*, or EITF 07-3. EITF 07-3 requires non-refundable advance payments for goods and services to be used in future research and development activities to be recorded as assets and the payments to be expensed when the research and development activities are performed. EITF 07-3 applies prospectively to new contractual arrangements entered into beginning in the first quarter of 2008. Prior to adoption, we recognized these non-refundable advance payments as an expense upon payment. The adoption of EITF 07-3 is not expected to have a significant impact on our consolidated financial statements.

In December 2007, the U.S. Securities and Exchange Commission issued SAB 110 to amend the SEC's views discussed in SAB 107 regarding the use of the simplified method in developing an estimate of expected life of share options in accordance with SFAS 123R. SAB 110 is effective for us beginning in the first quarter of 2008. As of December 31, 2007, we did not use the simplified method and the adoption of SAB 107, as amended by SAB 110, is not expected to have a significant impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations*, or FAS 141(R). FAS 141(R) will change how business acquisitions are accounted for. FAS 141(R) is effective for fiscal years beginning on or after December 15, 2008. The adoption of FAS 141(R) is not expected to have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements — an amendment of Accounting Research Bulletin No. 51*. SFAS No. 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS No. 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. The adoption of SFAS No. 160 is not expected to have a material impact on our consolidated financial statements.

Quantitative and Qualitative Disclosure About Market Risk

Foreign Currency Risk

Most of our sales contracts have been denominated in United States dollars, and therefore our revenue historically has not been subject to foreign currency risk. As we expand our international sales, we expect that an increasing portion of our revenue could be denominated in foreign currencies. As a result, our cash and cash equivalents and operating results could be increasingly affected by changes in exchange rates. Our international sales and marketing operations incur expense that is denominated in foreign currencies. This expense could be materially affected by currency fluctuations. Our exposures are to fluctuations in exchange rates for the United States dollar versus the Euro. Changes in currency exchange rates could adversely affect our consolidated operating results or financial position. Additionally, our international sales and marketing operations maintain cash balances denominated in foreign currencies. In order to decrease the inherent risk associated with translation of foreign cash balances into our reporting currency, we have not maintained excess cash balances in foreign currencies. We have not hedged our exposure to changes in foreign currency exchange rates because expenses in foreign

currencies have been insignificant to date, and exchange rate fluctuations have had little impact on our operating results and cash flows.

Interest Rate Risk

We had cash, cash equivalents and short-term investments totaling $240,000, $42,000 and $261,000 at December 31, 2007, 2006 and 2005, respectively. These amounts were invested primarily in money market funds, short-term United States Treasury obligations and commercial paper. The unrestricted cash, cash equivalents and short-term investments are held for working capital purposes. We do not enter into investments for trading or speculative purposes. We believe that we do not have any material exposure to changes in the fair value as a result of changes in interest rates due to the short term nature of our cash equivalents and short-term investments. Declines in interest rates, however, would reduce future investment income.

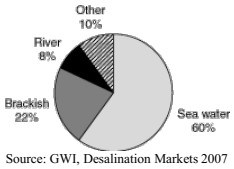
INDUSTRY

The demand for fresh water continues to escalate, driven by the need for drinking water to satisfy the world's growing population, changing weather patterns, an increasing need for water for agriculture and industry and the concentration of populations in urban areas that lack sufficient fresh water resources. For example, according to the World Water Council, approximately 260 gallons of water are needed to produce 2.2 pounds of wheat and 3,380 gallons of water are needed to produce 2.2 pounds of beef. The power industry is also a large consumer of water, as water is critical to the cooling processes used in fossil fuel and nuclear plants and in the production of biofuels. The United Nations Population Fund expects the global consumption of water to double every 20 years. A study conducted by the International Water Management Institute projects that by 2025, 33% of the population of the developing world will face severe water shortages. The uneven geographic distribution of fresh water supplies compounds this problem. Even in water-rich nations, population growth, environmental regulation and irrigation needs are placing constraints on existing water resources.

The United Nations Environmental Program estimates that by 2010, 80% of the world's population will live within 100 kilometers of a sea coast. With the growth of population centers along coastal areas and improvements in technology, desalination, once a luxury of oil-rich Middle Eastern countries and large-scale resorts, is rapidly becoming an economically viable alternative in many regions where traditional fresh water sources are becoming increasingly stressed. According to the February/March 2008 issue of International Desalination & Water Reuse Quarterly, there are approximately 14,000 desalination plants installed worldwide. Global Water Intelligence, or GWI, estimates that as of December 31, 2005, there were 39.9 million cubic meters per day of installed capacity, and that the growth in the market for new total desalination capacity should increase by approximately 13% per year from 2005-2015. We expect SWRO's share of new total desalination capacity to grow in excess of the overall industry growth rate particularly due to higher energy costs.

Desalination is the process of removing salt and other minerals and solids from water. The process is most commonly used to derive fresh water from sea water or brackish water. Brackish water is water that has more salinity than fresh water, but not as much as sea water, and is found in certain lakes, marshes, deltas, rivers and bays. The higher the salinity of the source water, the greater the energy required in the desalination process. We target the sea water segment of the desalination industry, which is the dominant segment of the market. More specifically, we operate primarily in the sea water reverse osmosis, or SWRO, sector of the sea water desalination market.

Desalination Market by Feedwater



Source: GWI, Desalination Markets 2007

Sea Water Desalination

Currently there are two basic methods of sea water desalination:

- thermal, which uses heat to evaporate fresh water from salt water; and
- SWRO, which uses high pressure to drive salt water through membranes, leaving concentrate behind.

The choice of processes depends largely on the cost of power. Thermal processes require more energy than SWRO processes because of the high energy required to boil water. Advances in SWRO processes, such as the use of more efficient energy recovery devices and membranes, have dramatically decreased the associated energy cost, making it the preferred method in regions where energy costs are high.

Thermal Desalination

Thermal desalination is the process of boiling water and condensing the vapor into fresh water. Because thermal desalination processes are energy intensive, the process is generally only viable for large-scale plants built primarily in oil-rich regions such as the Middle East where the cost of power is low. Although in recent years thermal technologies have evolved to require less net power consumption, these advances have not been able to achieve the reduced levels of energy consumption associated with SWRO. As a result, thermal plants continue to be constructed primarily in regions with low energy costs.

SWRO Desalination

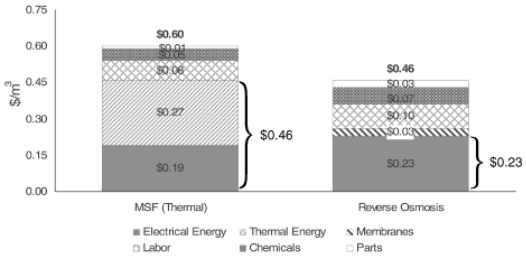
SWRO desalination uses high pressure to drive fresh water from sea water through reverse osmosis membranes. The pressure required for this process depends upon the permeability of the membranes and salinity of the water. As an example, brackish water desalination requires less pressure than sea water desalination due to its lower salinity. Technology advances have increased membrane permeability, lowering the pressure required while improving salt filtration. However, without an energy recovery device a significant amount of energy would be lost in the reject stream. Effective recovery of the energy contained within the reject stream has made the SWRO process significantly more energy efficient and economically attractive. The evolution of energy recovery devices for SWRO began with the use of the Pelton wheel in 1984, followed by the hydraulic turbocharger in 1992 and most recently isobaric technologies, including our PX device, which became commercially available in 1997.

SWRO versus Thermal

Declining SWRO desalination costs due to improved technology and increasing energy costs have made SWRO desalination the preferred method of water production in regions where the cost of energy is high and fresh water is scarce. Consequently, according to GWI, the share of total new contracted desalination capacity using SWRO has increased from approximately 42% in 1999 to approximately 71% in 2006, and is expected to continue to increase.

The surge in desalination project activity since 1990 is primarily due to advances in SWRO technology, including energy recovery devices and membranes, which have significantly reduced the cost of producing fresh water from sea water. According to GWI, using SWRO technology, the cost of producing a cubic meter of fresh water from sea water, which averaged approximately $10 per cubic meter in the mid-1960's, had dropped to as low as $0.46 per cubic meter by 2005. As shown below, energy costs associated with the SWRO process are approximately 50% less than those associated with the traditional thermal desalination process.

Relative Operating Costs of the Desalination Process as of 2006



Source: GWI, Desalination Markets 2007

Energy Recovery Devices

Wheel Technology

When SWRO was first commercialized on a large scale in 1984, engineers used existing water wheel technology, the Pelton wheel, which was first developed in 1880 in connection with gold mining, to recover the pressure energy from the reject stream. The Pelton wheel works by directing the high-pressure reject stream at a bucket wheel mounted on the same shaft as the high-pressure feed water pump, thereby recycling energy back into the SWRO process. However, as energy is transferred from the reject stream back into the feed water stream utilizing the Pelton wheel and pump system, energy is lost.

In the late 1980's, the hydraulic turbocharger was developed as an alternate energy recovery device for SWRO plants. Similar to the Pelton wheel, the hydraulic turbocharger uses a turbine to recover energy and transfers the energy back into the SWRO process with a high-pressure pump. While the hydraulic turbocharger was slightly more efficient than the Pelton wheel because of its higher rotating speed, it suffered from similar inefficiencies due to similar design characteristics.

Isobaric Technology

In 1975, the first isobaric technology device was piloted in Bermuda. In contrast to the Pelton wheel and turbocharger technology, isobaric technology employs a pressure equalizing method to transfer energy from the membrane reject stream directly to the membrane feed stream, bypassing the need to convert energy from the high pressure rejection stream into mechanical form. This direct positive displacement approach results in significantly higher transfer efficiency rates.

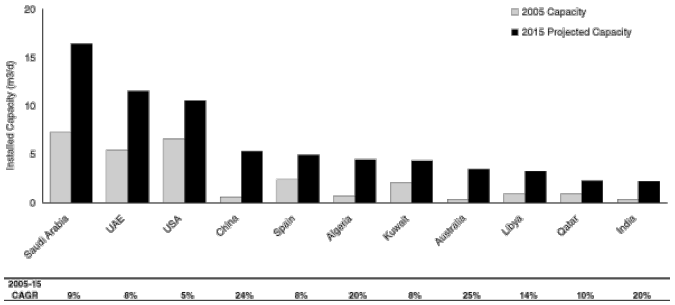
During the 1990's, the Dual Work Exchanger Energy Recovery, or DWEER, was developed and initially used in the manufacturer's SWRO plants in the Caribbean as a slow cycle isobaric energy recovery device. According to its manufacturer, Calder AG, the DWEER system attains efficiency rates of up to 97%. The DWEER system utilizes a piston and valve system in a high pressure batch process with large pressure vessels, similar to a steam locomotive, to capture and transfer the energy lost in the membrane reject stream. While the DWEER attains high rates of efficiency, it suffers from its large size, mechanical complexity with numerous moving parts that undergo millions of cycles per year, and corrosion potential due to its metal composition.

In early 1997, we introduced the initial version of our energy recovery device, the PX. In November 1997, we introduced and marketed our first ceramic-based PX device. Our PX device represented an advance in the available technology by utilizing ceramic construction and a rotating chamber design with only one moving part.

Desalination Growth Regions

Significant growth is forecasted in the broader desalination industry, which includes sea water, brackish and all other types of feedwater. According to GWI, countries such as Australia, Algeria, China and India are expected to achieve compound annual growth of at least 20% from 2005 to 2015.

Projected Desalination Installed Capacity—All Feedwater Types (2005-2015)



Source: GWI, Desalination Markets 2007

Middle East and North Africa

The Middle East dominates the desalination industry, accounting for approximately 70% of total contracted capacity in 2005, according to GWI 19th Annual Desalting Plant Inventory. As reported by ULTRAPURE WATER, the Arab states alone will need to spend $100 billion on desalination over the next 10 years. During 2007, several SWRO plants were contracted in Kuwait, Oman, Israel and the United Arab Emirates. Algeria and Saudi Arabia accounted for almost half of 2005 contracted capacity. All of Algeria's 2005 contracted capacity was SWRO while Saudi Arabia's SWRO capacity made up 17% of its total 2005 contracted capacity. This statistic demonstrates that in many oil rich Middle East countries traditional thermal desalination persists due to the abundance of subsidized power.

The recent emergence of large SWRO desalination plant projects in the Middle East, such as Al Fujairiah in the United Arab Emirates (170,000 cubic meters per day) and Shoiaba in Saudi Arabia (150,000 cubic meters per day), may demonstrate the beginning of a shift to SWRO, even where power has been historically inexpensive. Thermal desalination plants, typically located adjacent to power plants, pose an efficiency constraint for power generators. Power generators that would otherwise reduce power generation during off-peak seasons to cut costs, must continue operating at peak because the thermal desalination process necessitates continuity of operations. Many Middle East operators are turning to hybrid SWRO/thermal plants to accommodate off-peak usage periods. In addition, high maintenance and building costs associated with thermal plant construction may shift preferences to SWRO plants which are less expensive to build and operate. Specifically, thermal desalination plants are constructed of nickel/chromium based alloy metals to avoid corrosion, and these metals have experienced price increases in recent years.

Algeria is currently one of the most active desalination markets outside the Persian Gulf region. GWI predicts that Algeria will install 2.6 million cubic meters per day by 2010 and 4.5 million cubic meters per day by 2015.

Europe

The most significant European market to date has been Spain. Spain utilizes SWRO plants built by large Spanish EPC consortiums. Spain's Plan Hidrológico Nacional, which initially favored transferring water from the Ebro River to Spain's dry southern Mediterranean coast, changed its strategy in 2004 in favor of the construction of multiple SWRO desalination sites under a fast-track development program called Acuamed.

United States

While the U.S. market currently utilizes reverse osmosis primarily for brackish water, 1.2 to 1.7 million cubic meters of SWRO capacity are under consideration, according to GWI. However, permits, environmental impact studies and project financing present steep initial hurdles for U.S. municipalities. The most promising regions for SWRO are populated coastal areas, particularly California, Texas and Florida. California, in particular, is a potential locus for SWRO desalination. Population growth on the West Coast and environmental pressures place continued strain on the Colorado River.

The Affordable Desalination Collaboration, or ADC, project seeks to demonstrate to California municipalities that with state of the art technology, SWRO desalination is a cost effective alternative to traditional water sources. ADC also promotes the use of the PX technology in SWRO water projects.

Asia Pacific

Australia, China and India all represent large-scale SWRO opportunities. Asia Pacific countries have large populations in water stressed regions that border oceans. In particular, India, with its high population growth, offers a significant SWRO opportunity due to an accelerated use of water for irrigation, rapid industrialization and improving living standards. At the same time, existing water resources are diminishing. According to GWI, India currently accounts for 31% of the Asia Pacific region's contracted capacity.

In Australia, drought has played a significant role in the political decision to move forward on large SWRO plants. Australia's major population centers border the coast. The commissioning of a desalination plant in Perth (143,000 cubic meters per day) marked a major milestone for Australia. According to GWI, Australia built approximately 100,000 cubic meters per day of new capacity in the 2001–2005 period, and it is expected to add approximately 1.4 million cubic meters per day between 2006 and 2010.

GWI expects that China's desalination capacity will grow approximately 24% per annum from approximately 600,000 cubic meters per day in 2005 to over 5.3 million cubic meters per day by 2015. As the Chinese economy moves towards a free market, the water sector is expected to operate on a more commercial basis. For example, in Shanghai and Pudong the water utilities have become privatized. We believe that as such privatization continues, considerations of water production costs will lead to the commissioning of further SWRO plants that utilize our PX technology. Over the last five years, our PX device was selected for 14 new SWRO plants, which we believe represent a majority of the new SWRO plants commissioned during the same period.

BUSINESS

Overview

We are a leading global developer and manufacturer of highly efficient energy recovery devices utilized in the rapidly growing water desalination industry. We operate primarily in the sea water reverse osmosis, or SWRO, segment of the industry. SWRO uses pressure to drive salt water through filtering membranes to produce fresh water. Energy recovery devices have increased the cost-competitiveness of SWRO desalination compared to other means of fresh water supply and has enabled the ongoing rapid growth of the SWRO segment of the desalination industry worldwide. Our primary product, the PX Pressure Exchanger, or PX, helps optimize the energy intensive SWRO process by recapturing and recycling up to 98% of the energy in the high pressure reject stream, thereby reducing energy consumption by an estimated 60% as compared to a plant without any energy recovery devices.

We believe that the proven benefits of our proprietary technology have made us a leader in the SWRO energy recovery market due to the following:

- *Up to 98% energy recovery efficiency.* The PX device achieves high efficiency by minimizing energy loss. The tight fit between the ceramic components in a PX device minimizes leakage inside the device. In addition, the flow paths through the device are relatively open such that losses due to friction are minimized. Because losses are minimized, the energy output of the PX device is only slightly less than the energy input. This ratio is measured in terms of efficiency.
- *Proprietary design employing only one moving part.* The only moving part in the PX device is the ceramic rotor, which is surrounded by a ceramic sleeve and two end covers. The narrow gap between the rotor and surrounding components fills with high-pressure water which serves as a nearly frictionless hydrodynamic bearing. The combination of the extreme durability of ceramic and the low-friction bearing design results in very little wear over time.
- *Corrosion resistant, highly durable ceramic composition*. The advanced ceramic material used in the PX device is corrosion resistant, rigid and three times stronger than steel. This allows us to design the rotor and the sleeve to have and maintain narrow clearances despite the high operating pressures to which these devices are exposed and speeds at which they operate. These narrow clearances allow sea water to act as a lubricant, minimizing wear and leakage losses.
- *Small footprint, modular design and system redundancy.* Our PX devices are available in a range of standard product sizes. Higher capacities are achieved by arranging multiple devices in parallel. Customers specify the number of devices necessary for a given application, and additional capacity is provided by adding units. Further, due to the parallel arrangement of the PX devices, if one PX unit in an array should fail, the desalination plant can continue to operate.
- *Lower life cycle cost versus competitors.* Some of our competitors may price their energy recovery devices below that of our product. However, because of the PX device's high efficiency, durability, corrosion resistance, and modular design that allows for system redundancy, resulting in minimal plant shutdowns for PX device maintenance, we believe our product is the most cost effective energy recovery device alternative in the long term.

The PX device uses highly durable, ceramic components to capture and recycle the energy that otherwise would have been lost in the high pressure reject stream of the SWRO process and applies it to the low pressure sea water feed stream. The PX device has become a leading energy recovery solution in the sea water desalination industry, installed in over 300 desalination plants and specified in plant designs by over 60 original equipment manufacturers, or OEMs, and engineering, procurement and construction, or EPC, firms worldwide. We estimate that PX devices shipped as of December 31, 2007 will reduce electricity consumption in SWRO desalination plants by approximately 300 megawatts relative to comparable plants with no energy recovery devices. Assuming a rate of $0.08 per kilowatt hour, the deployment of PX devices in plants that otherwise had no energy recovery devices would result in annual electricity cost savings of approximately $210 million in the aggregate, which would equate to a reduction in carbon dioxide emissions of approximately 1.5 million tons per year.

Our successful market penetration has resulted in a rapidly increasing installed base of PX devices globally, which we expect to lead to aftermarket part replacement and service opportunities. We also manufacture a line of booster pumps for use in conjunction with same models of the PX device. As of December 31, 2007, we had shipped over 4,000 PX devices to desalination plants worldwide, including in China, Europe, India, Australia, Africa, the Middle East, North America and the Caribbean.

We design, manufacture and sell various PX models to serve a range of SWRO process flow rates for various plant designs and sizes. With respect to large desalination plants (greater than 50,000 cubic meters, or 13.2 million gallons, per day capacity), we sell our products to international EPCs, and with respect to smaller desalination facilities (fewer than 50,000 cubic meters per day capacity) we sell our products to OEMs for installation in hotels, power plants and municipal facilities. Our research, development and manufacturing facility is located in the San Francisco Bay technology corridor, and we have direct sales offices and technical support centers in many key desalination markets, including Madrid, Dubai, Shanghai and Fort Lauderdale.

Our Strengths

- ***Unique and efficient product.*** Our uniquely designed product offers several significant benefits to our customers and advantages over competing products. We manufacture the only commercially available rotary isobaric energy recovery device, which we believe is more effective at recovering and recycling energy than any other commercially available energy recovery device. The PX device incorporates highly-engineered corrosion resistant ceramic parts and a modular design that minimizes product maintenance and helps prevent plant shutdowns. Our rotary device has only one moving part and a continuous flow design, which complements the continuous flow of the SWRO process. This contrasts with competing isobaric energy recovery devices that utilize an alternating flow process with various moving parts more susceptible to wear, and which may require plant shutdowns for maintenance and part replacement. We believe these unique benefits lead to lower life cycle costs than competing products.
- ***Leading position in a rapidly growing industry.*** The combination of decreasing fresh water supplies, increasing fresh water demand and declining SWRO desalination costs is driving growth in the SWRO desalination industry. We believe we are the largest global supplier of energy recovery devices for SWRO, the fastest growing segment of the desalination market. According to GWI, the share of total new contracted sea water desalination capacity using SWRO has increased from approximately 42% in 1999 to approximately 71% in 2006.
- ***Rapid growth.*** Our net revenue increased from $4.0 million in 2003 to $35.4 million in 2007, representing a compound annual growth rate of 72%, driven by the rapid growth of the SWRO desalination industry and our increased penetration of this market. Our sales growth has enabled us to leverage our existing manufacturing cost base. We are developing several new products to provide additional cost and performance advantages. Additionally, as our installed base of PX devices ages and the number of installed units increases, we expect sales of replacement PX parts and services to increase.
- ***High barriers to entry.*** Historically, there has been a slow adoption rate for new technologies in the desalination industry. We have spent the last 11 years penetrating the market and establishing our company and product with major industry participants. Over this period, our PX device has been increasingly adopted into the standard plant specifications of many of the leading SWRO desalination plant designers. We have five U.S. and nine international counterpart patents covering specific design features of the PX device. In addition, we have developed significant know-how related to ceramic processing methods essential to the manufacturing, reliability and performance of the PX device.
- ***Diversified international blue chip customer base.*** Currently, most of our revenue has been derived from sales to large EPCs such as Acciona Water, Doosan Heavy Industries, Geida and GE Ionics. In addition, we are specified in plant designs by over 60 OEMs and EPCs worldwide and have sold PX devices to approximately 250 other customers, including small and mid-tier OEMs, hotel operators, power plants and municipalities.
- ***Strong, experienced management team.*** Our senior management team has significant industry experience in the design, construction and operation of SWRO desalination plants and the filtration industry. Our chief executive officer, G.G. Pique, joined us in 2000 after serving for seven years as the group vice president Latin America of US Filter Corporation (subsequently acquired by Vivendi) and has over 30 years of experience in the water treatment industry. He has built the management team, driven the "customer first" corporate culture and engineered the strategy leading to global acceptance of PX technology.

Our Strategy

- ***Increase market penetration.*** We actively work with EPCs and OEMs to specify our PX device in the designs of their SWRO desalination plant. For example, we believe our PX device is currently the specified energy recovery device for a majority of the SWRO facilities in China and is gaining acceptance in the Middle East where SWRO continues to displace thermal desalination. To further our market penetration, we are also expanding our existing sales channels and coverage footprint through new strategic hires and by increasing our product offerings. Additionally, we are continuing to increase the awareness of our technology through technical papers, trade shows, seminars, industry publications and trade association memberships.

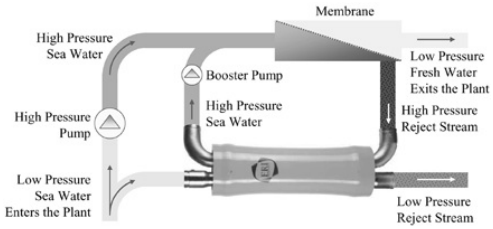
- ***Continue to broaden our product portfolio.*** We are developing new products that should continue to grow our market share and meet the increasing demands of our clients. As the SWRO market moves towards increasingly larger desalination plants, we are developing products designed to address these larger volume plants. Specifically, we have developed a product, the PX-1200 Titan, that is expected to provide a five-fold increase in water flow capacity from that of our largest current PX device. For customers who are more sensitive to up-front costs and who operate smaller plants, we are developing the Comp PX device. We also intend to expand our product portfolio to include additional circulation/booster pumps (internal or private label) and a bundled turnkey solution for customers that would include both a PX device and pump.
- ***Increase our aftermarket sales.*** Over time, components of our PX device will need to be repaired or replaced. Thus, as our installed base of PX devices ages and the number of installed units increases, we expect aftermarket sales of replacement PX parts and services to increase. We are also considering formulating a service contract model and strategic stocking centers to help drive additional aftermarket sales.
- ***Capitalize on growth opportunities in alternative power and other emerging sectors.*** We are diversifying our energy recovery offerings to capitalize on growth opportunities in emerging sectors. For example, osmotic power generation utilizes a process similar to that of SWRO and is a clean, alternate source of power currently under development. We are participating in an osmotic power pilot test facility being designed by a European utility company that may use PX technology. In addition, the PX device could potentially be applied in any process that has a high-pressure waste stream including chemical and petroleum processing. Also, participants in the growing brackish water reverse osmosis desalination market are increasingly interested in reducing energy consumption through the use of energy recovery devices such as our PX device.

Products and Services

Our core product, the PX, is an energy recovery device employed within SWRO desalination systems. The PX device utilizes the principle of positive displacement and isobaric chambers to achieve an extremely efficient transfer of energy from a high-pressure waste stream, the reject stream, to a low-pressure incoming feed stream, effectively recycling energy that otherwise would have been lost.

Our PX device uses a cylindrical rotor with longitudinal ducts parallel to its rotational axis to transfer the pressure energy from the reject stream directly to the feed stream. The rotor spins inside a sleeve between two end covers with port openings for low and high pressure. The low-pressure side of the rotor fills with sea water while the high-pressure side discharges sea water. The rotational action of the PX device is similar to that of a Gatling machine gun and is refilled with new sea water cartridges while rotating around a central axis. A liquid piston moves back and forth inside each duct, significantly minimizing mixing between the reject water and incoming sea water streams.

The flow diagram below depicts how our PX device takes pressure energy from the reject stream and recycles it back to the desalination process at up to 98% efficiency.



We produce a variety of PX models to suit the design and capacity needs of various SWRO plants. We also manufacture a line of booster pumps for use in conjunction with PX devices to service flows up to 300 gallons per minute, or gpm.

Current Products

65-Series PXs

The PX-220 has been our flagship product. However, we expect the recently introduced PX-260 to become our flagship product in late 2008. The 65-Series PX product line, named for the diameter of the rotor, includes the following models:

Model	Capacity
PX-260	220–260 gpm (48–58 m^3/hr)
PX-220	180–220 gpm (41–50 m^3/hr)
PX-180	140–180 gpm (32–41 m^3/hr)

The 65-Series is designed for SWRO plants with production capacities greater than 120 gpm (650 m^3/day). PX devices are manifolded together into trains to achieve unlimited capacity ranges.

4S-Series PXs

The 4S-Series devices are designed for plants with production capacities in the range of 25 to 300 gpm (140 to 1,600 m^3/day). The current product line includes the following models:

Model	Capacity
PX-140S	90–140 gpm (20–32 m^3/hr)
PX-90S	60–90 gpm (14–20 m^3/hr)
PX-70S	40–70 gpm (9–16 m^3/hr)
PX-45S	30–45 gpm (7–10 m^3/hr)
PX-30S	20–30 gpm (4–7 m^3/hr)

Booster Pumps

Our PX booster pumps are suitable for SWRO plants with production rates ranging from approximately 25 to 300 gpm (140 to 1,600 m^3/day). Each of the following series of booster pumps has two models to cover the pressure range and flow requirements of that series. Our current product line includes the following series:

Series	Capacity
HP-2400	150–300 gpm (34–68 m^3/hr)
HP-1250	80–170 gpm (18–39 m^3/hr)
HP-8500	30–110 gpm (7–25 m^3/hr)

New Products and Products in Development

We recently have developed and commercially released several new products. In addition, we are currently developing several new products for possible commercial release in 2009 and 2010.

PX-260

We launched the PX-260 in late 2007. The PX-260 utilizes the same vessel as the PX-220 but incorporates new ceramic designs and internal components. The PX-260 will provide higher capacity while achieving similar efficiency as the PX-220. We expect a number of customers who are currently using the PX-220 in their SWRO processes to purchase the PX-260 for their future projects. However, because of the six to 16 month sales cycle, we do not expect to ship the first large volume orders of the PX-260 until the fourth quarter of 2008.

PX-30S

We have recognized the need to supply units for pilot projects, typically mandated by large municipal water projects. The PX-30S was designed as a test unit and entry point to gain the approval and acceptance of large municipal projects. With only a 4-inch rotor, the PX-30S allows a municipal water operator to achieve the same efficiency as our larger

recovery devices, except on a smaller scale. The PX-30S, launched in October 2007, is also expected to serve as an attractive solution for smaller SWRO plants, particularly marine-based and solar-powered units.

Brackish PXs

We have developed and recently introduced a new line of brackish PX devices that takes advantage of the less stringent requirements of brackish water applications. Because less pressure is required to desalinate brackish water, brackish water reverse osmosis, or BWRO, requires less power than SWRO. Our new line of brackish PX devices should help us be competitive in the BWRO market.

Comp PX

We are developing a new PX device designed for customers who are more sensitive to up-front costs and who operate small plants or are in regions where energy costs are low. The device will not have the same durability as our current devices. The Comp PX is expected to be available in 2009.

PX-1200 Titan

We expect to commercially deploy the PX-1200 Titan, which is a 1,200 gpm (273 m^3/hr) PX device, in 2010 or later. The following highlights some of the PX-1200 Titan's primary features:

- five-fold increase in capacity compared to the PX-260;
- simple four-point hookup;
- scalability in cost and pricing; and
- simplicity of installation.

The PX-1200 Titan is intended to meet the requirements of the increasingly larger SWRO desalination facilities scheduled to be built in the near future.

Private Label Pump

We currently manufacture and sell a line of booster pumps for plants with production rates ranging from 25–300 gpm. We are evaluating a strategic expansion of our product portfolio by offering larger capacity private label booster pumps to our customers. We would outsource production of the pumps to one or more specialized pump manufacturers. This would provide our customers a one-stop shop solution for their energy recovery requirements.

Aftermarket Services and Sales

Due to the importance of the PX device in the operation of the plant, we have full-time employees and factory-trained contractors who perform engineering support and technical service functions on a global basis. As our installed base of PX devices ages and the number of installed units increases, we expect aftermarket sales of replacement PX parts and services to increase. We are also considering formulating a service contract model and strategic stocking centers to help drive additional aftermarket sales.

Future Market Opportunities

Leasing Model

While we have occasionally offered leasing options for PX products, we are evaluating a wide range of leasing models with potential strategic partners. A PX lease structure could comprise a lease of only the ceramics portion of an energy recovery solution or, alternatively, encompass an entire energy transfer center, which would include the manifold, booster pump and potentially, a high-pressure pump/motor.

SWRO Pump Bay

We currently build and market a line of booster pumps for plants with production rates up to 300 gpm. The addition of a full range of booster pumps to 1,200 gpm and above would complement the entire product suite of PX devices, providing an additional revenue opportunity. These booster pumps would enable us to offer our customers a fully integrated energy recovery solution, which would allow our customers to reduce implementation time. The addition of booster pumps to

complement larger rotor PX devices could be achieved through in-house production or, alternatively, through a strategic venture with an outside manufacturer.

Osmotic Power (Forward Osmosis)

A potential future technology, osmotic power, could also utilize PX devices. Osmotic power generates power by capturing the natural energy generated as fresh water is drawn into salt water, or forward osmosis. This occurs whenever there is a large source of fresh water in proximity to a large body of salt water, such as the Scandinavian fjords, the Salton Sea in California, the Great Salt Lake in Utah or the Dead Sea in Israel. We are currently in discussions with a European utility company that is designing an osmotic power pilot test facility that may use PX technology.

Sales and Marketing

As of December 31, 2007 our sales force consisted of seven employees. We have sales representatives located in Spain, China, the United States and the United Arab Emirates. They are compensated with both a base salary and a commission based on a percentage of the gross profit generated by their sales. We occasionally use outside sales agents who receive a commission when the purchase price is collected.

We sell the PX device through two main divisions which are aligned with our target markets. Our Agua Grande, or AG, division targets projects exceeding 50,000 cubic meters a day in overall capacity. Our OEM division targets projects with fewer than 50,000 cubic meters a day in overall capacity.

AG Target Customers

Sales to our AG customers is the fastest growing revenue source for our business. Each AG project typically represents a revenue opportunity ranging from $2 million to $7 million. These projects have an average sales cycle (time from initial project tender to the time the PX device is shipped to client) of six to 16 months and, in some cases, up to 36 months. EPCs are the primary target market for our PX-220s and 260s and our forthcoming PX-1200 Titan device. With the current pipeline of new SWRO plants exceeding 50,000 cubic meters per day capacity, we expect these customers to continue to be our largest revenue generators. These large projects also provide the most significant revenue opportunities for aftermarket services through operating, maintenance and extended warranty sales.

Our AG customers primarily consist of large EPC firms primarily located in the United States and Europe. We recently established a sales and technical center in Madrid, Spain, in proximity to many of the large European EPCs. This new strategic location allows rapid response to the complex requirements of European EPC customers.

OEM Target Customers

This customer group is defined as small to medium sized SWRO projects (fewer than 50,000 cubic meters a day). Unlike the AG customers, this group is highly fragmented. OEM customers are further divided into small (5,000 cubic meters a day) and mid-tier (5,000–50,000 cubic meters a day) operators that purchase both standardized and custom-made SWRO packages used by hotel chains, large resorts, cruise ship terminals, island bottlers and industrial/power plants. Because OEM customers are located worldwide, we have placed our sales force and service support strategically to address customer needs.

This customer group represents an ideal retrofit opportunity for cost-conscious operators utilizing competing energy recovery devices with lower efficiency rates. Based on our experience, the OEM market has a much shorter sales cycle than the AG group, with a typical sales cycle of one to three months.

Marketing

Our marketing and promotional efforts are undertaken in a variety of channels:

- *Demonstration, Retrofit and Pilot Test Facilities.* Many high-profile retrofit projects and pilot test facilities have demonstrated the tangible benefits of the PX device, increasing industry acceptance of our product. Upon commissioning in 2001, the Cyprus Dhekelia SWRO plant utilized the PX device in the largest isobaric train in the world. Our successful retrofit of the Dhekelia plant demonstrated to large international EPCs the efficiency and reliability of the PX device. Similarly, the Huntington Beach and Carlsbad (Poseidon/Dow FILMTEC) pilot test facilities in California provide us with conveniently accessible demonstration facilities to promote the benefits of the PX device to potential customers.

- *Technical Papers/Trade Shows.* We have leveraged the technical talent of our chief technical officer, Dr. Richard Stover, to generate technical papers, which are presented at trade shows and published in international trade magazines and journals. These papers provide an efficient yet low cost vehicle for educating OEMs and other end users about positive displacement isobaric technology.
- *Seminars.* We hold joint technical seminars with various industry participants on desalination solutions pertaining to core SWRO processes in an effort to disseminate information about the PX device.
- *Industry Publications/Trade Association Membership.* We gain important exposure through advertising in well-known industry publications. Advertising of the PX device has consisted of advertisements in Desalination and Water Reuse Quarterly, Arab Water World, GWI, Everything About Water (India), Agua Latinoamerica, Filtration and Separation Technology, InfoEnviro (Spain) and the Technology of Water Treatment (China).
- *Interactive Website.* We have developed a website focused on facilitating an understanding of PX technology, its economic benefits and practical applications. The suite of PX technical tools (The Power Model, SWRO Cost Estimator, ERI SIM™ SWRO Process Simulator and PX Animation) allows a potential user to review power consumption, cost and operation of the PX technology. We utilize our website as a management tool to provide content about our products and we track activity on our website.

In addition, we are a founding member, promoter and participant in the Affordable Desalination Collaboration, or ADC, a consortium of industry leaders, federal and state government agencies and water districts. ADC seeks to promote SWRO as an affordable, reliable and environmentally sound source of fresh water.

Customers

Currently, most of our revenue is generated from sales to large EPCs. In addition, as of December 31, 2007, we are specified in plant designs by over 60 OEMs and EPCs worldwide and have sold PX devices to approximately 250 other customers, including small and mid-tier OEMs, hotel operators, power plants and municipalities.

A limited number of our EPC customers accounts for a substantial portion of our net revenue. Specifically, Acciona Water, Geida and its affiliated entities and Doosan Heavy Industries represented approximately 20%, 23% and 13% of our total sales in 2007, respectively, and GE Ionics and Geida and its affiliated entities accounted for approximately 18% and 11% of our total sales in 2006, respectively. In 2005, GE Ionics and Multiplex Degremont JV accounted for 19% and 17% of our total revenue, respectively. No other customer accounted for more than 10% of our total revenue during any of these periods.

In order to make customer support efficient, we maintain strategic satellite technical centers, located in Madrid, the United Arab Emirates, Shanghai, Perth and Fort Lauderdale. These technical centers support existing customers and aftermarket sales efforts for both EPCs who deal in large projects and small OEM customers across multiple continents and time zones. In addition, we support a troubleshooting hotline.

We offer customer service and support programs including PX technology education, design review, startup support and operator training. We regularly conduct “PX school” in California and many places around the world to upgrade the skills of designers and operators in the application of PX technology.

In addition, we provide a number of product support resources and services. These include operations and maintenance manuals, a maintenance training video and the “PX Simulator” factory and regional technical seminars. We also offer the “PX Power Model” SWRO energy consumption calculator, manifold, rack and instrumentation designs, project management, startup assistance and field service.

Manufacturing

All of our PX devices are assembled, packaged and shipped from our facility in San Leandro, California. We purchase ceramic components in an unfinished state from approved suppliers and perform the final finishing and assembly in-house to help protect the proprietary nature of our products.

Our manufacturing team collaborates with our technical team to execute production, wet testing and product delivery. Currently, we outsource production of all metal and composite components and initial processing of most of our ceramic components to outside vendors. Final finishing of all end covers, rotors and sleeves is performed in-house to help maintain the integrity of trade secrets and patents.

We presently run one shift per day to meet current and near-term expected demand. Increased work schedules, outsourcing and additional personnel could combine to increase manufacturing capacity significantly above current

production levels. Critical end functions such as final testing and assembly are expected to remain in-house for the foreseeable future.

To avoid unnecessary inventory build-up and provide timely order fulfillment, our manufacturing team coordinates with our sales divisions to review sales forecasts and schedule production runs. Our manufacturing department generally maintains a four-week safety stock to meet any unforeseen shortfalls. We utilize an enterprise resource planning system to model for various production constraints. As manufacturing activity increases, a more advanced modeling system may eventually be needed to queue production runs and minimize inventory levels.

We use several strategies to optimize manufacturing efficiency and avoid costly downtime of both personnel and equipment:

- *Cross-training.* Our manufacturing employees are cross-trained in different functionalities. This practice reduces downtime while creating a knowledge buffer to ensure a reliable production flow. As needed, additional personnel can be focused on specific time-sensitive tasks.
- *Collaboration.* We emphasize new product development to keep us on the cutting edge of pressure exchange technology while continuously improving existing products.
- *Outsourcing.* Outsourcing allows us to concentrate on the final in-house finishing and grinding of ceramic components. Key proprietary information is kept in-house, preventing technology from passing outside of our company. Our manufacturing capacity can increase throughput without requiring additional units of labor and equipment.
- *Multiple-vendor Strategy.* To prevent supply chain disruption, improve supplier pricing concessions and ensure timely customer order fulfillment, we have expanded the scope of our vendor relationships. We utilize three outside ceramic vendors and are currently qualifying a fourth to establish an additional supplier of unfinished, PX-220/PX-260 rotors and sleeves. Because the ceramic components of our products are vital to the operation of our business, our selection of ceramic vendors entails a rigorous qualification process.
- *Quality Control.* Purchased materials must conform to our design specifications, go through a thorough receiving inspection as specified in our quality procedures and be delivered with material certifications. A quality assurance inspection report is completed and accepted prior to any material being placed into inventory. Ceramic components are inspected for cracks and defects, as well as to ensure they meet exacting size and dimension specifications, following any in-house production operation. Critical components such as housings, ports and ceramic components are marked with serial numbers for traceability. Assembled PX and booster pump models and ceramic cartridges are subjected to specific performance testing to ensure they comply with our standards and customer requirements.

Research and Development

Continued investment in research and development is critical to our business. Over the past four years, our mechanical designs have been integrated into a single standardized design format aimed at facilitating knowledge redundancy. This redundancy benefits our technical team design tools, including finite element analysis and computational fluid dynamics modeling. Our technical team's approach is targeted at establishing the necessary systems, procedures, tools and skills to foster new product innovation and accommodate a larger and more specialized staff, particularly as our technical needs grow.

The technical team serves as the knowledge base for dispersing technical information to other divisions and prospective customers. We also share our engineering drawings and designs with customers and vendors in an effort to promote industry knowledge and to continually improve our technology. As of December 31, 2007, our technical team consisted of seven employees.

We plan to continue to dedicate significant resources to these research and development efforts. Further, as we continue to expand internationally, we may incur additional costs to conform our products to comply with local laws and local product specifications.

Research and development expense totaled $1.7 million for 2007, $1.3 million for 2006 and $630,000 for 2005.

Competition

The market for energy recovery devices in desalination plants is competitive and continually evolving. The PX device competes with slow cycle isobarics, Pelton wheels and hydraulic turbochargers. Pelton wheels and hydraulic

turbochargers are used primarily in the OEM market in which we compete, and where customers are more sensitive to upfront prices. Slow cycle isobarics, and particularly the DWEER technology, are our main competition in the EPC market.

Our three primary competitors are Calder AG, Fluid Equipment Development Company and Pump Engineering Incorporated. Calder AG currently is the principal manufacturer of DWEER devices and Pelton wheels. Fluid Equipment Development Company and Pump Engineering manufacture hydraulic turbochargers. We expect competition to persist and intensify as the desalination market opportunity grows.

We believe that the principal factors of competition in our industry include device efficiency, price, innovation, customer service and durability. We believe that we compete favorably with respect to each of these factors. We differentiate our products from those of our competitors by having up to 98% energy recovery efficiency, a proprietary design employing only one moving part, a corrosion resistant, highly durable ceramic composition, smaller footprint, modular design and system redundancy, and lower life cycle cost. However, we cannot assure you that we will be able to compete successfully in the future against existing or new competitors, and increased competition may adversely affect our business.

Intellectual Property and Proprietary Rights

We rely on a combination of intellectual property rights, including patents, trade secrets and trademarks, as well as customary contractual protections.

We have five United States patents and nine international counterpart patents related to the PX device. The United States patents expire between 2011 and 2025, and the international patents expire at later dates. We have also applied for two additional United States patents and 14 international counterpart patents.

Our registered trademarks in the United States are “ERI,” the ERI logo, “Making Desalination Affordable,” “PX Pressure Exchanger” and “PX.” We also hold as trade secrets the specialized tooling, fixturing, instrumentation and processing techniques employed in the final production stages for ceramic components.

In addition, we generally control access to and use of our proprietary software and other confidential information through internal and external controls, including nondisclosure and assignment of intellectual property agreements with employees and contractors, and nondisclosure agreements with customers, and our online models and software are protected by United States and international copyright laws. We keep certain key proprietary manufacturing processes in-house to reduce the risk that they are not maintained as trade secrets. We have an array of security cameras in all manufacturing and office building to record and document access.

Employees

As of March 15, 2008, we had 67 employees consisting of 10 technicians, four employees in field service, eight employees in sales and marketing, two employees in customer services, 24 employees in management and administration and 19 employees in operations and production. A total of seven of these employees were located outside of the United States. In addition, we had three full-time independent contractors. We have not experienced any work stoppages. Our employees are non-union and we consider our employee relations to be good.

Facilities

We lease approximately 26,254 square feet of space in San Leandro, California pursuant to a lease that expires in April 2010, which house a ceramics manufacturing and research and development center, technical testing facilities and our executive headquarters. In February 2008 we entered into a two-year lease beginning in April 2008 for approximately 6,000 square feet for additional corporate office space, located approximately two miles away from our headquarters. We also maintain international sales offices in Madrid, the United Arab Emirates, Shanghai and Fort Lauderdale. We believe that our facilities are suitable and adequate to meet our current needs. We intend to add new facilities or expand existing facilities as we add employees to support existing customers and aftermarket sales, and we believe that suitable additional or substitute space will be available as needed to accommodate any such expansion of our operations.

Legal Proceedings

We are not party to any material litigation, and we are not aware of any pending or threatened litigation against us that we believe would adversely affect our business, operating results, financial condition or cash flows. In the future, we may be subject to legal proceedings in the ordinary course of our business.

MANAGEMENT

Executive Officers and Directors

Our executive officers and directors, and their ages and positions as of December 31, 2007, are set forth below:

Name	Age	Position
G.G. Pique	60	President and Chief Executive Officer
Richard Stover, Ph.D.	45	Chief Technical Officer and Vice President of Sales
Thomas D. Willardson	57	Chief Financial Officer
Marilyn A. Lobel	54	Chief Accounting Officer and Corporate Controller
Terrill Sandlin	59	Vice President of Manufacturing
MariaElena Ross	58	Vice President of Administration and Human Resources
Hans Peter Michelet	48	Executive Chairman of the Board
Ole Peter Lorentzen	55	Director
Arve Hanstveit	52	Director
Peter Darby	59	Director
Marius Skaugen	49	Director
Fred Olav Johannessen	54	Director
James Medanich	69	Director
Dominique Trempont	53	Director Nominee

G.G. Pique has served as our president and chief executive officer since August 2002. From October 2001 until August 2002, Mr. Pique served as our executive vice president, and from February 2000 until October 2001 Mr. Pique was a consultant to our company. From 1993 to 1999, Mr. Pique was the group vice president Latin America of US Filter Corporation, a company focused on the acquisition, turnaround, integration and growth management of water treatment companies, before it was acquired by Vivendi in 1999, and served as group president of the integrated companies from 1999 to January 2000. Since October 2007, Mr. Pique has served as member of the board of directors of International Desal Association, a non-profit association committed to the development of desalination technology world-wide. Mr. Pique has also served as a member of the board of directors of P-K Direct Inc., a manufacturer of electronic coils and transformers since May 2000. Mr. Pique has over 30 years of experience in the water treatment industry. Mr. Pique holds a B.S. in Chemical Engineering from the University of Connecticut and an M.B.A. from Hartford University.

Richard Stover, Ph.D. has served as our vice president of sales since November 2007 and our chief technical officer since December 2004. From December 2004 to November 2007, Dr. Stover also served as our vice president of engineering and research. From April 2002 to December 2004 Dr. Stover was the engineering manager at our company. Dr. Stover has over 20 years of experience in research and development, manufacturing and consulting for 3M and IBM, among others. Dr. Stover earned his B.S. in Chemical Engineering from the University of Texas at Austin and his Ph.D. in Chemical Engineering at the University of California at Berkeley.

Thomas D. Willardson has served as our chief financial officer since November 2007. From January 2006 to August 2007, Mr. Willardson served as executive vice president and chief financial officer of Cost Plus, Inc. From April 2004 to February 2006, Mr. Willardson served as chief financial officer of WebSideStory, Inc., a provider of on-demand digital marketing applications. From August 2003 until April 2004 he served as chief financial officer of Archimedes Technology Group Holdings, LLC, a privately held technology development company. From April 2002 until July 2003, Mr. Willardson was an independent financial consultant. Mr. Willardson holds a B.A. in Finance from Brigham Young University and an M.B.A. from the University of Southern California.

Marilyn A. Lobel has served as our chief accounting officer and corporate controller since January 2008. From March 2007 to December 2007, Ms. Lobel served as corporate controller and corporate secretary of Red.Com, Inc., a privately held company that manufactures digital cinema photography equipment. From February 2006 to March 2007, Ms. Lobel served as the chief accounting officer and corporate controller of Pacific Energy Partners, L.P., a public partnership that engages principally in the business of gathering, transporting, storing and distributing crude oil and refined petroleum products. From June 2004 to December 2005, Ms. Lobel served as the vice president of finance and corporate controller of Biolase Technology, Inc., a public company that manufactures medical devices. From January 2004 to June 2004, Ms. Lobel was an independent financial consultant. From May 2002 to December 2003, Ms. Lobel served as director of finance at Xoma Ltd., a public company engaged in research and development of biopharmaceuticals. Ms. Lobel is a

Certified Public Accountant currently licensed in the state of California and holds a B.S. in Business Administration from the University of Nevada.

Terrill Sandlin has served as our vice president of manufacturing since April 2002. From 1999 to 2001, he served as director of manufacturing for Novus Packaging Corporation, a packaging material company acquired by FP International in 2001. From 1978 to 1999, Mr. Sandlin served in various management positions, including as plant manager for Whitney Research, a valve manufacturer supplying exclusively for Swagelok Company. Mr. Sandlin holds a B.S. in Civil Engineering from the University of California at Berkeley.

MariaElena Ross has served as our vice president of administration and human resources since July 2006. From February 2005 to July 2006, Ms. Ross served as our executive director of human resources. From February 2002 to January 2005, Ms. Ross served as human resources manager for SPL World Group, a provider of revenue and operations management software for the utilities industry, before it was acquired by Oracle Corporation in 2006. Ms. Ross holds a B.A. in Anthropology from the University of California at Berkeley, a teaching credential from the University of San Francisco, and a J.D. from Hastings College of Law.

Hans Peter Michelet has served as the executive chairman of our board of directors since March 2008. As our executive chairman, he will play a role in investor relations and the determination of our strategic direction. Prior to being named the executive chairman of our board, Mr. Michelet had served as the chairman of our board since September 2004 and a member of our board of directors since August 1995. From January 2005 to November 2007, Mr. Michelet served as our interim chief financial officer. Mr. Michelet's other current directorships include serving as the chairman of the board of directors of SynchroNet Marine Inc., a maritime technology service provider, since June 2000 and as a member of the board of directors of Arvarius AS, a privately held Norwegian investment company, since June 1997. From September 1985 until February 2000, Mr. Michelet was a member of the Norwegian Society of Financial Analysts. Mr. Michelet holds a B.A. in Finance from the University of Oregon.

Ole Peter Lorentzen has served as a member of our board of directors since January 2007. Mr. Lorentzen has also served as the chairman of Caprice AS, an investment company, since October 1987, and as chief executive officer of Ludvig Lorentzen AS, an investment company, since December 1987. Mr. Lorentzen holds a B.A. in Business Administration from the University of Lund in Sweden.

Arve Hanstveit has served as a member of our board of directors since 1995. Since 1997, Mr. Hanstveit has served as partner and vice president of ABG Sundal Collier, a Scandinavian investment bank. Since February 2007, Mr. Hanstveit has also served on the board of directors of Kezzler AS, a privately held Norwegian company which delivers secure track and trace solutions to the pharmaceutical and consumer goods industry. Mr. Hanstveit holds a B.A. in Business from the Norwegian School of Management and an M.B.A. from the University of Wisconsin, Madison.

Peter Darby has served as a member of our board of directors since December 2001. Since September 2004, Mr. Darby has been a private investor. Mr. Darby was a managing member of Pema Properties, LLC, a company engaged in real estate development, from June 1995 to August 2004, after which Pema Properties was sold. Mr. Darby has over 30 years of experience in the water industry, which began with the founding of Advanced Structures, Inc. in 1976, which was a supplier for specialized pressure vessels used in reverse osmosis and other membrane-based water purification processes. Mr. Darby holds a B.S. in Mechanical Engineering from Michigan State University.

Marius Skaugen has served as a member of our board of directors since 1999. Mr. Skaugen has been a private investor since 1991. Mr. Skaugen has served as a member of the board of directors of Alf R. Bjercke & Co. AS, a private investment Norwegian company, since 2001, as a member of the boards of directors of Haut Brion AS, Morgenfuglen AS, Jampe AS, all of which are Norwegian private holding companies, since 2005. Mr. Skaugen received his B.B.A. in finance from the University of Oregon.

Fred Olav Johannessen has served as a member of our board of directors since June 1992. Since September 2001, Mr. Johannessen has served as president of the Nordiska Literary Agency in Denmark. Mr. Johannessen also has served as a member of the board of directors of Thalia Teater AS, a private theater production company in Norway, since June 1985, as a member of the board of directors of Lande & Co, a private media consulting company in Norway, since November 2005 and as a member of the board of directors of Folin, a private European company that invests in literary agencies, since March 1999. Mr. Johannessen earned his M.S. in Finance from Colorado State University.

James Medanich has served as a member of our board of directors since December 2001. Mr. Medanich has served as president and a member of the board of directors of the Piedmont Pacific Corporation, a private company engaged in the manufacture and sale of pipe couplings, since July 2002. Mr. Medanich served as president of our company from February 2001 until July 2002. Mr. Medanich earned his B.A. in Geology from the University of California at Berkeley.

Dominique Trempont has been appointed to serve as a member of our board of directors upon the effectiveness of our initial public offering. Mr. Trempont is currently a member of the board of directors of 3Com Corporation, a position he has held since June 2006. Mr. Trempont also is currently a member of the board of directors of Finisar Corporation, a public company that develops and markets high speed data communication systems and software for networking and storage, a position he has held since September 2005. Since June 2006, Mr. Trempont has served on the board of directors of Cquay Technologies Corp., a private company that develops next generation search software. Mr. Trempont was CEO-in-Residence at Battery Ventures, a venture capital firm, from September 2003 to September 2005. From May 1999 to November 2002, Mr. Trempont was chairman, president and chief executive officer of Kanisa, Inc., a software company focused on customer self-service, contact center, and peer support applications. Mr. Trempont has served as chief executive officer of Gemplus Corporation, a smart card application company, and chief financial officer at NeXT Software. Mr. Trempont received an undergraduate degree in Economics from College Saint Louis (Belgium), a bachelor's in Business Administration and Computer Sciences from IAG at the University of Louvain (Belgium) and a master's in Business Administration from INSEAD (France).

Board of Directors

Upon the completion of this offering, the board of directors will be divided into three classes, with each class serving for a staggered three-year term. The terms of the class I directors, class II directors and class III directors will expire upon the election and qualification of successor directors at the annual meeting of stockholders held during the calendar years 2009, 2010 and 2011, respectively.

Director Independence

In March 2008, our board of directors undertook a review of the independence of our directors and considered whether any director has a material relationship with us that could compromise his ability to exercise independent judgment in carrying out his responsibilities. As a result of this review, our board of directors determined that Messrs. Lorentzen, Johannessen, Medanich and Hanstveit, representing a majority of our directors, are "independent directors" as defined under the rules of the NASDAQ Global Market, or NASDAQ. Our board of directors expects that Mr. Trempont, upon his appointment to the board, will be an "independent director" as defined under the NASDAQ rules.

Committees of the Board of Directors

Our board of directors has an audit committee, a compensation committee and a nominating and governance committee, each of which has the composition and responsibilities described below.

Audit Committee

Upon the effectiveness of our initial public offering, our audit committee will consist of Messrs. Hanstveit, Lorentzen and Trempont, each of whom is a non-employee member of our board of directors. Mr. Trempont will serve as the chairman of the committee. The NASDAQ corporate governance rules require that each issuer has an audit committee of at least three members, and that one independent director (as defined in those rules) be appointed to the audit committee at the time of listing, a majority within 90 days after listing and the entire committee within one year after listing. Messrs. Hanstveit, Lorentzen and Trempont are independent directors. Mr. Trempont will be our "audit committee financial expert" as defined in SEC rules and will satisfy the financial sophistication requirements of NASDAQ for audit committee membership. The audit committee will be responsible for, among other things:

- overseeing the accounting and financial reporting processes and audits of our financial statements;
- selecting and hiring our independent registered public accounting firm, and approving the audit and non-audit services to be performed by our independent registered public accounting firm;
- assisting the board of directors in monitoring the integrity of our financial statements, our internal accounting and financial controls, our compliance with legal and regulatory requirements, the performance of our internal audit function and the qualifications, independence and performance of our independent registered public accounting firm;
- providing to the board of directors information and materials to make the board of directors aware of significant financial and audit-related matters that require the attention of the board of directors; and
- reviewing and discussing with management and our independent registered public accounting firm our annual and quarterly financial statements and annual and quarterly reports on Form 10-K and 10-Q.

Compensation Committee

Our compensation committee consists of Messrs. Hanstveit, Darby, Daniel Johnson, our vice president, information technology, and Ms. Ross. Immediately prior to the effectiveness of our initial public offering, Messrs. Darby and Johnson and Ms. Ross will resign from our compensation committee, and upon the effectiveness of our initial public offering, our compensation committee will consist of Messrs. Hanstveit, Lorentzen and Trempont. Mr. Darby is currently the chairman of our compensation committee, and upon the effectiveness of this offering Mr. Trempont will be appointed as chairman of our compensation committee. Our board of directors has determined that upon effectiveness of this offering, each member of our compensation committee will meet the requirements for independence under the current NASDAQ rules, the non-employee director definition of Rule 16b-3 promulgated under the Securities Exchange Act of 1934 and the outside director definition of Section 162(m) of the Internal Revenue Code of 1986, as amended. The compensation committee will be responsible for, among other things:

- overseeing our compensation policies, plans and benefit programs and making recommendations to the board of directors with respect to improvements or changes to the plans and adoption of other plans;
- reviewing and approving with respect to our chief executive officer and other executive officers' annual base salaries, annual incentive bonuses, including the specific goals and amounts, equity compensation, employment agreements, severance arrangements and change of control agreements/provisions, and any other benefits, compensation or arrangements;
- evaluating and approving the corporate goals and objectives relevant to the compensation of our chief executive officer; and
- administering our equity compensation plans.

Corporate Governance and Nominating Committee

Upon the effectiveness of this offering, Messrs. Hanstveit, Lorentzen and Trempont, each of whom is a non-employee member of our board of directors, will comprise our nominating and governance committee. Mr. Trempont will be the chairman of our nominating and governance committee. Our board of directors has determined that each member of our nominating and governance committee will meet the requirements for independence under the current NASDAQ rules. The nominating and governance committee will be responsible for, among other things:

- assisting our board of directors in identifying prospective director nominees and recommending to our board of directors the director nominees for each annual meeting of stockholders;
- evaluating the performance of current members of our board of directors;
- developing principles of corporate governance and recommending them to our board of directors;
- recommending to our board of directors persons to be members of each board committee; and
- overseeing the evaluation of our board of directors and management.

Director Compensation

None of our directors currently receives any compensation for his services as a member of our board of directors or any committee of our board of directors.

Following the closing of this offering, each non-employee member of our board of directors will be entitled to receive an annual retainer of $50,000 and options to purchase 50,000 shares of our common stock that will vest over four years. In addition, each chairman of our audit committee, compensation committee and nominating and governance committee will be entitled to receive options to purchase an additional 5,000 shares of our common stock that will vest over four years. All such options will be granted at the fair market value on the date of the award.

Code of Business Conduct and Ethics

We have adopted a code of business conduct and ethics that is applicable to all of our employees, officers and directors, which will become effective upon the effectiveness of this offering.

Compensation Committee Interlocks and Insider Participation

Our compensation committee consists of Messrs. Hanstveit, Darby and Johnson and Ms. Ross. Mr. Johnson and Ms. Ross are employees of our company. Mr. Johnson and Ms. Ross will resign from the compensation committee immediately prior to the effectiveness of this offering.

Hans Peter Michelet, our executive chairman, currently serves as a member of the board of directors of Arvarius AS. Marius Skaugen, one of our directors, is an executive officer and a controlling stockholder of Arvarius AS. None of our other executive officers currently serves, or in the past year has served, as a member of the board of directors or compensation committee of any entity that has one or more executive officers serving on our board of directors or compensation committee.

COMPENSATION DISCUSSION AND ANALYSIS

Philosophy and Objectives of our Executive Compensation Program

The principal objectives of our compensation and benefits programs for executive officers are to:

- attract and retain exceptional executives;
- reward superior performance;
- motivate our executives' performance toward clearly defined corporate goals; and
- align the interests of our executives with those of our stockholders.

Our compensation committee believes that maintaining and improving the quality and skills of our management and appropriately incentivizing their performance are critical factors that will affect the long-term value realized by our stockholders.

At the beginning of each fiscal year, our compensation committee approves specific corporate goals and objectives for our senior management to address within the fiscal year. Through our annual goal-setting process, individual objectives are aligned with our corporate objectives. We also evaluate and reward our executive officers based on their willingness to take a leadership position in improving the operation of our business and their ability to identify and exploit opportunities to grow our business.

Principal Components of our Executive Compensation Program

Our executive compensation program consists of five components:

- base salary;
- annual cash bonuses;
- equity-based incentives;
- benefits; and
- severance/termination benefits.

We believe that a program containing each of these components, combining both short and long-term incentives, is necessary to achieve our compensation objectives and that collectively these components have been effective in properly incentivizing our Named Executive Officers and helping to achieve our corporate goals.

Annual Review Process

Our compensation committee reviews data and makes executive compensation decisions on an annual basis. In connection with that process, executive officers are responsible for establishing and submitting for review to the chief executive officer (and in the case of the chief executive officer, directly to the compensation committee) their departmental goals and financial objectives for the then current fiscal year. The chief executive officer then compiles the information submitted and provides it, along with information relating to his own personal goals and objectives, to the compensation committee for review. The compensation committee, including the chief executive officer with respect to all officers and excluding the chief executive officer with respect to discussions of his own compensation, reviews, considers, and may amend the terms and conditions proposed by management.

As part of the annual review process, the compensation committee makes determinations of changes in annual base compensation based on numerous factors, including individual performance over the prior fiscal year, established corporate and financial objectives for the next fiscal year, our operating budgets, and a review of survey data relating to base compensation for the position at comparable companies. During the annual review process, the compensation committee also reviews our cash bonus plan for executive officers, with bonuses becoming payable under the plan based on management's achieving identified performance goals during the fiscal year, and considers each executive's equity incentive position, including the extent to which he or she was vested or unvested. Periodically, the compensation committee may provide refresher equity incentive grants, typically in the form of stock options, as an individual officer becomes substantially vested in his or her current equity position.

Weighting of Compensation Components

The compensation committee's determination of the appropriate use and weight of each component of executive compensation is subjective, based on the compensation committee's view of the relative importance of each component in meeting our overall objectives and factors relevant to the individual executive.

Base Salary

In general, base salaries for the Named Executive Officers are determined by evaluating the responsibilities of the executive's position, the executive's experience and the competitive marketplace. Any future base salary adjustments are expected to take into account changes in the executive's responsibilities, the executive's performance and changes in the competitive marketplace.

Cash Bonuses

Annual cash bonus incentives for our executive officers are designed principally to reward performance that furthers key corporate goals, particularly annual performance goals. We believe these objectives will change from year to year as our business evolves and our priorities change. Under our current bonus plan, the Executive Financial Compensation Bonus Plan, our executive officers are eligible to earn an annual bonus in an amount not to exceed 100% of his/her base salary. In 2007, each executive officer, other than our chief executive officer and executive chairman, had written performance objectives (such as, for example, hiring designated personnel) for the year. The actual bonuses paid were based on a subjective consideration of the achievement of the various objectives by our compensation committee.

For 2007 and 2008, our compensation committee capped the amount of bonus for which our chief executive officer was eligible to 100% of his base salary, and the capped amount of bonus for which our other Named Executive Officers, other than Mr. Michelet, were eligible to 30% of such executive officer's base salary. Based on subjective considerations of the individual's performance and achievement of objectives, our compensation committee approved bonuses for 2007 that were within the capped amount, and that ranged from 40% to 130% of the targeted bonus amounts. We expect that, for 2008, we will follow the same approach of determining bonuses based on a subjective consideration of the individual's performance.

In 2007, Mr. Michelet received a bonus in the amount of $125,000, which was paid outside the scope of the Executive Financial Compensation Bonus Plan. In 2008, Mr. Michelet will be eligible to receive an annual bonus in an amount not to exceed 100% of his base salary.

Equity Based Incentives

We grant equity based incentives to employees, including our executive officers, in order to create a corporate culture that aligns employee interests with stockholder interests. We have not adopted any specific stock ownership guidelines, and other than the issuance of shares to our founders when we were established and the sale of shares of common stock to our executive officers, in addition to other third parties, in connection with common stock offerings, our equity incentive plans have provided the principal method for our executive officers to acquire an equity position in our company, whether in the form of shares or options.

Prior to this offering, we granted options and other equity incentives to our officers under our 2001 Stock Option Plan, 2002 Stock Option/Stock Issuance Plan, 2004 Stock Option/Stock Issuance Plan or 2006 Stock Option/Stock Issuance Plan, as the case may be. In connection with this offering, our board of directors has adopted the 2008 Equity Incentive Plan, which we will implement following this offering. The 2008 Equity Incentive Plan permits the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance units, performance shares and other stock-based awards. Historically, our Stock Option/Stock Issuance Plans were administered by our board of directors. Going forward, all equity compensation plans and awards will be administered by our compensation committee under the delegated authority established in the compensation committee charter.

Our stock option grants are discretionary. Employees may be granted options for company stock upon approval by the board of directors. The plan is designed to give employees an opportunity to share in the company's success by allowing them to purchase shares of stock. After an initial grant in connection with the offer of employment, additional grants are based on the employee's performance which contributes towards meeting specific company performance milestones. However, the size and terms of any initial option grants to new employees, including executive officers, are based largely on competitive conditions applicable to the specific position and calibrated for the phase of the Company's development.

After the completion of this offering our practice will be to grant additional annual option grants to employees, including executive officers, when the individual becomes substantially vested and the board of directors or compensation

committee believes additional unvested equity incentives are appropriate as a retention incentive. We expect this practice will be implemented in connection with the compensation committee's annual performance review at the beginning of each fiscal year. In making its determination concerning additional option grants, the compensation committee will also consider, among other factors, individual performance and the size and terms of the individual's outstanding equity grants in the then-current competitive environment.

To date, our equity incentives have been granted principally with time-based vesting. Most new hire option grants, including for executive officers, vest over a four-year period with 25% vesting at the end of the first year of employment and the remainder vesting in equal monthly installments over the subsequent three years. We expect that additional annual option grants to continuing employees will typically vest over a four-year period with 25% vesting on each annual anniversary of the date of grant. Although our practice in recent years has been to provide equity incentives principally in the form of stock option grants that vest over time, our compensation committee may consider alternative forms of equity in the future, such as performance shares, restricted stock units or restricted stock awards with alternative vesting strategies based on the achievement of performance milestones or financial metrics.

During 2007, our board of directors reviewed the aggregate equity position of each of our executive officers as well as the portion of the aggregate equity incentives that were vested versus unvested. After these reviews our board of directors approved an option grant of 100,000 shares of our common stock at an exercise price of $5.00 per share to Thomas Willardson, our chief financial officer, in connection with his employment offer, and an option grant of 2,800 shares of our common stock at an exercise price of $5.00 per share to Richard Stover, our chief technical officer and vice president of sales.

Benefits

We provide the following benefits to our Named Executive Officers, generally on the same basis provided to all of our employees with the exception of life insurance coverage:

- health, dental and vision insurance;
- life insurance, including accidental death and dismemberment;
- employee stock option plan;
- medical and dependant care flexible spending account;
- long-term disability; and
- a 401(k) plan.

We believe these benefits are consistent with companies with which we compete for employees.

Severance and Termination Compensation

In connection with certain terminations of employment, our executive officers may be entitled to receive certain severance payments and benefits pursuant to their respective employment agreements, offer letters and/or management retention agreements. In setting the terms of and determining whether to approve these arrangements, our board of directors recognized that executives often face challenges securing new employment following termination and that distractions created by uncertain job security surrounding potential beneficial transactions may have a detrimental impact on their performance.

Chief Executive Officer

Under the terms of the March 2006 employment agreement with our president and chief executive officer, G.G. Pique, as amended in January 2008, if Mr. Pique is involuntarily terminated (other than for cause, death or disability) he will be entitled to receive the following benefits:

- lump sum payment, immediately following termination, of any and all base salary due and owing to him through the date of termination, plus an amount equal to his earned but unused vacation through the date of termination, reimbursement for all reasonable expenses and any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which his termination occurs;
- lump sum payment, immediately following termination, of an amount equal to 70% of Mr. Pique's then current annual base salary, less deductions required by law; and

- immediate vesting of all unvested equity compensation held by Mr. Pique as of the date of termination;
- until the earlier of one year from the date of termination or such time as Mr. Pique has become covered under another employer's plans with comparable coverage, continued health, dental, vision and life insurance benefits at the same levels of coverage and with the same relative ratios of premium payments by us and Mr. Pique as existed prior to the termination.

In addition, if during the term of the agreement, Mr. Pique is involuntarily terminated (other than for cause, death or disability) within one year following a change in control of our company, Mr. Pique will be entitled to receive the severance benefits described above and an additional lump sum payment of an amount equal to 30% of Mr. Pique's current annual base salary to be paid immediately following such termination.

Payment of the benefits described above is subject to Mr. Pique's executing a general release of claims against us or persons affiliated with us and agreeing not to prosecute any legal action or other proceeding based on any such claims.

In the event of a termination of employment for cause, including death or disability, or a voluntary termination by Mr. Pique, Mr. Pique will be entitled to receive:

- a lump sum payment of any and all base salary due and owing through to the date of termination;
- an amount equal to earned but unused vacation through the date of termination and reimbursement of all reasonable expenses; and
- any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which Mr. Pique's termination occurs.

Other Named Executive Officers

We also entered management retention agreements with our other Named Executive Officers, with the exception of Hans Peter Michelet. Under the terms of these agreements, if the executive is involuntarily terminated (other than for cause, death, or disability) our executive officers will be entitled to receive the following benefits:

- lump sum payment, immediately following termination, of any and all base salary due and owing to the executive through the date of termination, plus an amount equal to his/her earned but unused vacation through the date of termination, reimbursement for all reasonable expenses and any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the termination occurs;
- lump sum payment, immediately following termination, of an amount equal to 50% of the executive's current annual base salary, less deductions required by law, and an additional amount equal to 50% of the executive's current annual base salary if the executive is involuntarily terminated (other than for cause, death, or disability) within 12 months following a change of control; and
- immediate vesting of all unvested equity compensation held by the executive as of the date of termination;
- until the earlier of one year from the date of termination or such time as the executive has become covered under another employer's plans with comparable coverage, continued health, dental, vision and life insurance benefits at the same levels of coverage and with the same relative ratios of premium payments by us and the executive as existed prior to the termination.

Payment of the benefits described above under these management retention agreements is subject to the executive's executing and a general release of claims against us or persons affiliated with us and agreeing not to prosecute any legal action or other proceeding based on any such claims.

In the event of a termination of employment for cause, or upon death or disability, or a voluntary termination by the executive, the executive will be entitled to receive:

- a lump sum payment of any and all base salary due and owing through to the date of termination;
- an amount equal to earned but unused vacation through the date of termination and reimbursement of all reasonable expenses; and
- any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the executive's termination occurs.

Tax Deductibility

Section 162(m) of the Internal Revenue Code generally disallows a tax deduction to public corporations for compensation greater than $1 million paid for any fiscal year to certain executive officers. However, performance-based compensation is not subject to the $1 million deduction limit if certain requirements are met. Our compensation committee may consider the impact of Section 162(m) when designing our cash and equity bonus programs, but may elect to provide compensation that is not fully deductible as a result of Section 162(m) if it determines this is in our best interests.

COMPENSATION OF EXECUTIVE OFFICERS

Summary Compensation Table

The table below summarizes the compensation information in respect of the Named Executive Officers for 2007.

Name and Principal Position	Salary ($)	Bonus ($)(1)	Option Awards ($)(2)	Non-Equity Incentive Plan Compensation ($)(3)	All Other Compensation ($)(4)	Total ($)
G.G. Pique President and Chief Executive Officer	250,000	—	68,877	75,000	1,401	395,278
Hans Peter Michelet(5) Former Chief Financial Officer	109,615	125,000	—	—	—	234,615
Thomas Willardson(6) Chief Financial Officer	35,577	250	8,451	25,000	159	69,437
Richard Stover Chief Technical Officer and Vice President of Sales	216,461	1,000	12,420	69,300	278	299,459
Terrill Sandlin Vice President of Manufacturing	138,700	1,000	9,999	41,900	391	191,990
MariaElena Ross Vice President Administration and Human Resources	133,461	1,000	8,313	39,000	377	182,151

(1) The bonus amounts appearing in this column represent holiday bonuses paid to Messrs. Willardson, Stover and Sandlin and Ms. Ross and a year-end bonus paid to Mr. Michelet outside of our Executive Financial Compensation Bonus Plan.

(2) The amounts shown represent the compensation costs for financial reporting purposes of previously granted stock awards and stock options recognized for the year ended December 31, 2007 under FAS 123R, rather than an amount paid to or realized by the Named Executive Officer. The FAS 123R value as of the grant date for stock awards and stock options is spread over the number of months of service required for the grant to become non-forfeitable. The amount disclosed disregards estimates of forfeitures of awards that are otherwise included in the financial statement reporting for such awards. Ratable amounts expensed for stock options that were granted in years prior to 2007 are also reflected in this column.

(3) The amounts in this column represent total performance-based bonuses earned for services rendered during 2007. In 2007, under our Executive Financial Compensation Plan, our chief executive officer was eligible to earn an annual bonus in an amount not to exceed 100% of his base salary, and the maximum bonus amount for which our other Named Executive Officers were eligible, other than Mr. Michelet, was 30% of such executive officer's base salary.

(4) Represents amounts paid for life insurance for the executive.

(5) Mr. Michelet served as our interim chief financial officer from January 2005 to November 2007.

(6) Mr. Willardson was appointed as our chief financial officer in November 2007.

Grants of Plan-Based Awards in 2007

The following table sets forth information concerning non-equity incentive plan grants to the Named Executive Officers during 2007. The non-equity incentive plan consists of the Executive Financial Compensation Bonus Plan that is described in the Compensation Discussion and Analysis section above. The actual amounts realized in respect of the non-equity plan incentive awards are reported in the Summary Compensation Table under the Non-Equity Incentive Compensation Bonus Plan column. The table also sets forth information with respect to option awards granted by our company during 2007.

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards ($)(1)			All Other Option Awards: Number of Securities Underlying Options (#)	Exercise or Base Price of Option Awards ($)(2)	Grant Date Fair Value of Option Awards ($)(3)
		Threshold ($)	Target ($)	Maximum ($)			
G.G. Pique	—	—	187,500	250,000	—	—	—
Hans Peter Michelet(4)	—	—	—	—	—	—	—
Thomas Willardson(5)	11/7/07	—	—	—	100,000	5.00	237,000
Richard Stover	6/28/07	—	52,000	69,300	2,800	5.00	6,900
Terrill Sandlin	—	—	29,300	41,900	—	—	—
MariaElena Ross	—	—	29,300	39,000	—	—	—

(1) In 2007, under our Executive Financial Compensation Plan, our chief executive officer was eligible to earn an annual bonus in an amount not to exceed 100% of his base salary, and the maximum bonus amount for which our other Named Executive Officers were eligible, other than Mr. Michelet, was 30% of such executive officer's base salary. Mr. Michelet's bonus was paid outside of our Executive Financial Compensation Bonus Plan.

(2) The fair value of the common stock for options granted was estimated either by our board of directors with input from management or by the stock prices in conjunction with private placements with third parties.

(3) Amounts reflect the aggregate grant date fair value of stock options granted in 2007, calculated in accordance with SFAS No. 123(R) without regard to estimated forfeitures. See Note 9 of Notes to Consolidated Financial Statements for a discussion of assumptions made in determining the grant date fair value of our stock options.

(4) Mr. Michelet served as our interim chief financial officer from January 2005 to November 2007.

(5) Mr. Willardson was appointed as our chief financial officer in November 2007.

Outstanding Equity Awards At December 31, 2007

The following table presents certain information concerning equity awards held by our Named Executive Officers at the end of 2007.

	Option Awards				
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price ($)	Option Expiration Date
G.G. Pique	250,000(1)	—	187,500	2.65	12/08/16
Hans Peter Michelet	—	—	—	—	—
Thomas Willardson	47,083 (2)	—	47,083	5.00	10/31/17
	52,917 (3)	—	52,917	5.00	10/31/17
Richard Stover	59,000 (4)	—	29,500	1.00	12/14/15
	1,042 (5)	—	521	1.00	12/14/15
	30,000 (6)	—	22,500	2.65	12/08/16
	2,800 (7)	—	2,800	5.00	6/27/17
Terrill Sandlin	5,000 (8)	—	2,500	1.00	12/14/15
	30,000 (9)	—	22,500	2.65	12/08/16
MariaElena Ross	40,000 (10)	—	13,334	1.00	04/04/15
	45,000 (11)	—	22,500	1.00	12/14/15
	30,000 (12)	—	22,500	2.65	12/08/16

(1) This option was granted under the 2006 Stock Option/Stock Issuance Plan, or the 2006 Plan, on December 9, 2006 and vests for a period of four years beginning December 9, 2006. The options vest 25% on the first anniversary of the vesting commencement date and 1/36 of the remaining per month thereafter and will be fully vested on December 9, 2010.

(2) This option was granted under the 2006 Plan on November 1, 2007 and vests for a period of four years beginning November 1, 2007. The options vest 25% on the first anniversary of the vesting commencement date and 1/36 of the remaining per month thereafter and will be fully vested on November 1, 2011.

(3) This option was granted under the 2004 Stock Option/Stock Issuance Plan, or the 2004 Plan, on November 1, 2007 and vests for a period of four years beginning November 1, 2007. The options vest 25% on the first anniversary of the vesting commencement date and 1/36 of the remaining per month thereafter and will be fully vested on November 1, 2011.

(4) This option was granted under the 2004 Plan on December 15, 2005 and vests for a period of four years beginning December 15, 2005. The options vest 25% on the first anniversary of the vesting commencement date and 1/36 of the remaining per month thereafter and will be fully vested on December 15, 2009.

(5) This option was granted under the 2002 Stock Option/Stock Issuance Plan, or the 2002 Plan, on December 15, 2005 and vests for a period of four years beginning December 15, 2005. The options vest 25% on the first anniversary of the vesting commencement date and 1/36 of the remaining per month thereafter and will be fully vested on December 15, 2009.

(6) This option was granted under the 2006 Plan on December 9, 2006 and vests for a period of four years beginning December 9, 2006. The options vest 25% on the first anniversary of the vesting commencement date and 1/36 of the remaining per month thereafter and will be fully vested on December 9, 2010.

(7) This option was granted under the 2006 Plan on June 28, 2007 and vests for a period of four years beginning June 28, 2007. The options vest 25% on the first anniversary of the vesting commencement date and 1/36 of the remaining per month thereafter and will be fully vested on June 28, 2011.

(8) This option was granted under the 2004 Plan on December 15, 2005 and vests for a period of four years beginning December 15, 2005. The options vest 25 on the first anniversary of the vesting commencement date and 1/36 of the remaining per month thereafter and will be fully vested on December 15, 2009.

(9) This option was granted under the 2006 Plan on December 9, 2006 and vests for a period of four years beginning December 9, 2006. The options vest 25% on the first anniversary of the vesting commencement date and 1/36 of the remaining per month thereafter and will be fully vested on December 9, 2010.

(10) This option was granted under the 2002 Stock Option/Stock Issuance Plan on April 5, 2005 and vests for a period of four years beginning April 5, 2005. The options vest 25% on the first anniversary of the vesting commencement date and 1/36 of the remaining per month thereafter and will be fully vested on April 5, 2009.

(11) This option was granted under the 2002 Plan on December 15, 2005 and vests for a period of four years beginning December 15, 2005. The options vest 25 on the first anniversary of the vesting commencement date and 1/36 of the remaining per month thereafter and will be fully vested on December 15, 2009.

(12) This option was granted under the 2006 Plan on December 9, 2006 and vests for a period of four years beginning December 9, 2006. The options vest 25% on the first anniversary of the vesting commencement date and 1/36 of the remaining per month thereafter and will be fully vested on December 9, 2010.

Option Exercises and Stock Vested

None of our Named Executive Officers exercised any options and no shares vested for any of our Named Executive Officers during 2007.

Employment Arrangements with Named Executive Officers

G.G. Pique

In March 2006, we entered into an employment agreement with G.G. Pique, our president and chief executive officer. Under the employment agreement, we employ Mr. Pique for a period of two years from the date of the agreement, at the end of which Mr. Pique's agreement terminates and he will be employed with us on an at-will basis. Mr. Pique's initial base salary was set at $250,000, which the compensation committee reviews annually for potential adjustments. The employment agreement also provides Mr. Pique with an annual performance bonus opportunity in an amount not to exceed 100% of his base salary. In addition, Mr. Pique's employment agreement provides for the grant of options to purchase 250,000 shares of our common stock. Mr. Pique exercised those options, as well as options granted in 2003 and 2004 to purchase another 400,000 and 150,000 shares of our common stock, respectively, upon execution and delivery of promissory notes dated February 2005 in the aggregate amount of approximately $204,258, all of which notes were repaid in March 2008.

In January 2008, we amended Mr. Pique's employment agreement to provide for an increase of his annual base salary to $350,000. The amendment also extends Mr. Pique's term of employment with us for an additional 24 months from the date of the amendment, at the end of which term Mr. Pique's agreement terminates and he will be employed with us on an at-will basis. In addition, the amendment provides for the accelerated vesting of all stock options granted to Mr. Pique under his 2006 Equity Compensation Grant at the end of his employment term.

Hans Peter Michelet

During 2007, we paid Hans Peter Michelet a base salary in the amount of $109,615 and a bonus in the amount of $125,000 for his services as our interim chief financial officer. We did not enter into a formal employment agreement with Mr. Michelet relating to his services in this role.

In March 2008, our board approved an employment arrangement with Mr. Michelet for his services as executive chairman of our board. As our executive chairman, he will play a role in investor relations and the determination of our strategic direction. Under this arrangement, Mr. Michelet serves as an at-will employee of our company and his initial base salary is set at $250,000. Additionally, the employment arrangement provides for the grant of options to purchase 100,000 shares of our common stock and an annual performance bonus opportunity.

Thomas Willardson

We entered into an employment agreement in November 2007 with Thomas Willardson, our chief financial officer. Under the employment agreement, we employ Mr. Willardson for a period of eight months from the date of the agreement, at the end of which Mr. Willardson's agreement terminates and he will be employed with us on an at-will basis. Mr. Willardson's initial base salary was set at $250,000. The employment agreement also provides Mr. Willardson with an annual performance bonus opportunity in an amount not to exceed 100% of his base salary.

In February 2008, we amended Mr. Willardson's employment agreement, effective July 1, 2008. Pursuant to the amendment, Mr. Willardson's term of employment was extended from eight months to 13 months, at the end of which Mr. Willardson's employment becomes at-will. In addition, the amendment provides that Mr. Willardson's receipt of his 2008 annual bonus would be contingent upon the consummation of our initial public offering. In the event that the initial public offering is not consummated through no fault of Mr. Willardson, the amendment provides for the accelerated vesting of all stock options granted to Mr. Willardson as of December 31, 2008.

Richard Stover

We entered into an employment agreement dated July 1, 2006 with Richard Stover, our chief technical officer. Under the employment agreement, we employ Dr. Stover for a period of 24 months from the date of the agreement, at the end of which Dr. Stover's agreement terminates and he will be employed with us on an at-will basis. Dr. Stover's initial base salary was set at $210,000. The employment agreement also provides Dr. Stover with an annual performance bonus opportunity in an amount not to exceed 100% of his base salary. Pursuant to the employment agreement, we granted Dr. Stover an option to purchase 30,000 shares of our common stock. Dr. Stover exercised those options, as well as options granted in 2003 and 2004 to purchase another 50,000 and 75,000 shares of our common stock, respectively, upon execution

and delivery of promissory notes dated February 2005 in the aggregate amount of approximately $49,808, all of which notes were repaid in January 2008.

In February 2008, we amended Dr. Stover's employment agreement, effective July 1, 2008. Pursuant to the amendment, Dr. Stover's term of employment was extended from 24 months to 30 months, at the end of which Dr. Stover's employment becomes at-will. In addition, under the amendment Dr. Stover's base salary is increased to $231,000 effective as of January 1, 2008. The amendment also provides that in the event that the initial public offering is not consummated as scheduled, through no fault of Dr. Stover, all stock options granted to Dr. Stover in December 2006 will immediately and fully vest as of December 31, 2008.

Terrill Sandlin

We entered into an employment agreement dated July 1, 2006 with Terrill Sandlin, our vice president of manufacturing. Under the employment agreement, we employ Mr. Sandlin for a period of 24 months from the date of the agreement, at the end of which Mr. Sandlin's agreement terminates and he will be employed with us on an at-will basis. Mr. Sandlin's initial base salary was set at $130,000. The employment agreement also provides Mr. Sandlin with an annual performance bonus opportunity in an amount not to exceed 100% of his base salary. Pursuant to the employment agreement, we granted Mr. Sandlin an initial option to purchase 30,000 shares of our common stock. Mr. Sandlin exercised options granted in 2001, 2002 and 2004 to purchase an aggregate of 120,000 shares of our common stock upon execution and delivery of promissory notes dated February 2005 in the aggregate amount of approximately $36,000, all of which notes were repaid in March 2008.

In February 2008, we amended Mr. Sandlin's employment agreement, effective July 1, 2008. Pursuant to the amendment, Mr. Sandlin's term of employment was extended from 24 months to 30 months, at the end of which Mr. Sandlin's employment becomes at-will. In addition, under the amendment Mr. Sandlin's base salary is increased to $143,000 effective as of January 1, 2008. The amendment also provides that in the event that the initial public offering is not consummated as scheduled, through no fault of Mr. Sandlin, all stock options granted to Mr. Sandlin in December 2006 will immediately and fully vest as of December 31, 2008.

MariaElena Ross

We entered into an employment agreement dated July 1, 2006 with MariaElena Ross, our vice president of administration and human resources. Under the employment agreement, we employ Ms. Ross for a period of 24 months from the date of the agreement, at the end of which Ms. Ross's agreement terminates and she will be employed with us on an at-will basis. Ms. Ross's initial base salary was set at $130,000. The employment agreement also provides Ms. Ross with an annual performance bonus opportunity in an amount not to exceed 100% of her base salary. Pursuant to the employment agreement, we granted Ms. Ross an initial option to purchase 30,000 shares of our common stock.

In February 2008, we amended Ms. Ross's employment agreement, effective July 1, 2008. Pursuant to the amendment, Ms. Ross's term of employment was extended from 24 months to 30 months, at the end of which Ms. Ross's employment becomes at-will. In addition, under the amendment Ms. Ross's base salary is increased to $145,000 effective as of January 1, 2008. The amendment also provides that in the event that the initial public offering is not consummated as scheduled, through no fault of Ms. Ross, all stock options granted to Ms. Ross in December 2006 will immediately and fully vest as of December 31, 2008.

The severance and termination terms of our Named Executive Officers' current employment agreements are further discussed under the caption "Compensation Discussion and Analysis—Severance and Termination" above. Additionally, each of our Named Executive Officers has entered into our standard employment agreement, which contains customary provisions relating to restrictions on competition during the period of employment as well as restrictions on solicitation during the term of employment and for two years after termination.

Potential Payments Upon Termination or Change of Control

The table below reflects the compensation and benefits due to each of the Named Executive Officers in the event of termination of employment: (i) upon a voluntary termination; (ii) an involuntary for cause termination (including death and disability); (iii) an involuntary termination without cause; and (iv) an involuntary termination following a change in control. The amounts shown assume that each termination of employment was effective as of December 31, 2007. The amounts shown in the table are estimates of the amounts which would be paid upon termination of employment. The actual amounts to be paid can only be determined at the time of the termination of employment.

Name	Voluntary Termination ($)(1)	Involuntary Termination For Cause ($)(1)	Involuntary Termination Without Cause ($)(2)(3)	Involuntary Termination Within 12 Months Following a Change in Control ($)(3)(4)
G.G. Pique	25,700	25,700		
Hans Peter Michelet(5)	8,061	8,061		
Thomas Willardson(6)	7,722	7,722		
Richard Stover	12,382	12,382		
Terrill Sandlin	23,287	23,287		
MariaElena Ross	12,038	12,038		

(1) This amount includes: (i) base salary due and owing at termination; (ii) earned but unused vacation through the date of termination; (iii) reimbursement of all reasonable expenses; and (iv) any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the executive's termination occurs.

(2) This amount includes: (i) base salary due and owing at termination; (ii) earned but unused vacation through the date of termination; (iii) reimbursement of all reasonable expenses; (iv) any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the executive's termination occurs; (v) payment in an amount equal to 70% of current annual base salary, in the case of Mr. Pique, and 50% of current annual base salary, in the case of other Named Executive Officers; (vi) equity acceleration; and (vii) our payments for continued health, dental, vision and life insurance benefits for a period of one year.

(3) Equity acceleration is calculated as the spread value of all unvested stock options and restricted stock held by the executive on December 31, 2007, assuming an initial public offering price of our common stock of $. The vesting of all then-unvested stock options, restricted stock or other unvested equity incentives held by the executive immediately accelerates upon termination of executive's employment without cause.

(4) This amount includes: (i) base salary due and owing at termination; (ii) earned but unused vacation through the date of termination; (iii) reimbursement of all reasonable expenses; (iv) any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the executive's termination occurs; (v) payment in an amount equal to 100% of current annual base salary; (vi) equity acceleration; and (vii) our payments for continued health, dental, vision and life insurance benefits for a period of one year.

(5) Mr. Michelet served as our interim chief financial officer from January 2005 to November 2007.

(6) Mr. Willardson was appointed as our chief financial officer in November 2007.

In addition to the benefits described above, our 2002 Stock Option/Stock Issuance Plan, 2004 Stock Option/Stock Issuance Plan and 2006 Stock Option/Stock Issuance Plan provide for the acceleration of vesting of awards in certain circumstances in connection with or following a change of control of our company. See "Employee Benefit Plans" below.

Employee Benefit Plans

2008 Equity Incentive Plan

The following contains a summary of the material terms of our 2008 Equity Incentive Plan, or the 2008 Plan, which was approved by our board of directors in March 2008 and which we expect our stockholders will approve prior to the completion of this offering. The 2008 Plan, which will be effective immediately prior to the effectiveness of this offering, is the successor to our 2006 Stock Option/Stock Issuance Plan. No further awards will be granted under our 2006 Stock Option/Stock Issuance Plan after this offering. The awards outstanding after this offering under the 2006 Stock Option/Stock Issuance Plan will continue to be governed by their existing terms.

Purpose of the 2008 Plan. The 2008 Plan is intended to promote our long-term success and the creation of stockholder value by encouraging employees, directors and consultants to focus on critical long-range objectives, encouraging the attraction and retention of employees, directors and consultants with exceptional qualifications and linking employees, directors and consultants directly to stockholder interests through increased stock ownership.

Term of the 2008 Plan. The 2008 Plan will continue in effect for seven years from its adoption date, unless our board of directors decides to terminate the plan earlier.

Share Reserve. The maximum number of shares that we have authorized for issuance under the 2008 Plan is 1,000,000 shares.

Any award intended to comply with Section 162(m) of the Code shall be limited to 800,000 shares per individual in a single calendar year. All shares available under the 2008 Plan may be issued upon the exercise of incentive stock options.

As of the first day of each year, commencing in 2009, the aggregate number of shares that may be issued or transferred under the 2008 Plan shall automatically increase by a number equal to the lowest of (a) 5% of the total number of shares then outstanding, (b) 2,500,000 shares or (c) the number determined by the board of directors. Notwithstanding the foregoing, the maximum aggregate number of shares that may be issued or transferred under the 2008 Plan during the term of the Plan shall not exceed 10,000,000 shares.

In general, if options or other awards granted under the 2008 Plan are forfeited or terminate for any other reason before being exercised or settled, then the shares subject to such options or awards will again become available for awards under the 2008 Plan.

Administration of the 2008 Plan. The 2008 Plan is administered by a committee of our board of directors, which will have complete discretion to make all decisions relating to the interpretation and operation of the 2008 Plan. The committee will have the discretion to determine who will receive an award, the type of award, the number of shares that will be covered by the award, the vesting requirements of the award, if any, and all other features and conditions of the award. The committee may implement rules and procedures that differ from those described below in order to adapt the 2008 Plan to the requirements of countries other than the United States. Any action taken or determination made by the committee will be final, binding and conclusive on all affected persons. Within the limits set forth by the 2008 Plan, the committee may also reprice outstanding options and modify outstanding awards in other ways.

Eligibility. Any employee, consultant or non-employee director may be selected by the committee to participate in the 2008 Plan. Except as set forth below with respect to incentive options, all awards may be granted by the committee to any employee, consultant or non-employee director who performs services for us or our parent or subsidiary and who is determined by the committee to be eligible for an award.

Type of 2008 Plan Awards. Awards granted under the 2008 Plan may include any of the following:

- non-qualified options are options to purchase shares of our common stock at an exercise price of not less than 100% of the fair market value per share on the date of grant;
- incentive options are options designed to meet certain tax code provisions, which provide favorable tax treatment to optionees if certain conditions are met. Incentive options are issued at an exercise price not less than 100% of the fair market value per share (or 110% of fair market value per share if issued to 10% stockholders) on the date of grant and may only be granted to employees;
- stock units are rights to receive a specified number of shares of our common stock, the fair market value of such common stock in cash or a combination of cash and shares upon expiration of the vesting period specified for such stock units by the committee;

- restricted shares are shares of common stock which are issued to the participant subject to such forfeiture and other restrictions as the committee, in its sole discretion, shall determine. Restricted shares may not be transferred by the participant prior to the lapse of such restrictions; and
- stock appreciation rights are rights to receive shares of our common stock, cash or a combination of shares and cash, the value of which is equal to the spread or excess of (i) the fair market value per share on the date of exercise over (ii) the fair market value per share on the date of grant with respect to a specified number of shares of common stock.

Performance Awards. The committee may grant performance awards to employees, consultants or non-employee directors based on performance criteria measured over a specified period of one or more years. Such criteria may include operating profits (including EBITDA), net profits, earnings per share, profit returns and margins, revenue, stockholder return and/or value, stock price and working capital or, for awards not intended to comply with Section 162(m) of the Code, such other performance criteria determined by the board of directors.

Vesting of Awards and Exercise of Options and Stock Appreciation Rights. Options and stock appreciation rights vest at the time or times determined by the committee. In most cases, our options vest over the four-year period following the date of grant. Vesting may accelerate in the event of death or disability. The 2008 Plan provides that no participant may receive options covering more than 500,000 shares and stock appreciation rights covering more than 500,000 shares in the same calendar year, except that a newly hired employee may receive options covering up to 800,000 shares and stock appreciation rights covering up to 800,000 shares in the first calendar year of employment.

Restricted shares and stock units vest at the time or times determined by the committee and may be subject to service-based or performance-based vesting conditions. The 2008 Plan provides that no participant may receive restricted shares or stock units that are subject to performance-based vesting conditions covering more than 800,000 shares in a single calendar year. Vesting may accelerate in the event of death or disability.

Change in Control. If a change in control of our company occurs, the vesting of an award under the 2008 Plan will generally not accelerate unless the surviving corporation in a merger or consolidation does not assume the option or award or replace it with a comparable award. A change in control includes:

- a merger of our company after which our stockholders own 50% or less of the surviving corporation or its parent company;
- a sale of all or substantially all of our assets;
- a change in the composition of the board of directors, as a result of which less than 50% of the incumbent directors either had been directors two years before the change in composition of the board or were appointed or nominated by the board by a majority of the directors who had been directors two years before or had been selected in this manner; or
- an acquisition of 50% or more of our outstanding stock by any person or group, other than a person related to our company, such as a holding company owned by our stockholders.

In the event that we are a party to a merger or consolidation in which options or awards are not assumed or replaced with comparable awards by the surviving corporation, all outstanding options or awards shall be subject to the agreement of merger or consolidation, which shall provide for one or more of the following:

- the acceleration of vesting of 100% of the then unvested portion of the common stock subject to any outstanding options and stock appreciation rights;
- the cancellation of all outstanding options and stock appreciation rights in exchange for a payment to the holders thereof equal to the excess of (i) the fair market value of the common shares subject to such options and stock appreciation rights over (ii) their exercise price. Such payment shall be made in the form of cash, cash equivalents or securities of the surviving corporation or its parent, and such payment may be made in installments and deferred until the date or dates when such options and stock appreciation rights would have vested; and
- The cancellation of all outstanding stock units and a payment to the holders thereof equal to the fair market value of the common stock subject to such stock units. Such payment shall be made in the form of cash, cash equivalents or securities of the surviving corporation or its parent, and such payment may be made in installments and deferred until the date or dates when such stock units would have vested.

In addition, our committee shall have the discretion, in connection with a change in control or otherwise, to provide for the acceleration of vesting at any time of some or all of any options or awards granted under our 2008 Plan.

Amendment and Termination of 2008 Plan. The board of directors may amend or terminate the 2008 Plan at any time. No amendment can be effective prior to its approval by our stockholders, to the extent that such approval is required by applicable legal requirements or any exchange on which our common stock is listed.

2006 Stock Option/Stock Issuance Plan

Our 2006 Stock Option/Stock Issuance Plan, or the 2006 Plan, was adopted by our board of directors and approved by our stockholders in May 2006. The plan provides for the grant of stock issuances and stock options to our employees, non-employee directors, consultants and independent advisors. The 2006 Plan is divided into two separate equity programs, an option grant program and a stock issuance program, each of which is discussed in more detail below.

We have reserved a total of 850,000 shares of our common stock for issuance pursuant to the 2006 Plan. As of December 31, 2007, options to purchase 760,783 shares of our common stock were outstanding and 39,017 shares were available for future grant under this plan. Our board of directors has decided not to grant any additional options or other awards under this plan following the completion of this offering. However, this plan will continue to govern the terms and conditions of the outstanding awards previously granted under this plan.

The 2006 Plan calls for administration to be carried out by the board of directors or a committee delegated by the board of directors. Our 2006 Plan is administered by our compensation committee.

Under the 2006 Plan, the plan administrator has the full authority to determine: (i) with respect to grants under the option grant program, which eligible persons are to receive option grants, the times when those grants are to be made, the number of shares to be covered by each such grant, the status of the granted option as either an incentive option or a nonstatutory option, the times when each option is to become exercisable, the exercise price per share, the vesting schedule applicable to the option shares and the maximum term for which the option is to remain outstanding; and (ii) with respect to stock issuances under the stock issuance program, which eligible persons are to receive stock issuances, the times when those issuances are to be made, the number of shares to be issued to each participant, the vesting schedule applicable to the issued shares and the consideration to be paid by the participant for such shares. The plan administrator also has the absolute discretion either to grant or to effect stock issuances.

Option Grant Program

The exercise price of all options, except for incentive options (or options that satisfy the requirements of the Internal Revenue Code Section 422) granted under our option grant program must not be less than 85% of the fair market value of our common stock on the date of grant. However, with respect to any participant who is a 10% stockholder, the exercise price of such options must not be less than 110% of the fair market value on the grant date. The term of any options granted under our option grant program may not exceed 10 years. With respect to incentive options, the exercise price per share of an incentive option must not be less than 100% of the fair market value on the grant date. Also, the aggregate fair market value of the incentive options that become exercisable for the first time during any one calendar year must not exceed $100,000. Finally, the term of any incentive option granted to an employee who is a 10% stockholder may not exceed five years.

After termination of service by an employee, director or consultant, for any reason other than death, disability or misconduct, he or she has a period of one month following the date of termination during which to exercise his or her option. If termination is due to death or disability, the option will remain exercisable for 12 months. If the termination is due to misconduct, then all outstanding options held by the individual terminates immediately. While the plan administrator may, at its discretion, extend the period of time for which the option is to remain exercisable, no option may is exercisable after the expiration of its term.

Our option grant program provides that in the event of a change in control of our company, defined as a merger or consolidation where more than fifty percent of the total combined voting power of our outstanding securities are transferred to a person or persons different from those holding our securities immediately prior to such transaction, or the sale, transfer or other disposition of all or substantially all of our assets, the shares subject to each outstanding option shall automatically vest in full so that each such option becomes fully exercisable and may be exercised as fully vested shares prior to the effective date of the change in control. However, such shares may not vest on such an accelerated basis if:

- the option is assumed by the successor corporation and our repurchase rights with respect to the unvested option shares are assigned to such corporation;

- such option is to be replaced with the successor corporation's cash incentive program, which preserves the spread existing on the unvested option shares and provides for subsequent payout in accordance with the same vesting schedule applicable to those unvested option shares; or
- acceleration of the option is subject to other limitations imposed by the plan administrator at the time of the option grant.

In any case, our option grant program gives the plan administrator the discretion to provide for automatic acceleration of one or more outstanding options in the event of a change in control, whether or not those options are to be assumed in the change in control.

Our option grant program also gives the plan administrator the full power and authority to structure an option so that the shares subject to that option will automatically vest on an accelerated basis should the option holder's service terminate by reason of an involuntary termination within a period not to exceed 18 months following the effective date of a change in control. Any option so accelerated remains exercisable until the earlier of the expiration of the option term or the expiration of one year from the effective date of the involuntary termination.

Stock Issuance Program

Under our stock issuance program, the plan administrator has discretion to fix the purchase price of the shares. However, such price may not be less than 85% of the fair market value of our common stock on the issue date, and with respect to any shares issued to a 10% stockholder, the purchase price may not be less than 110% of the fair market value on the issue date.

Shares of our common stock issued under the stock issuance program may be fully and immediately vested upon issuance or may vest in installments over the participant's period of service or upon attainment of specific performance goals. While the plan administrator has discretion in determining the vesting schedule, no vesting schedule may be more restrictive than 20% per year vesting, with initial vesting to occur no later than one year after the issuance date. However, such limitation does not apply to common stock issuances made to our officers, non-employee board members or independent consultants.

Our stock issuance program gives the participant full stockholder rights with respect to any shares of common stock issued under such program, whether or not the participant's interest in those shares is vested. Our stock issuance program also calls for immediate surrender and cancellation of any unvested shares of common stock should the participant's service be terminated or his/her performance goals not be attained with respect to such unvested shares. However, the plan administrator may at its discretion waive such the surrender and cancellation of the unvested shares at any time.

Our stock issuance program further provides that in the event of a change in control, all repurchase rights under the program terminates immediately and shares subject to those rights immediately vest in full, except to the extent that: (i) our repurchase rights are assigned to such corporation; or (ii) acceleration is subject to other limitations imposed by the plan administrator at the time the repurchase right is issued.

The plan administrator has the discretionary authority to provide that our repurchase rights with respect to unvested shares automatically terminate and the shares subject to such rights immediately vest in the event that the participant's service terminates by reason of an involuntary termination within a period not to exceed 18 months following the effective date of a change in control.

2004 Stock Option/Stock Issuance Plan

Our 2004 Stock Option/Stock Issuance Plan, or 2004 Plan, was adopted by our board of directors and approved by our stockholders in January 2004. Our 2004 Plan provides for the grant of stock issuances and stock options to our employees, non-employee directors, consultants and other independent advisors. The administration and features of the 2004 Plan and the terms of the options granted thereunder are substantially similar to the corresponding features of the 2006 Plan.

We have reserved a total of 850,000 shares of our common stock for issuance pursuant to the 2004 Plan. As of December 31, 2007, options to purchase 339,208 shares of our common stock were outstanding and 8,709 shares were available for future grant under this plan. Our board of directors has decided not to grant any additional options or other awards under this plan following the completion of this offering. However, this plan will continue to govern the terms and conditions of the outstanding awards previously granted under this plan.

2002 Stock Option/Stock Issuance Plan

Our 2002 Stock Option/Stock Issuance Plan, or 2002 Plan, was adopted by our board of directors in March 2002 and approved by our stockholders in April 2002. Our 2002 Plan provides for the grant of stock issuances and stock options to our employees, non-employee directors, consultants and other independent advisors. The administration and features of the 2002 Plan and the terms of the options granted thereunder are substantially similar to the corresponding features of the 2006 Plan.

We have reserved a total of 1,509,375 shares of our common stock for issuance pursuant to the 2002 Plan. As of December 31, 2007, options to purchase 180,417 shares of our common stock were outstanding and 5,625 shares were available for future grant under this plan. Our board of directors has decided not to grant any additional options or other awards under this plan following the completion of this offering. However, this plan will continue to govern the terms and conditions of the outstanding awards previously granted under this plan.

2001 Stock Option Plan

Our 2001 Stock Option Plan was adopted by our board of directors in March 2001 and approved by our stockholders in April 2001. Our 2001 Stock Option Plan provides for the grant of stock options to our employees, consultants and directors as well as prospective employees, consultants and directors in connection with written offers of employment or other service relationship with our Company.

We have reserved a total of 2,500,000 shares of our common stock for issuance pursuant to the 2001 Stock Option Plan. As of December 31, 2007, no options to purchase shares of our common stock remained outstanding and no shares were available for future grant under this plan.

The 2001 Stock Option Plan calls for administration to be carried out by our board of directors. Under our 2001 Stock Option Plan, the board of directors have the full power and authority to determine: (i) which eligible persons are to receive option grants, the times when those grants are to be made, the number of shares to be covered by each such grant; (ii) the status of the granted option as either an incentive option or a nonstatutory option; (iii) the fair market value of shares of stock or other property; (iv) the terms, conditions and restrictions applicable to each option and any shares acquired upon their exercise, including without limitation: (a) the exercise price, (b) the method of payment for shares purchased upon exercise of the option, (c) the method for satisfaction of any tax withholding obligation arising in connection with the option or such shares, (d) the timing, terms and conditions of the exercisability of the option or the vesting of any shares acquired upon their exercise, (e) the time of expiration of the option, (f) the effect of the optionee's termination of employment or service, and (g) all other terms, conditions and restrictions applicable to the option. Our board of directors also has the full authority to amend the exercisability of any option or the vesting of any shares acquired upon their exercise, including with respect to the period following any optionee's termination of employment or service with our Company.

The 2001 Stock Option Plan provides for the grant of either incentive options or nonstatutory options. However, the board may only issue incentive options to those individuals who are deemed employees of our Company on the effective grant date of the option.

The exercise price of nonstatutory options must not be less than 85% of the fair market value of our common stock on the date of grant. However, with respect to any participant who is a 10% stockholder, the exercise price of such options must not be less than 110% of the fair market value on the grant date. The term of any options granted may not exceed 10 years. With respect to incentive options, the exercise price per share of an incentive option must not be less than the fair market value of a share of stock on the effective grant date. Also, the aggregate fair market value of the incentive options that become exercisable for the first time during any one calendar year must not exceed $100,000. Finally, the term of any incentive option granted to an employee who is a 10% stockholder may not exceed five years.

Our 2001 Stock Option Plan provides that in the event of a change of control of our Company, defined as a direct or indirect sale or exchange by our stockholders of more than 50% of the voting stock of our Company, a merger or consolidation in which our Company is a party, the sale exchange or transfer of all or substantially all of the assets of our company, or a liquidation or dissolution of our Company, the acquiring corporation must either assume our rights and obligations under outstanding options or substitute for outstanding options substantially equivalent options for the acquiring corporation's stock.

Our 2001 Stock Option Plan also provides for indemnification of our board of directors and any officers or employees delegated to act on behalf of the board of directors against any action, suit or proceeding initiated against them by reason of any action taken by them or their failure to act under or in connection with the 2001 Stock Option Plan.

In January 2007, our board of directors amended our 2001, 2002, 2004 and 2006 Stock Option Plans to allow for accelerated vesting of all unvested options upon an optionee's death resulting while employed and engaged in the course and scope of company business.

Defined Contribution Plan

401(k) Plan. We maintain a tax-qualified retirement plan that provides eligible employees with an opportunity to save for retirement on a tax advantaged basis. Eligible employees are able to participate in the 401(k) plan as of the first day of the month. Employees must 21 years of age to participate. Participants may contribute from 1% to 20% of their annual salary, subject to the annual maximum determined by the IRS. All participants' interests in their deferrals are 100% vested when contributed. The 401(k) plan permits us to make matching contributions to eligible participants, where we match 50% of the first 6% of each participant's contributions. Pre-tax contributions are allocated to each participant's individual account and are then invested in selected investment alternatives according to the participants' directions. The 401(k) plan is intended to qualify under Sections 401(a) and 501(a) of the Internal Revenue Code. As a tax-qualified retirement plan, contributions to the 401(k) plan and earnings on those contributions are not taxable to the employees until distributed from the 401(k) plan and all contributions are deductible by us when made. Participants are fully vested in our contribution account after four years of service. Participants may borrow money from the accumulated value of his/her vested accounts. However, the maximum loan amount must be either the lesser of $50,000 or 50% of the vested account balance. Such loans are to be repaid through payroll deductions over a five year period. Upon termination of employment any outstanding loan balance is due within 30 days. If such loan is not paid within 30 days, the loan is reported as a withdrawal and subject to an income tax.

Limitation on Liability and Indemnification Matters

Our amended and restated certificate of incorporation and amended and restated bylaws that will become effective upon the completion of this offering contain provisions that limit the personal liability of our directors for monetary damages to the fullest extent permitted by Delaware law. Consequently, our directors will not be personally liable to us or our stockholders for monetary damages for any breach of fiduciary duties as directors, except liability for:

- any breach of the director's duty of loyalty to us or our stockholders;
- any act or omission not in good faith or that involves intentional misconduct or a knowing violation of law;
- unlawful payments of dividends or unlawful stock repurchases or redemptions as provided in Section 174 of the Delaware General Corporation Law; or
- any transaction from which the director derived an improper personal benefit.

Our amended and restated certificate of incorporation that will become effective upon the completion of this offering provides that we indemnify our directors to the fullest extent permitted by Delaware law. In addition, our amended and restated bylaws that will become effective upon the completion of this offering provide that we indemnify our directors and officers to the fullest extent permitted by Delaware law. Our amended and restated bylaws, that will become effective upon the completion of this offering also provide that we will advance expenses incurred by a director or officer in advance of the final disposition of any action or proceeding, and permit us to secure insurance on behalf of any officer, director, employee or other agent for any liability arising out of his or her actions in that capacity, regardless of whether we would otherwise be permitted to indemnify him or her under the provisions of Delaware law. After the effectiveness of this offering, we expect to enter into agreements to indemnify our directors, executive officers and other employees as determined by the board of directors. With certain exceptions, these agreements provide for indemnification for related expenses including, among others, attorneys' fees, judgments, fines and settlement amounts incurred by any of these individuals in any action or proceeding. We believe that these bylaw provisions and indemnification agreements are necessary to attract and retain qualified persons as directors and officers. We also maintain directors' and officers' liability insurance.

The limitation of liability and indemnification provisions in our amended and restated certificate of incorporation and amended and restated bylaws that will become effective upon the completion of this offering, may discourage stockholders from bringing a lawsuit against our directors for breach of their fiduciary duty of care. They may also reduce the likelihood of derivative litigation against our directors and officers, even though an action, if successful, might benefit us and other stockholders. Further, a stockholder's investment may be adversely affected to the extent that we pay the costs of settlement and damage awards against directors and officers. At present, there is no pending litigation or proceeding involving any of our directors, officers or employees for which indemnification is sought, and we are not aware of any threatened litigation that may result in claims for indemnification.

CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

Since January 1, 2007, there has not been, nor is there currently proposed, any transaction or series of transactions to which we were or are a party in which the amount involved exceeds $120,000 and in which any of our directors, executive officers, holders of more than 5% of any class of our voting securities, or any member of the immediate family of or any entities affiliated with any of the foregoing persons, had or has a direct or indirect material interest, other than arrangements which are described where required under the heading titled "Management" above, and the transactions described below.

Common Stock Purchases and Sales

In June 2007, Caprice AS, a Norwegian corporation, purchased 64,752 shares of our common stock at a price of $5.00 per share for an aggregate purchase price of $323,760. This purchase was part of a private placement of our common stock to various investors. Ole Peter Lorentzen, one of our directors, is a controlling stockholder of Caprice AS. Caprice AS is a holder of more than 5% of our outstanding common stock.

Stock Option Grants

Certain stock option grants to our directors and executive officers and related option grant policies are described above in this prospectus under the caption "Management."

Employment Arrangements and Indemnification Agreements

We have entered into employment arrangements with certain of our executive officers. See "Employment Agreements" and "Potential Payments on Termination or Change of Control" under "Management" above.

Our amended and restated bylaws and amended and restated certificate of incorporation that will be effective upon the completion of this offering require us to indemnify our directors and executive officers in the event that they are named parties to certain actions, suits or proceedings. See "Management—Limitations on Liability and Indemnification Matters" above.

Promissory Notes

G.G. Pique

In February 2005, in connection with the exercise of incentive stock options issued pursuant to certain stock option agreements entered into between us and G.G. Pique, our president and chief executive officer, Mr. Pique purchased an aggregate of 750,000 shares of our common stock with three promissory notes totaling $195,000, payable to us. All three promissory notes bore interest at 3.76% per annum and were secured first by a pledge of the underlying shares purchased by Mr. Pique and then by Mr. Pique's assets until payment in full of the promissory notes, including accrued interest. As of December 31, 2007, 2006 and 2005, $7,000, $8,000 and $7,000, respectively, of interest had accrued on the notes. The entire principal and accrued interest of all three promissory notes were repaid in full in March 2008.

Hans Peter Michelet

In February 2005, in connection with the exercise of a warrant issued pursuant to a certain common stock warrant agreement entered into between us and Hans Peter Michelet, our executive chairman, Mr. Michelet purchased 100,000 shares of our common stock for an aggregate price of $20,000 with a promissory note payable to us in the amount of $20,000. The promissory note bore interest at 3.76% per annum and was secured first by a pledge of the underlying shares purchased by Mr. Michelet and then by Mr. Michelet's assets until payment in full of the promissory note, including accrued interest. As of December 31, 2007, 2006 and 2005, $3,000 of interest had accrued on the note for each such year. The entire principal and accrued interest were repaid in full in March 2008.

Terrill Sandlin

In February 2005, in connection with the exercise of incentive stock options issued pursuant to certain stock option agreements entered into between us and Terrill Sandlin, our vice president of manufacturing, Mr. Sandlin purchased an aggregate of 120,000 shares of our common stock with three promissory notes payable to us totaling $36,000. All three promissory notes bore interest at 3.76% per annum and were secured first by a pledge of the underlying shares purchased by Mr. Sandlin and then by Mr. Sandlin's assets until payment in full of the promissory notes, including accrued interest. As of

December 31, 2007, 2006 and 2005, $2,000, $1,000 and $1,000, respectively, of interest had accrued on the notes. The entire principal and accrued interest of all three promissory notes were repaid in full in March 2008.

Richard Stover

In February 2005, in connection with the exercise of incentive stock options issued pursuant to certain stock option agreements entered into between us and Richard Stover, our chief technical officer, Dr. Stover purchased an aggregate of 175,000 shares of our common stock with three promissory notes payable to us totaling $51,000. All three promissory notes bore interest at 3.76% per annum and were secured first by a pledge of the underlying shares purchased by Dr. Stover and then by Dr. Stover's assets until payment in full of the promissory notes, including accrued interest. As of December 31, 2007, 2006 and 2005, $2,000 of interest had accrued on the notes for each such year. The entire principal and accrued interest of all three promissory notes were repaid in full in January 2008.

C. Peter Darby

In February 2005, in connection with the exercise of a non-statutory stock option issued pursuant to a certain stock option agreement entered into between us and Peter Darby, one of our directors, Mr. Darby purchased 250,000 shares of our common stock for an aggregate price of $50,000 with a promissory note payable to us in the amount of $50,000. The promissory note bore interest at 3.76% per annum and was secured first by a pledge of the underlying shares purchased by Mr. Darby and then by Mr. Darby's assets until payment in full of the promissory note, including accrued interest. As of December 31, 2007, 2006 and 2005, $2,000 of interest had accrued on the note for each such year. The entire principal and accrued interest were repaid in full in March 2008.

James Medanich

In February 2005, in connection with the exercise of non-statutory stock options issued pursuant to certain stock option agreements entered into between us and James Medanich, one of our directors, Mr. Medanich purchased an aggregate of 100,000 shares of our common stock with a promissory note payable to us in the amount of $20,000. The promissory note bore interest at 3.76% per annum and was secured first by a pledge of the underlying shares purchased by Mr. Medanich and then by Mr. Medanich's assets until payment in full of the promissory note, including accrued interest. As of December 31, 2007, 2006 and 2005, $2,000 of interest had accrued on the note for each such year. The entire principal and accrued interest were repaid in full in March 2008.

Other Relationships

We entered into an independent contractor agreement with Darby Engineering, LLC in January 2008, pursuant to which Darby Engineering will provide engineering and management consulting services to us for a period of 12 months, after which the agreement will be on a month-to-month basis. Pursuant to the independent contractor agreement, Darby Engineering will be compensated for services rendered as follows: $1,000 for each day worked at Darby Engineering's offices and $1,200 for each day worked at any other location, provided that Darby Engineering will provide at least eight days of service per month. Peter Darby, one of our directors, is a managing member of Darby Engineering LLC.

PRINCIPAL AND SELLING STOCKHOLDERS

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information with respect to the beneficial ownership of our common stock at December 31, 2007, as adjusted to reflect the sale of common stock offered by us in this offering, for:

- each person who we know beneficially owns more than 5% of our common stock;
- each of our directors;
- each of our Named Executive Officers;
- all of our directors and executive officers as a group; and
- each selling stockholder.

We have determined beneficial ownership in accordance with SEC rules. Except as indicated by the footnotes below, we believe, based on the information furnished to us, that the persons and entities named in the table below have sole voting and investment power with respect to all shares of common stock that they beneficially own, subject to applicable community property laws.

Applicable percentage ownership is based on 39,777,446 shares of common stock outstanding at December 31, 2007. For purposes of the table below, we have assumed that shares of common stock will be outstanding upon completion of this offering. In computing the number of shares of common stock beneficially owned by a person and the percentage ownership of that person, we deemed to be outstanding all shares of common stock subject to options and warrants held by that person or entity that are currently exercisable or exercisable within 60 days of December 31, 2007. We did not deem these shares outstanding, however, for the purpose of computing the percentage ownership of any other person. Beneficial ownership representing less than one percent is denoted with an "*."

Unless otherwise indicated, the address of each beneficial owner listed in the table below is c/o Energy Recovery, Inc. 1908 Doolittle Drive, San Leandro, California, 94577.

	Shares Beneficially Owned		
		Percent	
Name of Beneficial Owner	Number	Before Offering	After Offering
5% Stockholders (other than directors and Named Executive Officers)			
Arvarius AS(1) Parkv.57 c/o B. Skaugen AS 0256 Oslo, Norway	12,026,533	28.9%	
Caprice AS(2) Haakon Vi's Gate 1 0161 Oslo, Norway	4,480,638	11.3	
Directors and Named Executive Officers:			
Hans Peter Michelet	1,781,613	4.5	
James Medanich(3)	3,606,534	9.1	
Fred Olav Johannessen(4)	2,829,497	7.1	
Ole Peter Lorentzen(5)	4,480,638	11.3	
Arve Hanstveit(6)	2,031,751	5.1	
Peter Darby(7)	856,375	2.1	
Marius Skaugen(1)(8)	13,885,399	33.3	
G.G. Pique(9)	1,130,000	2.8	
Richard Stover(10)	267,842	*	
Thomas D. Willardson(11)	100,000	*	
Terrill Sandlin(12)	155,000	*	
MariaElena Ross(13)	115,000	*	
All directors and executive officers as a group (12 persons)	31,239,649	73.6	
Selling Stockholders:			

* Less than one percent.

(1) Includes warrants to purchase 1,904,122 shares of common stock that are exercisable within 60 days of December 31, 2007. Mr. Skaugen, one of our directors, is a controlling stockholder of Arvarius AS.

(2) Mr. Lorentzen, one of our directors, is a controlling stockholder of Caprice AS.

(3) Consists of 3,047,485 shares held of record by Mr. Medanich, 275,551 shares held of record by Mr. Medanich and his wife and 283,498 shares held of record by his wife.

(4) Consists of 1,390,165 shares held of record by Mr. Johannessen, 80,000 shares held of record by Mr. Johannessen's wife, 355,500 shares held of record by Mr. Johannessen's children, 307,210 shares held of record by Logar AS, 375,792 shares held of record by Kalamaris Invest AS, 66,025 shares held of record by Osip ApS, and 254,805 shares held of record by Rolechoice Ltd. Mr. Johannessen has shared voting and investment power over the shares that are owned by his children. Mr. Johannessen is the sole shareholder of Osip ApS and Rolechoice Ltd. Mr. Johannessen is also a controlling stockholder of Logar AS.

(5) Includes 4,480,638 shares of common stock held by Caprice AS. Mr. Lorentzen, one of our directors, is a controlling stockholder of Caprice AS.

(6) Consists of 1,831,751 shares held of record by Mr. Hanstveit and 200,000 shares held of record by Mr. Hanstveit's daughters. Mr. Hanstveit has shared voting and investment power over the shares that are owned by his daughters.

(7) Consists of 250,000 shares held of record by Mr. Darby, 586,375 shares held of record by Mr. Darby and his wife as trustees of the Darby Revocable Trust dated February, 9, 1998, and a warrant held by Mr. Darby and his wife to purchase 20,000 shares of common stock that are exercisable within 60 days of December 31, 2007.

(8) Consists of 25,075 shares held of record by Mr. Skaugen, 1,219,221 shares held of record by B. Skaugen AS, 307,285 shares held of record by Lafite AS, 307,285 shares held of record by Mouton AS and 12,026,533 shares held of record by Arvarius AS. Mr. Skaugen has shared voting and investment power over the shares owned by Lafite AS and Mouton AS. Mr. Skaugen is also a controlling stockholder of Arvarius AS and B. Skaugen AS.

(9) Consists of 730,000 shares held of record by Mr. Pique, a warrant held by Mr. Pique to purchase 150,000 shares of common stock that is exercisable within 60 days of December 31, 2007, and options to purchase 250,000 shares of common stock that are exercisable within 60 days of December 31, 2007.

(10) Includes options to purchase 92,842 shares of common stock that may be exercised within 60 days of December 31, 2007, of which 51,570 shares are subject to a right of repurchase at cost within 60 days of December 31, 2007 in the event of the termination of Dr. Stover's employment with us. The right of repurchase lapses at a rate of 1,876 shares per month until June 2008 and at a rate of 1,934 shares of common stock per month thereafter.

(11) Includes options to purchase 100,000 shares of common stock that may be exercised within 60 days of December 31, 2007, all of which are subject to a right of repurchase at cost within 60 days of December 31, 2007 in the event of the termination of Mr. Willardson's employment with us. The right of repurchase lapses at a rate of 25,000 shares per month as of November 2008 and at a rate of 2,083 shares of common stock per month thereafter.

(12) Includes options to purchase 35,000 shares of common stock that may be exercised within 60 days of December 31, 2007, of which 23,542 shares are subject to a right of repurchase at cost within 60 days of December 31, 2007 in the event of the termination of Mr. Sandlin's employment with us. The right of repurchase lapses at a rate of 729 shares of common stock per month.

(13) Includes options to purchase 115,000 shares of common stock that may be exercised within 60 days of December 31, 2007, of which 53,542 shares are subject to a right of repurchase at cost within 60 days of December 31, 2007 in the event of the termination of Ms. Ross's employment with us. The right of repurchase lapses at a rate of 2,396 shares of common stock per month.

DESCRIPTION OF CAPITAL STOCK

General

The following is a summary of the rights of our common stock and certain provisions of our amended and restated certificate of incorporation and amended and restated bylaws, as they will be in effect upon the completion of this offering. For more detailed information, please see our amended and restated certificate of incorporation and amended and restated bylaws, which are filed as exhibits to the registration statement of which this prospectus is a part.

Immediately following the completion of this offering, our authorized capital stock will consist of shares, with a par value of $0.001 per share, of which:

- 200,000,000 shares are designated as common stock; and
- 10,000,000 shares are designated as preferred stock.

At December 31, 2007, we had outstanding 39,777,446 shares of common stock, held of record by 135 stockholders. In addition, as of December 31, 2007, 1,280,608 shares of our common stock were subject to outstanding options, and 2,074,122 shares of our capital stock were subject to outstanding warrants that do not expire upon the completion of this offering. For more information on our capitalization, see “Capitalization” above.

Common Stock

The holders of our common stock are entitled to one vote per share on all matters to be voted on by our stockholders. Holders of common stock are entitled to receive such dividends as may be declared by the board of directors out of funds legally available therefor. In the event of our liquidation, dissolution or winding up, holders of common stock are entitled to share ratably in all assets remaining after payment of liabilities and distribution of the liquidation preferences of any then outstanding shares of preferred stock. There are no redemption or sinking fund provisions applicable to the common stock.

Preferred Stock

After the consummation of this offering and the filing of our amended and restated certificate of incorporation, our board of directors will have the authority, without further action by our stockholders, to designate and issue up to the total number of authorized shares of preferred stock in one or more series and to fix the rights, preferences, privileges and restrictions granted to or imposed upon each such series of preferred stock, including dividend rights, dividend rate, conversion rights, voting rights, rights and terms of redemption, redemption prices, liquidation preference and sinking fund terms, any or all of which may be greater than or senior to the rights of the common stock. The issuance of preferred stock could adversely affect the voting power of holders of common stock and reduce the likelihood that such holders will receive dividend payments or payments upon liquidation. Such issuance could have the effect of decreasing the market price of the common stock. The issuance of preferred stock or even the ability to issue preferred stock could also have the effect of delaying, deterring or preventing a change of control or other corporate action. Immediately after the completion of this offering, no shares of preferred stock will be outstanding, and we currently have no plans to issue any shares of preferred stock.

Warrants

At December 31, 2007, we had warrants outstanding to purchase 2,074,122 shares of our common stock at exercise prices ranging from $0.20 to $1.00 per share. These warrants will expire at various times between May 21, 2011 and November 1, 2015. Each warrant contains provisions for the adjustment of the exercise price and the number of shares issuable upon exercise in the event of stock dividends, stock splits, reorganizations, reclassifications, consolidations and the like.

Anti-Takeover Effects of Delaware Law and Our Amended and Restated Certificate of Incorporation and Amended and Restated Bylaws That Will Become Effective Upon Completion of This Offering

Certain provisions of Delaware law, our amended and restated certificate of incorporation and our amended and restated bylaws to become effective upon completion of this offering contain provisions that could have the effect of delaying, deferring or discouraging another party from acquiring control of us. These provisions, which are summarized below, are expected to discourage certain types of coercive takeover practices and inadequate takeover bids. These provisions are also designed, in part, to encourage persons seeking to acquire control of us to first negotiate with our board of directors. We believe that the benefits of increased protection of our potential ability to negotiate with an unfriendly or unsolicited

acquirer outweigh the disadvantages of discouraging such proposals, including proposals that are priced above the then-current market value of our common stock, because, among other reasons, the negotiation of such proposals could result in an improvement of their terms.

Amended and Restated Certificate of Incorporation and Amended and Restated Bylaws

Our amended and restated certificate of incorporation and amended and restated bylaws to become effective upon completion of this offering include provisions that:

- authorize the board of directors to issue, without further action by the stockholders, up to 10,000,000 shares of undesignated preferred stock;
- require that any action to be taken by our stockholders be effected at a duly called annual or special meeting and not by written consent;
- specify that special meetings of our stockholders can be called only by the board of directors, the chairman of the board of directors, the chief executive officer or the president;
- establish an advance notice procedure for stockholder approvals to be brought before an annual meeting of our stockholders, including proposed nominations of persons for election to the board of directors;
- provide that directors may be removed only for cause;
- provide that vacancies on our board of directors may be filled only by a majority of directors then in office, even though less than a quorum;
- establish that our board of directors is divided into three classes, Class I, Class II and Class III with each class serving staggered terms;
- specify that no stockholder is permitted to cumulate votes at any election of directors; and
- require a super-majority of votes to amend certain of the above-mentioned provisions.

Delaware Anti-Takeover Statute

We will be subject to the provisions of Section 203 of the Delaware General Corporation Law regulating corporate takeovers. In general, Section 203 prohibits a publicly-held Delaware corporation from engaging, under certain circumstances, in a business combination with an interested stockholder for a period of three years following the date the person became an interested stockholder unless:

- prior to such date, the board of directors of the corporation approved either the business combination or the transaction which resulted in the stockholder becoming an interested stockholder;
- upon completion of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, excluding for purposes of determining the voting stock outstanding (but not the outstanding voting stock owned by the interested stockholder), (1) shares owned by persons who are directors and also officers and (2) shares owned by employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer; or
- at or subsequent to the date of the transaction that resulted in a stockholder becoming an interested stockholder, the business combination is approved by the board of directors of the corporation and authorized at an annual or special meeting of stockholders, and not by written consent, by the affirmative vote of at least 66 2/3% of the outstanding voting stock which is not owned by the interested stockholder.

Generally, a business combination includes a merger, asset or stock sale, or other transaction resulting in a financial benefit to the interested stockholder. An interested stockholder is a person who, together with affiliates and associates, owns or, within three years prior to the determination of interested stockholder status, did own 15% or more of a corporation's outstanding voting stock. We expect the existence of this provision to have an anti-takeover effect with respect to transactions our board of directors does not approve in advance. We also anticipate that Section 203 may discourage business combinations or other attempts that might result in a premium over the market price for the shares of common stock held by our stockholders.

The provisions of Delaware law, our amended and restated certificate of incorporation and our amended and restated bylaws to become effective upon completion of this offering could have the effect of discouraging others from attempting hostile takeovers and, as a consequence, they may also inhibit temporary fluctuations in the market price of our common stock that often result from actual or rumored hostile takeover attempts. These provisions may also have the effect of preventing changes in our management. It is possible that these provisions could make it more difficult to accomplish transactions that stockholders may otherwise deem to be in their best interests.

Transfer Agent and Registrar

The transfer agent and registrar for our common stock is American Stock Transfer & Trust Company. The transfer agent's address is 59 Maiden Lane, Plaza Level, New York, New York 10038, and its telephone number is (800) 937-5449.

Listing

We expect to apply to list our common stock on the NASDAQ Global Market.

SHARES ELIGIBLE FOR FUTURE SALE

Before this offering, there has not been a public market for shares of our common stock. Future sales of substantial amounts of shares of our common stock, including shares issued upon the exercise of outstanding options, in the public market after this offering, or the possibility of these sales occurring, could cause the prevailing market price for our common stock to fall or impair our ability to raise equity capital in the future.

Upon the completion of this offering, a total of shares of common stock will be outstanding, assuming that there are no exercises of options or warrants to purchase common stock that were outstanding as of , 2008. Of these shares, all shares of common stock sold in this offering by us, plus any shares sold upon exercise of the underwriters' option to purchase additional shares, will be freely tradable in the public market without restriction or further registration under the Securities Act, unless these shares are held by "affiliates," as that term is defined in Rule 144 under the Securities Act.

The remaining shares of common stock will be "restricted securities," as that term is defined in Rule 144 under the Securities Act. These restricted securities are eligible for public sale only if they are registered under the Securities Act or if they qualify for an exemption from registration under Rules 144 or 701 under the Securities Act, which are summarized below.

Subject to the lock-up agreements described below and the provisions of Rules 144 and 701 under the Securities Act, these restricted securities will be available for sale in the public market as follows:

Date	Number of Shares
On the date of this prospectus	
Between 90 and 180 days after the date of this prospectus	
At various times beginning more than 180 days after the date of this prospectus	

In addition, of the shares of our common stock that were subject to stock options outstanding as of , 2008, options to purchase shares of common stock were vested as of , 2008 and will be eligible for sale 180 days following the effective date of this offering.

Rule 144

In general, under Rule 144 an affiliate who has beneficially owned shares of our common stock that are deemed restricted securities for at least six months would be entitled to sell, within any three-month period a number of shares that does not exceed the greater of:

- 1% of the number of shares of our common stock then outstanding, which will equal approximately shares immediately after this offering; or
- the average weekly trading volume of our common stock on the NASDAQ Global Market during the four calendar weeks preceding the filing of a notice on Form 144 with respect to that sale.

These sales may commence beginning 90 days after the date of this prospectus, subject to continued availability of current public information about us. Such sales under Rule 144 are also subject to certain manner of sale provisions and notice requirements.

A person who is not one of our affiliates and who is not deemed to have been one of our affiliates at any time during the three months preceding a sale may sell the shares proposed to be sold according to the following conditions:

- If the person has beneficially owned the shares for at least six months, including the holding period of any prior owner other than an affiliate, the shares may be sold, subject to continued availability of current public information about us.
- If the person has beneficially owned the shares for at least one year, including the holding period of any prior owner other than an affiliate, the shares may be sold without any Rule 144 limitations.

Rule 701

In general, under Rule 701 as currently in effect, any of our employees, consultants or advisors who purchase shares from us in connection with a compensatory stock or option plan or other written agreement in a transaction before the effective date of this offering that was completed in reliance on Rule 701 and complied with the requirements of Rule 701 will, subject to the lock-up restrictions described below, be eligible to resell such shares 90 days after the effective date of

this offering in reliance on Rule 144, but without compliance with certain restrictions, including the holding period, contained in Rule 144.

Lock-Up Agreements

We, all of our directors and officers and all holders of our common stock or securities convertible into common stock outstanding immediately prior to this offering have agreed that, without the prior written consent of Citi and Credit Suisse Securities (USA) LLC on behalf of the underwriters, we and they will not, during the period ending 180 days after the date of this prospectus offer, sell, contract to sell, pledge, grant any option to purchase, make any short sale or otherwise dispose of any shares of our common stock, or any options or warrants to purchase any shares of our common stock, or any securities convertible into, exchangeable for or that represent the right to receive shares of our common stock, whether now owned or hereinafter acquired, owned directly by us or them (including holding as a custodian) or with respect to which we or they have beneficial ownership within the rules and regulations of the SEC, whether any transaction described above is to be settled by delivery of shares of our common stock or such other securities, in cash or otherwise. These agreements are subject to certain exceptions, and are also subject to extension for up to an additional 18 days, as set forth in "Underwriting" below.

Registration Statements

We intend to file a registration statement on Form S-8 under the Securities Act covering all of the shares of common stock subject to options outstanding or reserved for issuance under our stock plans. We expect to file this registration statement as soon as practicable after this offering. However, none of the shares registered on Form S-8 will be eligible for resale until the expiration of the lock-up agreements to which they are subject.

MATERIAL UNITED STATES TAX CONSIDERATIONS FOR NON-U.S. HOLDERS

The following is a general discussion of material United States federal income and estate tax considerations with respect to the acquisition, ownership and disposition of shares of our common stock applicable to non-U.S. holders. In general, a "non-U.S. holder" is any holder other than:

- a citizen or resident of the United States;
- a corporation created or organized in or under the laws of the United States or any political subdivision thereof;
- an estate, the income of which is includible in gross income for United States federal income tax purposes regardless of its source; or
- a trust if (a) a court within the United States is able to exercise primary supervision over the administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust or (b) it has a valid election in effect under applicable Treasury regulations to be treated as a United States person.

Generally, an individual may be treated as a resident of the United States in any calendar year for United States federal income tax purposes by, among other ways, being present in the United States for at least 31 days in that calendar year and for an aggregate of at least 183 days during a three-year period ending in the current calendar year. For purposes of this calculation, such individual would count all of the days in which he or she was present in the current year, one-third of the days present in the immediately preceding year, and one-sixth of the days present in the second preceding year. Residents are taxed for United States federal income tax purposes as if they were citizens of the United States.

This discussion is based on current provisions of the Internal Revenue Code, final, temporary or proposed Treasury regulations promulgated thereunder, judicial opinions, published positions of the Internal Revenue Service and all other applicable authorities, all of which are subject to change (possibly with retroactive effect). We assume in this discussion that a non-U.S. holder holds shares of our common stock as a capital asset (generally property held for investment).

This discussion does not address all aspects of United States federal income and estate taxation that may be important to a particular non-U.S. holder in light of that non-U.S. holder's individual circumstances, nor does it address any aspects of United States state, local or non-U.S. taxes. This discussion also does not consider any specific facts or circumstances that may apply to a non-U.S. holder subject to special treatment under the United States federal income tax laws, including without limitation:

- banks, insurance companies or other financial institutions;
- partnerships or other entities classified as partnerships for United States federal income tax purposes;
- tax-exempt organizations;
- tax-qualified retirement plans;
- dealers in securities or currencies;
- traders in securities that elect to use a mark-to-market method of accounting for their securities holdings;
- certain United States expatriates; and
- persons that will hold common stock as a position in a hedging transaction, "straddle" or "conversion transaction" for tax purposes.

Accordingly, we urge prospective investors to consult with their own tax advisors regarding the United States federal, state, local and non-U.S. income and other tax considerations of acquiring, holding and disposing of shares of our common stock.

If a partnership holds shares of our common stock, the tax treatment of a partner will generally depend upon the status of the partner and the activities of the partnership. Any partner in a partnership holding shares of our common stock should consult its own tax advisors.

Dividends

In general, dividends we pay, if any, to a non-U.S. holder will be subject to United States withholding tax at a rate of 30% of the gross amount. The withholding tax might not apply or might apply at a reduced rate under the terms of an applicable income tax treaty between the United States and the non-U.S. holder's country of residence. A non-U.S. holder must demonstrate its entitlement to treaty benefits by certifying, among other things, its nonresident status. A non-U.S. holder generally can meet this certification requirement by providing an Internal Revenue Service Form W-8BEN or appropriate substitute form to us or our paying agent. Also, special rules apply if the dividends are effectively connected with a trade or business carried on by the non-U.S. holder within the United States and, if a treaty applies, are attributable to a permanent establishment of the non-U.S. holder within the United States. Dividends effectively connected with this United States trade or business, and, if a treaty applies, attributable to such a permanent establishment of a non-U.S. holder, generally will not be subject to United States withholding tax if the non-U.S. holder files certain forms, including Internal Revenue Service Form W-8ECI (or any successor form), with the payor of the dividend, and generally will be subject to United States federal income tax on a net income basis, in the same manner as if the non-U.S. holder were a resident of the United States. A non-U.S. holder that is a corporation may be subject to an additional "branch profits tax" at a rate of 30% (or a reduced rate as may be specified by an applicable income tax treaty) on the repatriation from the United States of its "effectively connected earnings and profits," subject to certain adjustments. A non-U.S. holder of shares of our common stock eligible for a reduced rate of United States withholding tax pursuant to an income tax treaty may obtain a refund of any excess amounts withheld by filing an appropriate claim for refund with the Internal Revenue Service.

Gain on Sale or Other Disposition of Common Stock

In general, a non-U.S. holder will not be subject to United States federal income tax on any gain realized upon the sale or other disposition of the holder's shares of our common stock unless:

- the gain is effectively connected with a trade or business carried on by the non-U.S. holder within the United States and, if required by an applicable income tax treaty as a condition to subjecting a non-U.S. holder to United States income tax on a net basis, the gain is attributable to a permanent establishment of the non-U.S. holder maintained in the United States, in which case a non-U.S. holder will be subject to United States federal income tax on any gain realized upon the sale or other disposition on a net income basis, in the same manner as if the non-U.S. holder were a resident of the United States. Furthermore, the branch profits tax discussed above may also apply if the non-U.S. holder is a corporation;
- the non-U.S. holder is an individual and is present in the United States for 183 days or more in the taxable year of disposition and certain other tests are met, in which case a non-U.S. holder will be subject to a flat 30% tax on any gain realized upon the sale or other disposition, which tax may be offset by United States source capital losses (even though the individual is not considered a resident of the United States); or
- we are or have been a United States real property holding corporation (a USRPHC) for United States federal income tax purposes at any time within the shorter of the five-year period preceding the disposition and the non-U.S. holder's holding period. We do not believe that we are a USRPHC, and we do not anticipate becoming a USRPHC. If we are or were to become a USRPHC at any time during this period, generally gains realized upon a disposition of shares of our common stock by a non-U.S. holder that did not directly or indirectly own more than 5% of our common stock during this period would not be subject to United States federal income tax, provided that our common stock is "regularly traded on an established securities market" (within the meaning of Section 897(c)(3) of the Internal Revenue Code). Our common stock will be treated as regularly traded on an established securities market during any period in which it is listed on a registered national securities exchange or any over-the-counter market.

United States Federal Estate Tax

Shares of our common stock that are owned or treated as owned by an individual who is not a citizen or resident (as defined for United States federal estate tax purposes) of the United States at the time of death will be includible in the individual's gross estate for United States federal estate tax purposes, unless an applicable estate tax treaty provides otherwise, and therefore may be subject to United States federal estate tax.

Backup Withholding, Information Reporting and Other Reporting Requirements

Generally, we must report annually to the Internal Revenue Service and to each non-U.S. holder the amount of dividends paid to, and the tax withheld with respect to, each non-U.S. holder. These reporting requirements apply regardless of whether withholding was reduced or eliminated by an applicable tax treaty. Copies of this information also may be made

available under the provisions of a specific treaty or agreement with the tax authorities in the country in which the non-U.S. holder resides or is established.

United States backup withholding tax is imposed (at a current rate of 28%) on certain payments to persons that fail to furnish the information required under the United States information reporting requirements. A non-U.S. holder of shares of our common stock will be subject to this backup withholding tax on dividends we pay unless the holder certifies, under penalties of perjury, among other things, its status as a non-U.S. holder (and we or our paying agent do not have actual knowledge or reason to know the holder is a United States person) or otherwise establishes an exemption.

Under the Treasury regulations, the payment of proceeds from the disposition of shares of our common stock by a non-U.S. holder made to or through a United States office of a broker generally will be subject to information reporting and backup withholding unless the beneficial owner certifies, under penalties of perjury, among other things, its status as a non-U.S. holder (and the broker does not have actual knowledge or reason to know the holder is a United States person) or otherwise establishes an exemption. The payment of proceeds from the disposition of shares of our common stock by a non-U.S. holder made to or through a non-U.S. office of a broker generally will not be subject to backup withholding and information reporting, except as noted below. In the case of proceeds from a disposition of shares of our common stock by a non-U.S. holder made to or through a non-U.S. office of a broker that is:

- a United States person;
- a "controlled foreign corporation" for United States federal income tax purposes;
- a foreign person 50% or more of whose gross income from certain periods is effectively connected with a United States trade or business; or
- a foreign partnership if at any time during its tax year (a) one or more of its partners are United States persons who, in the aggregate, hold more than 50% of the income or capital interests of the partnership or (b) the foreign partnership is engaged in a United States trade or business;

information reporting (but not backup withholding) will apply unless the broker has documentary evidence in its files that the owner is a non-U.S. holder and certain other conditions are satisfied, or the beneficial owner otherwise establishes an exemption (and the broker has no actual knowledge or reason to know to the contrary).

Backup withholding is not an additional tax. Any amounts withheld under the backup withholding rules from a payment to a non-U.S. holder can be refunded or credited against the non-U.S. holder's United States federal income tax liability, if any, provided that the required information is furnished to the Internal Revenue Service in a timely manner.

THE FOREGOING DISCUSSION OF CERTAIN UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS IS FOR GENERAL INFORMATION ONLY AND IS NOT TAX ADVICE. ACCORDINGLY, EACH PROSPECTIVE HOLDER OF SHARES OF OUR COMMON STOCK SHOULD CONSULT HIS, HER OR ITS OWN TAX ADVISOR WITH RESPECT TO THE FEDERAL, STATE, LOCAL AND FOREIGN TAX CONSEQUENCES OF THE ACQUISITION, OWNERSHIP AND DISPOSITION OF OUR COMMON STOCK.

UNDERWRITING

Under the terms and subject to the conditions contained in an underwriting agreement dated , 2008, we and the selling stockholders have agreed to sell to the underwriters named below, for whom Citigroup Global Markets Inc. and Credit Suisse Securities (USA) LLC are acting as joint bookrunning managers and representatives, the following respective numbers of shares of common stock:

Underwriter	Number of Shares
Citigroup Global Markets Inc.	
Credit Suisse Securities (USA) LLC	
Total	

The underwriting agreement provides that the underwriters are obligated to purchase all the shares of common stock in the offering if any are purchased, other than those shares covered by the over-allotment option described below. The underwriting agreement also provides that if an underwriter defaults, the purchase commitments of non-defaulting underwriters may be increased or the offering may be terminated.

All sales of the common stock in the United States will be made by U.S. registered broker/dealers.

We and the selling stockholders have granted to the underwriters a 30-day option to purchase on a pro rata basis up to additional shares from us and an aggregate of additional outstanding shares from the selling stockholders at the initial public offering price less the underwriting discounts and commissions. The option may be exercised only to cover any over-allotments of common stock.

The underwriters propose to offer the shares of common stock initially at the public offering price on the cover page of this prospectus and to selling group members at that price less a selling concession of $ per share. After the initial public offering the representatives may change the public offering price and concession and discount to broker/dealers.

The following table summarizes the compensation and estimated expenses we and the selling stockholders will pay:

	Per Share		Total	
	Without Over-allotment	With Over-allotment	Without Over-allotment	With Over-allotment
Underwriting discounts and commissions paid by us	$	$	$	$
Expenses payable by us	$	$	$	$
Underwriting discounts and commissions paid by selling stockholders	$	$	$	$

The representatives have informed us that they do not expect sales to accounts over which the underwriters have discretionary authority to exceed 5% of the shares of common stock being offered.

We, our officers and directors, and all holders of our common shares, including the selling stockholders, have agreed that, for a period of 180 days from the date of this prospectus, we and they will not, without the prior written consent of each of Citi and Credit Suisse Securities (USA) LLC, dispose of or hedge any shares of our common stock or any securities convertible into or exchangeable for our common stock. Citi and Credit Suisse Securities (USA) LLC in their sole discretion may release any of the securities subject to these lock-up agreements at any time without notice. The 180-day lock-up period will be automatically extended if: (1) during the last 17 days of the 180-day period we issue an earnings release or announce material news or a material event; or (2) prior to the expiration of the 180-day period, we announce that we will release earnings results during the 16-day period following the last day of the 180-day period, in which case the restrictions will continue to apply until the expiration of the 18-day period beginning on the issuance of the earnings release or the announcement of the material news or event, unless Citi and Credit Suisse Securities (USA) LLC waive, in writing, such an extension.

We and the selling stockholders have agreed to indemnify the underwriters against liabilities under the Securities Act, or contribute to payments that the underwriters may be required to make in that respect.

We intend to apply to list the shares of common stock on the NASDAQ Global Market.

In connection with the offering the underwriters may engage in stabilizing transactions, over-allotment transactions, syndicate covering transactions, penalty bids and passive market making in accordance with Regulation M under the Securities Exchange Act of 1934, or the Exchange Act.

- Stabilizing transactions permit bids to purchase the underlying security so long as the stabilizing bids do not exceed a specified maximum.
- Over-allotment involves sales by the underwriters of shares in excess of the number of shares the underwriters are obligated to purchase, which creates a syndicate short position. The short position may be either a covered short position or a naked short position. In a covered short position, the number of shares over-allotted by the underwriters is not greater than the number of shares that they may purchase in the over-allotment option. In a naked short position, the number of shares involved is greater than the number of shares in the over-allotment option. The underwriters may close out any covered short position by either exercising their over-allotment option and/or purchasing shares in the open market.
- Syndicate covering transactions involve purchases of the common stock in the open market after the distribution has been completed in order to cover syndicate short positions. In determining the source of shares to close out the short position, the underwriters will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase shares through the over-allotment option. If the underwriters sell more shares than could be covered by the over-allotment option, a naked short position, the position can only be closed out by buying shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there could be downward pressure on the price of the shares in the open market after pricing that could adversely affect investors who purchase in the offering.
- Penalty bids permit the representatives to reclaim a selling concession from a syndicate member when the common stock originally sold by the syndicate member is purchased in a stabilizing or syndicate covering transaction to cover syndicate short positions.
- In passive market making, market makers in the common stock who are underwriters or prospective underwriters may, subject to limitations, make bids for or purchases of our common stock until the time, if any, at which a stabilizing bid is made.

These stabilizing transactions, syndicate covering transactions and penalty bids may have the effect of raising or maintaining the market price of our common stock or preventing or retarding a decline in the market price of the common stock. As a result the price of our common stock may be higher than the price that might otherwise exist in the open market. These transactions may be effected on the NASDAQ Global Market or otherwise and, if commenced, may be discontinued at any time.

A prospectus in electronic format may be made available on the web sites maintained by one or more of the underwriters, or selling group members, if any, participating in this offering and one or more of the underwriters participating in this offering may distribute prospectuses electronically. The representatives may agree to allocate a number of shares to underwriters and selling group members for sale to their online brokerage account holders. Internet distributions will be allocated by the underwriters and selling group members that will make internet distributions on the same basis as other allocations.

In the ordinary course, the underwriters and their affiliates have provided, and may in the future provide, investment banking, commercial banking, investment management, or other financial services to us and our affiliates for which they have received compensation and may receive compensation in the future.

Each underwriter has represented, warranted and agreed that:

- it has not offered and will not make an offer of the common stock to the public in the United Kingdom prior to the publication of a prospectus in relation to the common stock and the approval of the offer by the Financial Services Authority, or, FSA or, where appropriate, approval in another Member State and notification to the FSA, all in accordance with the Prospectus Directive, except that it may make an offer of the stock to persons who fall within the definition of "qualified investor" as that term is defined in Section 86(1) of the Financial Services and Markets Act 2000, or FSMA, or otherwise in circumstances which do not result in an offer of transferable securities to the public in the United Kingdom within the meaning of the FSMA;
- it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of any stock in circumstances in which

Section 21(1) of the FSMA does not apply to us or to persons who have professional experience in matters relating to investments falling within Article 19(5) of the FSMA; and

- it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the stock in, from or otherwise involving the United Kingdom.

We will not offer to sell any common stock to any member of the public in the Cayman Islands.

The common stock may not be offered or sold in Hong Kong, by means of any document, other than to persons whose ordinary business is to buy or sell stock or debentures, whether as principal or agent, or in circumstances which do not constitute an offer to the public within the meaning of the Companies Ordinance (Cap. 32) of Hong Kong. No advertisement, invitation or document relating to the common stock, whether in Hong Kong or elsewhere, may be issued, which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to common stock which are or are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" within the meaning of the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made thereunder.

The common stock has not been and will not be registered under the Securities and Exchange Law of Japan (Law No. 235 of 1948 as amended), or the Securities Exchange Law, and disclosure under the Securities Exchange Law has not been and will not be made with respect to the common stock. Accordingly, the common stock may not be, directly or indirectly, offered or sold in Japan or to, or for the benefit of, any resident of Japan or to others for re-offering or re-sale, directly or indirectly in Japan or to, or for the benefit of, any resident of Japan except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Securities Exchange Law and other relevant laws, regulations and ministerial guidelines of Japan. As used in this paragraph, "resident of Japan" means any person residing in Japan, including any corporation or other entity organized under the laws of Japan.

This prospectus has not been and will not be registered as a prospectus with the Monetary Authority of Singapore under the Securities and Futures Act (Cap. 289) of Singapore, or the Securities and Futures Act. Accordingly, the common stock may not be offered or sold or made the subject of an invitation for subscription or purchase nor may this prospectus or any other document or material in connection with the offer or sale, or invitation for subscription or purchase of such common stock be circulated or distributed, whether directly or indirectly, to the public or any members of the public in Singapore other than: (1) to an institutional investor or other person falling within Section 274 of the Securities and Futures Act, (2) to a sophisticated investor, and in accordance with the conditions specified in Section 275 of the Securities and Futures Act or (3) pursuant to, and in accordance with the conditions of any other applicable provision of the Securities and Futures Act.

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a Relevant Member State), and effective as of the date on which the Prospectus Directive is implemented in that Relevant Member State (the Relevant Implementation Date), no common stock have been offered to the public in that Relevant Member State prior to the publication of a prospectus in relation to the common stock which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and brought to the attention of the competent authority in that Relevant Member State, all in accordance with the Prospectus Directive. Notwithstanding the foregoing, an offer of common stock may be made effective as of the Relevant Implementation Date to the public in that Relevant Member State at any time:

(1) to legal entities which are authorized or regulated to operate in the financial markets or, if not so authorized or regulated, whose corporate purpose is solely to invest in securities;

(2) to any legal entity which has two or more of (a) an average of at least 250 employees during the last financial year; (b) a total balance sheet of more than €43,000,000 and (c) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts; or

(3) in any other circumstances which do not require the publication by the issuer of a prospectus pursuant to Article 3 of the Prospectus Directive. For the purposes of this paragraph, the expression an "offer of common stock to the public" in relation to any common stock in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the common stock to be offered so as to enable an investor to decide to purchase or subscribe the common stock, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State and the expression Prospectus Directive means Directive 2003/71/EC and includes any relevant implementing measure in each Relevant Member State.

The common stock has not been registered under the Korean Securities and Exchange Law. Each of the underwriters has represented and agreed that it has not offered, sold or delivered and will not offer, sell or deliver, directly or indirectly, any common stock in Korea or to, or for the account or benefit of, any resident of Korea, except as otherwise permitted by applicable Korean laws and regulations; and any securities dealer to whom it sells common stock will agree that it will not offer any common stock, directly or indirectly, in Korea or to any resident of Korea, except as permitted by applicable Korean laws and regulations, or to any other dealer who does not so represent and agree.

This prospectus has not been reviewed by or registered with the Oslo Stock Exchange or the Norwegian Register of Business Enterprises. The shares are being offered in Norway solely in reliance upon the exemption provided by Section 5-2, second paragraph of the Norwegian Securities Trading Act of June 19, 1997 no. 79.

NOTICE TO CANADIAN RESIDENTS

Resale Restrictions

The distribution of the shares in Canada is being made only on a private placement basis exempt from the requirement that we and the selling shareholders prepare and file a prospectus with the securities regulatory authorities in each province where trades of shares are made. Any resale of the shares in Canada must be made under applicable securities laws which will vary depending on the relevant jurisdiction, and which may require resales to be made under available statutory exemptions or under a discretionary exemption granted by the applicable Canadian securities regulatory authority. Purchasers are advised to seek legal advice prior to any resale of the shares.

Representations of Purchasers

By purchasing shares in Canada and accepting a purchase confirmation a purchaser is representing to us, the selling shareholders and the dealer from whom the purchase confirmation is received that:

- the purchaser is entitled under applicable provincial securities laws to purchase the shares without the benefit of a prospectus qualified under those securities laws;
- where required by law, that the purchaser is purchasing as principal and not as agent;
- the purchaser has reviewed the text above under Resale Restrictions; and
- the purchaser acknowledges and consents to the provision of specified information concerning its purchase of the shares to the regulatory authority that by law is entitled to collect the information.

Further details concerning the legal authority for this information is available on request.

Rights of Action – Ontario Purchasers Only

Under Ontario securities legislation, certain purchasers who purchase a security offered by this prospectus during the period of distribution will have a statutory right of action for damages, or while still the owner of the shares, for rescission against us and the selling stockholders in the event that this prospectus contains a misrepresentation without regard to whether the purchaser relied on the misrepresentation. The right of action for damages is exercisable not later than the earlier of 180 days from the date the purchaser first had knowledge of the facts giving rise to the cause of action and three years from the date on which payment is made for the shares. The right of action for rescission is exercisable not later than 180 days from the date on which payment is made for the shares. If a purchaser elects to exercise the right of action for rescission, the purchaser will have no right of action for damages against us or the selling stockholders. In no case will the amount recoverable in any action exceed the price at which the shares were offered to the purchaser and if the purchaser is shown to have purchased the securities with knowledge of the misrepresentation, we and the selling stockholders will have no liability. In the case of an action for damages, we and the selling stockholders will not be liable for all or any portion of the damages that are proven to not represent the depreciation in value of the shares as a result of the misrepresentation relied upon. These rights are in addition to, and without derogation from, any other rights or remedies available at law to an Ontario purchaser. The foregoing is a summary of the rights available to an Ontario purchaser. Ontario purchasers should refer to the complete text of the relevant statutory provisions.

Enforcement of Legal Rights

All of our directors and officers as well as the experts named herein and the selling stockholders may be located outside of Canada and, as a result, it may not be possible for Canadian purchasers to effect service of process within Canada upon us or those persons. All or a substantial portion of our assets and the assets of those persons may be located outside of Canada and, as a result, it may not be possible to satisfy a judgment against us or those persons in Canada or to enforce a judgment obtained in Canadian courts against us or those persons outside of Canada.

Taxation and Eligibility for Investment

Canadian purchasers of shares should consult their own legal and tax advisors with respect to the tax consequences of an investment in the shares in their particular circumstances and about the eligibility of the shares for investment by the purchaser under relevant Canadian legislation.

LEGAL MATTERS

The validity of the shares of common stock offered hereby will be passed upon for us by Baker & McKenzie LLP, San Francisco, California. Certain legal matters in connection with this offering will be passed upon for the underwriters by Davis Polk & Wardwell, Menlo Park, California.

EXPERTS

The financial statements and schedule included in this prospectus have been audited by BDO Seidman, LLP, an independent registered public accounting firm, to the extent and for the periods set forth in their report appearing elsewhere herein, and are included in reliance upon such report given upon the authority of said firm as experts in auditing and accounting.

WHERE YOU CAN FIND ADDITIONAL INFORMATION

We have filed with the SEC a registration statement on Form S-1 under the Securities Act with respect to the shares of our common stock offered hereby. This prospectus, which constitutes a part of the registration statement, does not contain all of the information set forth in the registration statement or the exhibits and schedules filed therewith. For further information about us and the common stock offered hereby, we refer you to the registration statement and the exhibits and schedules filed thereto. Statements contained in this prospectus regarding the contents of any contract or any other document that is filed as an exhibit to the registration statement are not necessarily complete and each such statement is qualified in all respects by reference to the full text of such contract or other document filed as an exhibit to the registration statement. A copy of the registration statement, and the exhibits and schedules thereto, may be inspected without charge at the public reference facilities maintained by the SEC in Room 1580, 100 F Street, N.E. Washington, D.C. 20549. Upon completion of this offering, we will be required to file periodic reports, proxy statements and other information with the SEC pursuant to the Securities Exchange Act of 1934. We intend to provide our stockholders with annual reports containing financial statements that have been audited by an independent registered public accounting firm and to file with the SEC quarterly reports containing unaudited financial data for the first three quarters of each year. You may read and copy this information at the Public Reference Room of the SEC, 100 F Street, N.E., Room 1580, Washington, D.C. 20549. You may obtain information on the operation of the public reference rooms by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet website that contains reports, proxy statements and other information about issuers, like us, that file electronically with the SEC. The address of that site is www.sec.gov.

ENERGY RECOVERY, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of
Energy Recovery, Inc.

We have audited the accompanying consolidated balance sheets of Energy Recovery, Inc. as of December 31, 2007 and 2006 and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2007. In connection with our audits of the financial statements, we have also audited the financial statement schedule listed in Item 16(b). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and schedule, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and schedule. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Energy Recovery, Inc. at December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 9 to the consolidated financial statements, effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123 (Revised), *Share-Based Payment*.

/s/ BDO Seidman LLP
San Jose, California
March 28, 2008

ENERGY RECOVERY, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	Years Ended December 31,	
	2007	**2006**
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 240	$ 42
Restricted cash	366	475
Accounts receivable, net of allowance for doubtful accounts of $121 and $230 in 2007 and 2006, respectively	13,131	5,646
Unbilled receivables, current	1,653	1,007
Notes receivable from stockholders	20	111
Inventories	4,791	2,888
Deferred tax assets, net	1,052	676
Prepaid expenses and other current assets	320	240
Total current assets	21,573	11,085
Unbilled receivables, non-current	2,255	712
Restricted cash, non-current	1,221	69
Property and equipment, net	1,671	1,056
Intangible assets, net	345	312
Deferred tax assets, non-current, net	148	183
Other assets, non-current	91	122
Total Assets	$27,304	$13,539
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 1,697	$ 1,114
Accrued expenses and other current liabilities	1,868	1,716
Liability for early exercise of stock options	20	111
Income taxes payable	1,154	1,397
Accrued warranty reserve	868	85
Deferred revenue	488	145
Customer deposits	318	79
Current portion of long-term debt	172	493
Current portion of capital lease obligations	38	38
Total current liabilities	6,623	5,178
Long-term debt	557	133
Capital lease obligations, non-current	63	101
Total Liabilities	7,243	5,412
Commitments and Contingencies (Note 7)		
Stockholders' Equity:		
Preferred stock, $0.001 par value; 10,000,000 shares authorized; zero shares issued and outstanding	—	—
Common stock, $0.001 par value; 45,000,000 shares authorized; 39,777,446 and 38,222,493 shares issued and outstanding in 2007 and 2006, respectively	40	38
Additional paid-in capital	20,762	14,519
Notes receivable from stockholders	(835)	(736)
Accumulated other comprehensive loss	(5)	—
Retained earnings (accumulated deficit)	99	(5,694)
Total Stockholders' Equity	20,061	8,127
Total Liabilities and Stockholders' Equity	$27,304	$13,539

See accompanying notes to consolidated financial statements.

ENERGY RECOVERY, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Years Ended December 31,		
	2007	2006	2005
Net revenue	$35,414	$20,058	$10,689
Cost of revenue(1)	14,852	8,131	4,685
Gross profit	20,562	11,927	6,004
Operating expenses:			
Sales and marketing(1)	5,230	3,648	1,779
General and administrative(1)	4,299	3,372	2,458
Research and development(1)	1,705	1,267	630
Total operating expenses	11,234	8,287	4,867
Income from operations	9,328	3,640	1,137
Other income (expense):			
Interest expense	(105)	(77)	(216)
Interest and other income	517	58	35
Income before provision for income taxes	9,740	3,621	956
Provision for income taxes	3,947	1,239	62
Net Income	$ 5,793	$ 2,382	$ 894
Earnings per share:			
Basic	$ 0.15	$ 0.06	$ 0.02
Diluted	$ 0.14	$ 0.06	$ 0.02
Number of shares used in per share calculations:			
Basic	39,060	38,018	36,790
Diluted	41,433	40,244	38,454

(1) Includes stock-based compensation expense.

See accompanying notes to consolidated financial statements.

ENERGY RECOVERY, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME
Years Ended December 31, 2007, 2006 and 2005
(in thousands)

	Common Stock		Additional Paid-in Capital	Note Receivable from Stockholders	Accumulated Other Comprehensive Income	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity
	Shares	Amount					
Balance at December 31, 2004	32,425	$ 32	$ 9,932	$ —	$ —	$ (8,970)	$ 994
Net income	—	—	—	—	—	894	894
Comprehensive income	—	—	—	—	—	—	894
Issuance of common stock	5,344	6	2,246	(763)	—	—	1,489
Interest on notes receivable from stockholders	—	—	—	(32)	—	—	(32)
Repayment of notes receivable from stockholders	—	—	—	222	—	—	222
Issuance of warrants to purchase common stock	—	—	132	—	—	—	132
Employee stock-based compensation	—	—	1,003	—	—	—	1,003
Balance at December 31, 2005	37,769	38	13,313	(573)	—	(8,076)	4,702
Net income	—	—	—	—	—	2,382	2,382
Comprehensive income	—	—	—	—	—	—	2,382
Issuance of common stock	453	—	142	(137)	—	—	5
Interest on notes receivable from stockholders	—	—	—	(31)	—	—	(31)
Repayment of notes receivable from stockholders	—	—	—	5	—	—	5
Employee stock-based compensation	—	—	1,061	—	—	—	1,061
Non-employee stock-based compensation	—	—	3	—	—	—	3
Balance at December 31, 2006	38,222	38	14,519	(736)	—	(5,694)	8,127
Net income	—	—	—	—	—	5,793	5,793
Foreign currency translation adjustments	—	—	—	—	(5)	—	(5)
Comprehensive income							5,788
Issuance of common stock	1,555	2	5,207	(91)	—	—	5,118
Interest on notes receivable from stockholders	—	—	—	(31)	—	—	(31)
Repayment of notes receivable from stockholders	—	—	—	23	—		23
Employee stock-based compensation			1,008	—	—	—	1,008
Non-employee stock-based compensation	—	—	28	—	—	—	28
Balance at December 31, 2007	39,777	$ 40	$ 20,762	$ (835)	$ (5)	$ 99	$ 20,061

See accompanying notes to consolidated financial statements.

ENERGY RECOVERY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Years Ended December 31,		
	2007	**2006**	**2005**
Cash Flows From Operating Activities			
Net income	$ 5,793	$ 2,382	$ 894
Adjustments to reconcile net income to net cash from operating activities:			
Depreciation and amortization	323	231	126
Impairment of intangible assets	31	—	—
Interest accrued on notes receivables from stockholders	(31)	(31)	(32)
Stock-based compensation	1,036	1,064	1,003
Issuance of warrants in exchange for debt guarantee	—	—	132
(Gain) loss on foreign currency transactions	(351)	4	—
Provision for doubtful accounts	(109)	80	104
Provision for warranty claims	850	61	161
Provision for excess or obsolete inventory	47	30	77
Changes in operating assets and liabilities:			
Accounts receivable	(7,025)	(1,513)	(3,132)
Unbilled receivables	(2,189)	(1,719)	—
Inventories	(1,950)	(960)	(901)
Deferred tax assets, net	(341)	(859)	0
Prepaid and other assets	(49)	(135)	(156)
Accounts payable	583	270	346
Accrued expenses and other liabilities	214	1,002	(23)
Income taxes payable	(243)	1,334	64
Deferred revenue	343	115	30
Customer deposits	239	(534)	613
Net cash (used in) provided by operating activities	(2,829)	822	(694)
Cash Flows From Investing Activities			
Capital expenditures	(918)	(328)	(566)
Restricted cash	(1,043)	(109)	(436)
Other	(84)	(74)	(35)
Net cash (used in) investing activities	(2,045)	(511)	(1,037)
Cash Flows From Financing Activities			
Proceeds from long-term debt	639	118	313
Repayment of long-term debt	(98)	(164)	(492)
Repayment of revolving note, net	(438)	(563)	545
Repayment of capital lease obligation	(38)	(60)	(25)
Net proceeds from issuance of common stock	5,118	5	1,389
Repayment of notes receivables from a stockholder	23	5	222
Repayment of notes payable to a stockholder	—	—	(100)
Other short term financing activities	(129)	129	—
Net cash provided by (used in) financing activities	5,077	(530)	1,852
Effect of exchange rate differences on cash and cash equivalents	(5)	—	—
Net change in cash and cash equivalents	198	(219)	121
Cash and cash equivalents, beginning of year	42	261	140
Cash and cash equivalents, end of year	$ 240	$ 42	$ 261
Supplemental disclosure of cash flow information			
Cash paid for interest	$ 97	$ 78	$ 70
Cash paid for income taxes	$ 4,555	$ 764	$ 1
Supplemental disclosure of non-cash transactions			
Issuance of common stock in exchange for notes receivable from stockholders	$ 91	$ 137	$ 763
Issuance of common stock in exchange for reduction in note payable from stockholders	$ —	$ —	$ 100
Equipment purchased under capital leases	$ —	$ 42	$ 161

See accompanying notes to consolidated financial statements.

ENERGY RECOVERY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business

Energy Recovery, Inc. ("the Company" or "ERI") was established in 1992, and is a leading global developer and manufacturer of highly efficient energy recovery devices utilized in the water desalination industry. The Company operates primarily in the sea water reverse osmosis ("SWRO") segment of the industry, which uses pressure to drive sea water through filtering membranes to produce fresh water. The Company's primary energy recovery device is the PX Pressure Exchanger® (PX®), which helps optimize the energy intensive SWRO process by reducing energy consumption by up to 60% as compared to the same process without any energy recovery devices. Products are manufactured in the United States of America ("U.S.") at ERI's headquarters located in San Leandro, California, and shipped from this location to specified customer locations worldwide. The Company has direct sales offices and technical support centers in Madrid, Dubai, Shanghai and Fort Lauderdale and the research and development center is located in San Leandro, California.

The Company was incorporated in Virginia in April 1992 and reincorporated in Delaware in March 2001. The Company incorporated its wholly owned subsidiaries, Osmotic Power, Inc. Energy Recovery, Inc. International and Energy Recovery Iberia, S.L., in September 2005, July 2006 and September 2006, respectively.

2. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its foreign wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the Unites States of America ("U.S. GAAP") requires management to make judgments, estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results may materially differ from those estimates. The Company's most significant estimates and judgments involve the determination of revenue recognition, allowance for doubtful accounts, allowance for product warranty, valuation of the Company's stock and stock-based compensation, reserve for excess and obsolete inventory, deferred taxes and valuation allowances on deferred tax assets.

Cash and Cash Equivalents

The Company considers all highly liquid investments with a remaining maturity of three months or less at the time of purchase to be cash equivalents. The Company invests primarily in money market funds as these investments are subject to minimal credit and market risks.

Allowances of Doubtful Accounts

The Company records a provision for doubtful accounts based on its historical experience and a detailed assessment of the collectability of its accounts receivable. In estimating the allowance for doubtful accounts, the Company's management considers, among other factors, (1) the aging of the accounts receivable, (2) the Company's historical write-offs, (3) the credit worthiness of each customer and (4) general economic conditions.

Restricted Cash

The Company has irrevocable letters of credit with a bank securing performance under contracts with customers. At December 31, 2007 and 2006, the outstanding amounts with the bank were $1.6 million and $475,000, respectively. The Company has deposited a corresponding amount into a certificate of deposit that secures the letters of credit.

At December 31, 2006, the Company also had $69,000 deposited with another bank in an escrow account securing the Company's facility lease. During 2007, the lessor authorized an early closure of the escrow account and the restriction was released.

Inventories

Inventories are stated at the lower of cost (using the weighted average cost method) or market. The Company calculates inventory reserve for excess and obsolete inventories based on current inventory levels, expected useful life and estimated future demand of the products and spare parts. Cost of inventory is determined in accordance with Statement of Financial Accounting Standards ("SFAS") No. 151, *Inventory Costs*, an amendment of ARB No. 43, Chapter 4.

Property and Equipment

Property and equipment are stated at cost and depreciated over the estimated useful lives of the assets (generally three to seven years) using the straight-line method. A significant portion of equipment for the Company's manufacturing facility is acquired under capital lease obligations. These assets are amortized over periods consistent with depreciation of owned assets of similar types, generally five years. Lease improvements represent the remodeling expenses for the leased office space and are depreciated over the shorter of either the estimated useful lives or the term of the lease using the straight-line method. Software purchased for internal use consists primarily of amounts paid for perpetual licenses to third party software providers and are depreciated over the estimated useful lives, generally three to five years.

SFAS No. 143, *Accounting for Asset Retirement Obligations* and Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*, an interpretation of SFAS 143, requires the recognition of a liability for the fair value of a legally required conditional asset retirement obligation when incurred, if the liability's fair value can be reasonably estimated. Management reviewed the Company's facility lease and concluded that the cost, if any of potential physical reinstatement obligations is not reasonably determinable, and as such, no asset retirement obligation was recorded in the financial statements for the years presented.

Maintenance and repairs are charged directly to expense as incurred, whereas improvements and renewals are generally capitalized in their respective property accounts. When an item is retired or otherwise disposed of, the cost and applicable accumulated depreciation are removed and the resulting gain or loss is recognized in the results of operations.

Intangible Assets

Intangible assets represent patents owned by the Company and are recorded at cost and are amortized on a straight-line basis over their expected useful life of 17 to 20 years.

Impairment of Long-Lived Assets

The Company accounts for its long-lived assets, including property and equipment and intangibles, in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* The Company evaluates its long-lived assets for indicators of possible impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. An impairment loss would be recognized when estimated undiscounted future cash flows expected to result from the use of an asset and its eventual disposition are less than its carrying amount. During 2007, the Company determined that a patent was impaired as a result of the development of a new patent which effectively superceded and replaced an existing patent; accordingly, the Company recorded an impairment reserve of $31,000 for the year ended December 31, 2007, and this amount was included in research and development expense in the consolidated statement of operations. No impairment expense was recorded for the years ended December 31, 2006 and 2005.

Revenue Recognition

The Company recognizes revenue in accordance with SEC Staff Accounting Bulletin ("SAB") No. 104, *Revenue Recognition* ("SAB 104"). The Company recognizes revenue when the earnings process is complete, as evidenced by an agreement with the customer, transfer of title occurs, fixed pricing is determinable and collection is probable. Transfer of title typically occurs upon shipment of the equipment pursuant to a written purchase order or contract. The portion of the sales agreement related to the field services and training for commissioning of a desalination plant is deferred per guidance of Emerging Issues Task Force ("EITF") No. 00-21, *Revenue Arrangements with Multiple Deliverables*, by applying the residual value method. Under this method, revenue allocated to undelivered elements is based on vendor-specific objective evidence of fair value of such undelivered elements, and the residual revenue is allocated to the delivered elements. Vendor specific objective evidence of fair value for such undelivered elements is based upon the price we charge for such product or

service when it is sold separately. The Company may modify its pricing in the future, which could result in changes to our vendor specific objective evidence of fair value for such undelivered elements. The services element of our contracts represents an incidental portion of the total contract price.

Under the Company's revenue recognition policy, evidence of an arrangement has been met when it has an executed purchase order or a stand-alone contract. Typically, our smaller projects utilize purchase orders that conform to our standard terms and conditions that require the customer to remit payment generally within 30 to 90 days from product delivery. In some cases, if credit worthiness cannot be determined, prepayment is required from the smaller customers.

For our large projects, stand-alone contracts are utilized. For these contracts, consistent with industry practice, the customers typically require their suppliers, including the Company, to accept contractual holdback provisions whereby the final amounts due under the sales contract are remitted over extended periods of time. These retention payments typically range between 10% and 20%, and in some instances up to 30%, of the total contract amount and are due and payable when the customer is satisfied that certain specified product performance criteria have been met upon commissioning of the desalinization plant, which in the case of the Company's PX device may be 12 months to 24 months, and in some instances up to 36 months, from the date of product delivery as described further below.

The specified product performance criteria for the Company's PX device generally pertains to the ability of the Company's product to meet its published performance specifications and warranty provisions, which the Company's products have demonstrated on a consistent basis. This factor, combined with the Company's historical performance metrics measured over the past 10 years, provides management with a reasonable basis to conclude that its PX device will perform satisfactorily upon commissioning of the plant. To ensure this successful product performance, the Company provides service, consisting principally of supervision of customer personnel, and training to the customers during the commissioning of the plant. The installation of the PX device is relatively simple, requires no customization and is performed by the customer under the supervision of Company personnel. The Company defers the fair value of the service and training component of the contract and recognizes such revenue as services are rendered. Based on these factors, management has concluded that delivery and performance have been completed when the product has been delivered (title transfers) to the customer.

The Company performs an evaluation of credit worthiness on an individual contract basis, to assess whether collectibility is reasonably assured. As part of this evaluation, management considers many factors about the individual customer, including the underlying financial strength of the customer and/or partnership consortium and management's prior history or industry specific knowledge about the customer and its supplier relationships. To date, the Company has been able to conclude that collectibility was reasonably assured on its sales contracts at the time the product was delivered and title has transferred; however, to the extent that management concludes that it is unable to determine that collectibility is reasonably assured at the time of product delivery, the Company will defer all or a portion of the contract amount based on the specific facts and circumstances of the contract and the customer.

Under the stand-alone contracts, the usual payment arrangements are summarized as follows:

- an advance payment, typically 10% to 20% of the total contract amount, is due upon execution of the contract;
- a payment upon delivery of the product, typically in the range of 50% to 70% of the total contract amount, is due on average between 120 and 150 days from product delivery, and in some cases up to 180 days; and
- a retention payment, typically in the range of 10% to 20%, and in some cases up to 30%, of the total contract amount is due subsequent to product delivery as described further below.

Under the terms of the retention payment component, the Company is generally required to issue to the customer a product performance guarantee that takes the form of a collateralized letter of credit, which is issued to the customer approximately 12 to 24 months after the product delivery date. The letter of credit is collateralized by restricted cash on deposit with the Company's financial institution (See Restricted Cash under Summary of Significant Accounting Policies). The letter of credit remains in place for the performance period as specified in the contract, which is generally 24 months and which runs concurrent with the Company's standard product warranty period. Once the letter of credit has been put in place, the Company invoices the customer for this final retention payment under the sales contract. During the time between the product delivery and the issuance of the letter of credit, the amount of the final retention payment is classified on the balance sheet as unbilled receivable, of which a portion may be classified as long term to the extent that the billable period extends beyond one year. Once the letter of credit is issued, the Company invoices the customer and reclassifies the retention

amount from unbilled receivable to accounts receivable where it remains until payment, typically 120 to 150 days after invoicing. (See Note 3 — Balance Sheet Information: Unbilled Receivables).

The Company does not provide its customers with a right of product return. However, the Company will accept returns of products that are deemed to be damaged or defective when delivered that are covered by the terms and conditions of the product warranty. Product returns have not been significant. Reserves are established for possible product returns related to the advance replacement of products pending the determination of a warranty claim.

Shipping and handling charges billed to customers are included in sales. The cost of shipping to customers is included in cost of revenue.

The Company sells its product to resellers and engineering, procurement and construction ("EPC") companies which are not subject to sales tax. Accordingly, the adoption of EITF Issue No. 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation)*, does not have an impact on the Company's consolidated financial statements.

Warranty Costs

The Company sells products with a limited warranty for a period of one to two years. In August 2007, the Company modified the warranty to offer a five-year term on the ceramic components for new sales agreements executed after August 7, 2007. The Company accrues for warranty costs based on estimated product failure rates, historical activity and expectations of future costs. The Company periodically evaluates and adjusts the warranty costs to the extent actual warranty costs vary from the original estimates.

The Company may offer extended warranties on an exception basis and these are accounted for in accordance with Financial Accounting Standards Board ("FASB") Technical Bulletin 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts for Sales of Extended Warranties.*

Income Taxes

The Company accounts for income taxes in accordance with SFAS No. 109, "*Accounting for Income Taxes*" ("SFAS 109"), issued by FASB. SFAS 109 requires an entity to recognize deferred tax liabilities and assets. Deferred tax assets and liabilities are recognized for the future tax consequence attributable to the difference between the tax bases of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets and liabilities are measured using the enacted tax rate expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that included the enactment date. Valuation allowances are provided if, based upon the available evidence, management believes it is more likely than not that some or all of the deferred assets will not be realized or the use of prior years' net operating losses may be limited.

On July 13, 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in any entity's financial statements in accordance with SFAS 109 and prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Under FIN 48, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more likely than not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Additionally, FIN 48 provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company adopted the provisions of FIN 48 on January 1, 2007. Measurement under FIN 48 is based on judgment regarding the largest amount that is greater than 50% likely of being realized upon ultimate settlement with a taxing authority. The total amount of unrecognized tax benefits as of the date of adoption was immaterial. As a result of the implementation of FIN 48, the Company recognized no increase in the liability for unrecognized tax benefits.

The Company adopted the accounting policy that interest recognized in accordance with Paragraph 15 of FIN 48 and penalty recognized in accordance with Paragraph 16 of FIN 48 are classified as part of its income taxes. The amounts of interest and penalty recognized in the statement of operations and statement of financial position for the year ended December 31, 2007 were insignificant.

The Company's operations are subject to income and transaction taxes in the U.S. and in foreign jurisdictions. Significant estimates and judgments are required in determining the Company's worldwide provision for income taxes. Some of these estimates are based on interpretations of existing tax laws or regulations. The ultimate amount of tax liability may be uncertain as a result.

The Company is subject to taxation in the U.S. and various states and foreign jurisdictions. There are no ongoing examinations by taxing authorities at this time. The Company's various tax years from 1997 to 2007 remain open in various taxing jurisdictions.

Stock-Based Compensation—Employees

Prior to January 1, 2006, the Company accounted for stock-based compensation to employees and members of the Company's board of directors under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25"), and related interpretations. Under APB 25, compensation expense for stock-based payment awards is based on the difference, if any, on the date of the grant, between the value of the Company's stock and the exercise price and is recognized over the vesting period of the awards. Accordingly, prior to January 1, 2006, no stock-based compensation expense was recognized in the Company's statements of operations for stock options granted to employees and directors that had an exercise price equal to the value of the Company's stock on the date of grant. The Company also followed the disclosure requirements of SFAS No. 123, *Accounting for Stock-Based Compensation*, amended by SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure* and used the minimum value method for pro-forma disclosures based on the disclosure provisions that was available for non–public companies.

On January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), *Share-Based Payment* ("SFAS 123R"), which requires the measurement and recognition of compensation expense in the statement of operations for all awards made to employees and members of the Company's Board of Directors on estimated fair values. SFAS 123R supersedes the Company's previous accounting under APB 25.

Under the provisions of SFAS 123R, share-based compensation expense is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the employee's requisite service period, generally the vesting period of the awards. Under SFAS 123R, non-public companies that used the minimum value method under disclosure provisions of SFAS 148 shall apply the provisions of SFAS 123R prospectively to new and/or modified awards at the adoption date, and shall continue to account for any portion of awards outstanding at the adoption date, using the accounting principles originally applied to those awards. Accordingly, for awards granted prior to January 1, 2006 for which the requisite service period had not been performed as of December 31, 2005, the Company continued to recognize compensation expense on the remaining unvested awards under the intrinsic-value method of APB 25. In accordance with the requirements of SFAS 123R for non-public companies, the Company has not provided pro-forma disclosures for the year ended December 31, 2005 since the Company used the minimum value method for pro-forma disclosures for awards granted prior to January 1, 2006. For all awards granted or modified after December 31, 2005, the Company began recognizing compensation expense of the fair value, less expected forfeitures, on a straight-line basis over the vesting period.

To determine the inputs for the Black-Scholes options pricing model, the Company is required to develop several assumptions, which are highly subjective. These assumptions include:

- the length of its options' lives, which is based on anticipated future exercises;
- its common stock's volatility;
- the number of shares of common stock pursuant to which options which will ultimately be forfeited;
- the risk-free rate of return; and
- future dividends.

The Company uses the Black-Scholes options pricing model to determine the fair value of stock options. The determination of the fair value of stock-based payment awards on the date of grant is affected by stock price as well as assumptions regarding a number of complex and subjective variables. These variables include expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rates and

expected dividends. The estimated grant date fair values of the employee stock options were calculated using the Black-Scholes options pricing model, based on the following assumptions:

	Years Ended December 31,	
	2007	2006
Expected term	5 years	5 years
Expected volatility	50%	50%
Risk-free interest rate	3.45%	4.70%
Dividend yield	0%	0%

Expected Term. Under the Company's option plans, the expected term of options granted is determined using the weighted average period during which the stock options are expected to remain outstanding and is based on the options vesting term, contractual terms and disclosure information from similar publicly traded companies to develop reasonable expectations about future exercise patterns and post-vesting employment termination behavior.

Expected Volatility. Since the Company has been a private entity through 2007 with no historical data regarding the volatility of its common stock price, the expected volatility used is based on volatility of a representative industry peer group. In evaluating similarity, the Company considered factors such as industry, stage of life cycle and size.

Risk-Free Interest Rate. The risk-free rate is based on U.S. Treasury issues with remaining terms similar to the expected term on the options.

Dividend Yield. The Company has never declared or paid any cash dividends and does not plan to pay cash dividends in the foreseeable future, and, therefore, used an expected dividend yield of zero in the valuation model.

Forfeitures. SFAS No. 123R also requires the Company to estimate forfeitures at the time of grant, and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. All stock-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods. If the Company's actual forfeiture rate is materially different from its estimate, the stock-based compensation expense could be significantly different from what the Company has recorded in the current period.

The absence of an active market for its common stock also requires management and board of directors to estimate the fair value of its common stock for purposes of granting options and for determining stock-based compensation expense. In response to these requirements, management and the board of directors estimate the fair market value common stock based on factors such as the price of the most recent common stock sales to investors, the valuations of comparable companies, the status of its development and sales efforts, our cash and working capital amounts, revenue growth, and additional objective and subjective factors relating to its business on an annual basis.

Stock-based compensation expense related to awards granted and or modified to employees was allocated as follows (in thousands):

	Years Ended December 31,		
	2007	2006	2005
Cost of revenue	$ 117	$ 143	$ 88
Sales and marketing	349	310	86
General and administrative	383	425	731
Research and development	159	183	98
	$ 1,008	$ 1,061	$ 1,003

To calculate the excess tax benefits available as of the date of adoption for use in offsetting future tax shortfalls, the Company elected the "short-form" method in accordance with FASB Staff Position FAS No. 123R-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards*.

Stock-Based Compensation—Non-Employees

The Company accounts for awards granted to non-employees other than members of the Company's board of directors in accordance with SFAS 123 and the EITF Abstract No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services,* which require such awards to be recorded at their fair value on the measurement date. The measurement of stock-based compensation is subject to periodic adjustment as the underlying awards vest. The Company amortizes compensation expense related to non-employee awards in accordance with FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans.*

Stock-based compensation expense related to awards granted and/or modified to non-employees was allocated as follows (in thousands):

	Years Ended December 31,		
	2007	2006	2005
Sales and marketing	$ 23	$ —	$ —
General and administrative	5	3	—
	$ 28	$ 3	$ —

See Note 9—Stockholders' Equity for additional information.

Foreign Currency

The Company's reporting currency is the U.S. dollar, while the functional currencies of the Company's foreign subsidiaries are their respective local currencies. The asset and liability accounts of the Company's foreign subsidiaries are translated from their local currencies at the rates in effect at the balance sheet date. Revenue and expenses are translated at average rates of exchange prevailing during the period. Translation adjustments are accumulated and reported as a component of stockholders' equity. Foreign currency transaction gains and losses which result from transactions with customers that are denominated in a currency other than the entity's functional currency are recorded in other income and expense in the consolidated statements of operations.

Advertising Expense

Advertising expense is charged to operations in the year in which it is incurred. Total advertising expense amounted to $118,000, $68,000 and $35,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

Comprehensive Income

In accordance with SFAS No. 130, *Reporting Comprehensive Income*, the Company is required to display comprehensive income and its components as part of the Company's full set of consolidated financial statements. Comprehensive income is composed of net income and other comprehensive income, including currency translation adjustments.

Fair Value of Financial Instruments

The carrying amount of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities are reasonable estimates of their fair value because of the short maturity of these items.

The carrying amount of long-term debt reasonably approximates its fair value as the majority of the borrowings are at interest rates that fluctuate with current market conditions.

The Company has determined that it is not practicable to estimate the fair value of its non-current unbilled receivables as there is no ready market for such instruments. See Note 3 — Balance Sheet Information: Unbilled Receivables for additional information.

ENERGY RECOVERY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Earnings Per Share

In accordance with SFAS No. 128, *Earnings per Share*, the following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share data):

	Years Ended December 31,		
	2007	2006	2005
Numerator:			
Net income	$ 5,793	$ 2,382	$ 894
Denominator:			
Weighted average common shares outstanding	39,060	38,018	36,790
Effect of dilutive securities:			
Nonvested shares	4	—	155
Stock options	438	318	245
Warrants	1,931	1,908	1,264
Total shares for purpose of calculating diluted net income per share	41,433	40,244	38,454
Earnings per share:			
Basic	$ 0.15	$ 0.06	$ 0.02
Diluted	$ 0.14	$ 0.06	$ 0.02

The following potential common shares were excluded from the computation of diluted net income per share because their effect would have been anti-dilutive:

	Years Ended December 31,		
	2007	2006	2005
Nonvested shares	78	481	—
Stock options	283	38	—

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value, and enhances fair value measurement disclosure. In February 2008, the FASB issued FASB Staff Position 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13 ("FSP 157-1") and FSP 157-2, Effective Date of FASB Statement No. 157. FSP 157-1 amends SFAS 157 to remove certain leasing transactions from its scope. FSP 157-2 delays the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until the beginning of the first quarter of 2009. The measurement and disclosure requirements related to financial assets and financial liabilities are effective for the Company beginning in the first quarter of 2008. The adoption of SFAS 157 for financial assets and financial liabilities will not have a significant impact on the Company's consolidated financial statements. However, the resulting fair values calculated under SFAS 157 after adoption may be different from the fair values that would have been calculated under previous guidance. The Company is currently evaluating the impact that SFAS 157 will have on its consolidated financial statements when it is applied to non-financial assets and non-financial liabilities beginning in the first quarter of 2009.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("SFAS 159"). SFAS 159 permits companies to choose to measure certain financial instruments and other items at fair value. The standard requires that unrealized gains and losses are reported in earnings for items measured using the fair

value option. SFAS 159 is effective for the Company beginning in the first quarter of 2008. The adoption of SFAS 159 is not expected to have a significant impact on the Company's consolidated financial statements.

In June 2007, the FASB ratified EITF Issue No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities* ("EITF 07-3"). EITF 07-3 requires non-refundable advance payments for goods and services to be used in future research and development ("R&D") activities to be recorded as assets and the payments to be expensed when the R&D activities are performed. EITF 07-3 applies prospectively to new contractual arrangements entered into beginning in the first quarter of 2008. Prior to adoption, the Company recognized these non-refundable advance payments as an expense upon payment. The adoption of EITF 07-3 is not expected to have a significant impact on the Company's consolidated financial statements.

In December 2007, the U.S. Securities and Exchange Commission ("SEC") issued SAB 110 to amend the SEC's views discussed in SAB 107 regarding the use of the simplified method in developing an estimate of expected life of share options in accordance with SFAS 123R. SAB 110 is effective for the Company beginning in the first quarter of 2008. As of December 31, 2007, the Company did not use the simplified method and the adoption of SAB 107, as amended by SAB 110, is not expected to have a significant impact on the Company's consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* ("FAS 141(R)"). FAS 141(R) will change how business acquisitions are accounted for. FAS 141(R) is effective for fiscal years beginning on or after December 15, 2008. The adoption of FAS 141(R) is not expected to have a material impact on the Company's consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51*. SFAS No. 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS No. 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. The adoption of FAS 141(R) is not expected to have a material impact on the Company's consolidated financial statements.

3. Balance Sheet Information

Accounts Receivable:

Accounts receivable consisted of the following (in thousands):

	Years Ended December 31,	
	2007	2006
Accounts receivable	$ 13,252	$ 5,876
Less: allowance for doubtful accounts	(121)	(230)
	$ 13,131	$ 5,646

Unbilled Receivables

The Company has unbilled receivables pertaining to customer contractual holdback provisions, whereby the Company invoices the final retention payment(s) due under its sales contracts in periods generally ranging from 12 to 24 months (and in some cases up to 36 months) after the product has been shipped to the customer and revenue has been recognized.

Long-term unbilled receivables as of December 31, 2007 and 2006 consisted of unbilled receivables from customers due more than one year subsequent to period end. The customer holdbacks represent amounts intended to provide a form of

security for the customer rather than a form of long-term financing; accordingly, these receivables have not been discounted to present value. At December 31, 2007, the expected payment schedule for these accounts was as follows (in thousands):

Years Ending December 31,	
2009	$ 1,367
2010	232
2011	656
	$ 2,255

Inventories

Inventories consisted of the following (in thousands):

	Years Ended December 31,	
	2007	2006
Raw materials	$ 2,974	$ 1,051
Work in process	75	59
Finished goods	1,742	1,778
	$ 4,791	$ 2,888

Excess and obsolete reserves included in inventory at December 31, 2007 and 2006 were $102,000 and $55,000, respectively.

Property and Equipment

Property and equipment consisted of the following:

	Years Ended December 31,	
	2007	2006
Machinery and equipment	$ 2,209	$ 1,485
Office equipment, furniture, and fixtures	368	287
Automobiles	22	—
ERP software	166	158
Leasehold improvements	301	172
Construction in progress	169	215
	3,235	2,317
Less: accumulated depreciation and amortization	(1,564)	(1,261)
	$ 1,671	$ 1,056

Depreciation and amortization expense was approximately $304,000, $212,000 and $142,000 for the years ended December 31, 2007, 2006 and 2005, respectively. Included in these amounts was amortization expense related to equipment under capital leases of approximately $37,000, $39,000 and $18,000 for the years ended December 31, 2007, 2006 and 2005, respectively. The Company estimates the costs to complete construction in progress to be approximately 10% of the total costs incurred of $169,000 as of December 31, 2007.

Intangible Assets

Intangible assets consisted of the following (in thousands):

	Years Ended December 31,	
	2007	2006
Patents at cost	$ 573	$ 489
Less: accumulated amortization	(197)	(177)
Less: impairment reserve	(31)	—
Net carrying amount	$ 345	$ 312

Amortization of intangibles was approximately $19,000 for each of the years ended December 31, 2007, 2006 and 2005.

Future estimated amortization expense on intangible assets is as follows (in thousands):

Years Ending December 31,	
2008	$ 26
2009	25
2010	25
2011	25
2012	25
Thereafter	219
	$ 345

The weighted average remaining life at December 31, 2007 is 14.6 years.

Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consisted of the following (in thousands):

	Years Ended December 31,	
	2007	2006
Accrued payroll and commission expenses	$ 1,014	$ 1,359
Checks issued against future deposits	—	129
Inventory in transit	393	—
Professional fees	180	40
Other accrued expenses and current liabilities	281	188
	$ 1,868	$ 1,716

4. Long-Term Debt

Long-term debt consisted of the following (in thousands):

	Years Ended December 31,	
	2007	2006
Revolving note payable	$ —	$ 438
Promissory notes payable	729	177
Other notes payable	—	11
	729	626
Less: current portion	(172)	(493)
Long-term debt	$ 557	$ 133

Future minimum principal payments due under long-term debt arrangements consist of the following (in thousands):

Years Ending December 31,	
2008	$ 172
2009	172
2010	172
2011	128
2012	85
	$ 729

Revolving Notes Payable and Promissory Note Payable

On December 1, 2005, the Company entered into an agreement with a financial institution for a $2.0 million revolving note ("revolving note") and a $222,000 fixed rate-installment note ("fixed promissory note") with maturity dates of December 1, 2006, subsequently extended to March 1, 2007 and December 15, 2010, respectively. The revolving note bears interest of base rate or LIBOR-based rate as elected by the Company. The interest rate was amended on April 26, 2006 to modify the definition of base rate and increase the rate to base rate plus 1% or LIBOR plus 2.5%. The fixed promissory note bears an annual interest rate of 10%. These notes are secured by the Company's accounts receivable, inventories, property, equipment and other general intangibles except for intellectual property.

On April 26, 2006, the Company entered into a loan and security agreement ("loan and security agreement") with the financial institution for an additional $2.0 million credit facility ("credit facility") with a maturity date of December 1, 2006, subsequently extended to March 1, 2007. The credit facility advances bear interest rates of base rate plus 1% or LIBOR plus 2.5%. The credit facility is secured by the Company's cash and cash equivalents, accounts receivable, inventory, property and other general intangibles except for intellectual property.

On December 7, 2006, the revolving note was amended to increase the face amount of the note to $3.5 million.

On March 1, 2007, the Company renewed the revolving note and the loan and security agreement ("the first modification") to a maturity date of March 31, 2008. Additional amended terms under the first modification were an interest rate change to base rate or LIBOR plus 2.5%, limitation of advances to a borrowing base, and various reporting requirements and satisfaction of certain financial ratios and covenants by the Company.

On March 28, 2007, the Company modified the loan and security agreement ("the second modification") to add a $1.0 million equipment promissory note ("equipment promissory note"). The equipment promissory note bears an interest rate of cost of funds plus 3% and matures September 30, 2012. Additional amended terms under the second modification were changes to the financial ratios and covenants that were to be maintained by the Company.

As of December 31, 2006, borrowings outstanding on the revolving note and the fixed promissory note were $438,000 and $177,000, respectively. There were no borrowings under the credit facility. The interest rate for the revolving note elected by the Company was the base rate at 9.25%. The Company was in compliance with all covenants under the loan and security agreement.

As of December 31, 2007 there were no borrowings under the revolving note and the credit facility. The amounts outstanding on the fixed promissory note and the equipment promissory note were $133,000 and $596,000, respectively at December 31, 2007. The interest rate for the equipment promissory note at December 31, 2007 was 7.81%. The Company was in compliance with all covenants under the loan and security agreement.

On March 28, 2008 the Company entered into a new credit agreement with its existing financial institution that replaces the $2.0 million credit facility and the $3.5 million revolving note. The new credit facility allows borrowings of up to $9.0 million on a revolving basis at LIBOR plus 2.75%. This new credit facility expires on September 30, 2008 and is secured by the Company's accounts receivable, inventories, property, equipment and other intangibles except intellectual property.

During the years presented, the Company provided certain customers with irrevocable standby letters of credit to secure its obligations for the delivery of products in accordance with sales arrangements. These letters of credit were issued under the Company's revolving note credit facility and generally terminate within eight months from issuance. At December 31, 2007 the amounts outstanding on the letters of credit totaled approximately $2.2 million.

Other Note Payable

The other note payable as of December 31, 2006 consisted of one obligation with an insurance corporation for financing of property and casualty insurance and bears a fixed interest rate of 9.19%.

5. Capital Leases

The Company leases certain equipment under agreements classified as capital leases. The terms of the lease agreements generally range up to five years. As of December 31, 2007, costs and accumulated amortization of equipment under capital leases were $193,000 and $92,000, respectively. As of December 31, 2006 costs and accumulated amortization of equipment under capital leases were $215,000, and $76,000, respectively.

Future minimum payments under capital leases consist of the following (in thousands):

Years Ending December 31,	
2008	$ 50
2009	43
2010	27
Total future minimum lease payments	120
Less: amount representing interest	(19)
Present value of net minimum capital lease payments	101
Less: current portion	(38)
Long-term portion	$ 63

6. Income Taxes

The components of the provision for income taxes consist of the following (in thousands):

	Years Ended December 31,		
	2007	2006	2005
Current tax expense:			
Federal	$ 3,466	$ 1,654	$ —
State	806	442	62
Foreign	16	2	—
	$ 4,288	$ 2,098	$ 62
Deferred tax (benefit) expense:			
Federal	(327)	(775)	—
State	(14)	(84)	—
	$ (341)	$ (859)	$ —
Total provision for income taxes	$ 3,947	$ 1,239	$ 62

A reconciliation of income taxes computed at the statutory federal income tax rate to the provision for income taxes included in the accompanying statements of operations is as follows (in thousands, except percentages):

	Years Ended December 31,		
	2007	2006	2005
U.S. federal taxes at statutory rate	35%	34%	34%
State income taxes, net of federal benefit	5	5	4
Stock-based compensation	3	11	36
Valuation allowance	—	(13)	(73)
Disallowed interest	—	—	5
Extraterritorial income exclusion	—	(3)	—
Other	(1)	(1)	1
Effective tax rate	42%	33%	7%

ENERGY RECOVERY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Total deferred tax assets and liabilities consist of the following (in thousands):

	Years Ended December 31,	
	2007	2006
Deferred tax assets:		
Net operating loss carry forwards	$ 220	$ 232
Accruals and reserves	1,210	664
Tax credit carry forwards	–	9
Net deferred tax assets	$ 1,430	$ 905
Deferred tax liabilities:		
Depreciation on property and equipment	$ (90)	$ (46)
Unrecognized gain on translation of foreign currency receivables	(140)	–
Total deferred tax liabilities	$ (230)	$ (46)
Net deferred tax assets (liabilities)	$ 1,200	$ 859
As reported on the balance sheet:		
Current assets, net	$ 1,052	$ 676
Non-current assets, net	148	183
Net deferred tax assets	$ 1,200	$ 859

The Company had net deferred tax assets of approximately $1.2 million and $859,000 at December 31, 2007 and 2006, respectively, relating principally to accrued expenses and tax effects of net operating loss carry-forwards. In assessing the recoverability of deferred tax assets, management considers whether it is more likely than not that the assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible.

Management considers, among other things, projected future taxable income in making this assessment. Based upon the projections for future taxable income over the periods in which the deferred tax items are recognizable for tax reporting purposes, management has determined it is more likely than not that the Company will realize the benefits of most these differences at December 31, 2007 and 2006.

At December 31, 2007 and 2006, the Company had net operating loss carry-forwards of approximately $588,000 and $630,000, respectively, for federal and $252,000 and $294,000, respectively, for California. The net operating loss carry-forwards, if not utilized, will expire in 2021 for federal and 2013 for California purposes. Utilization of the net operating loss carry-forwards is subject to a substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. The annual limitation will result in the expiration of the net operating loss carry-forwards before utilization. Management has estimated the amount which may ultimately be realized and recorded deferred tax assets accordingly.

The Company adopted the provisions of FIN 48 on January 1, 2007. Measurement under FIN 48 is based on judgment regarding the largest amount that is greater than 50% likely of being realized upon ultimate settlement with a taxing authority. The total amount of unrecognized tax benefits as of the date of adoption was immaterial. As a result of the implementation of FIN 48, the Company recognized no increase in the liability for unrecognized tax benefits.

The Company adopted the accounting policy that interest recognized in accordance with Paragraph 15 of FIN 48 and penalty recognized in accordance with Paragraph 16 of FIN 48 are classified as part of its income taxes. The amounts of

interest and penalty recognized in the statement of operations and statement of financial position for the year ended December 31, 2007 were insignificant.

7. Commitments and Contingencies

Lease Obligations

The Company leases facilities under fixed non-cancelable operating leases that expire on various dates through June 2010. Future minimum lease payments consist of the following (in thousands):

Years Ending December 31,	
2008	$ 411
2009	316
2010	135
	$ 862

Total rent and lease expense was $462,000, $287,000 and $155,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

Warranty

Changes in the Company's accrued warranty reserve and the expenses incurred under its warranties were as follows (in thousands):

	Years Ended December 31,	
	2007	2006
Balance, beginning of period	$ 85	$ 110
Warranty costs charged to cost of revenue, including extended warranty costs	850	61
Utilization of warranty	(67)	(86)
Balance, end of period	$ 868	$ 85

Warranty costs during 2007 included costs attributable to extended service contracts, for which the Company had recognized in 2007 estimated service costs to the extent that such costs were expected to exceed the related service revenue.

Purchase Obligations

The Company did not have any non-cancelable contractual purchase obligations with its vendors at December 31, 2007.

The Company had purchase order arrangements with its vendors for which it had not received the related goods or services at December 31, 2007. These arrangements are subject to change based on the Company's sales demand forecasts and the Company has the right to cancel the arrangements prior to the date of delivery. The majority of these purchase order arrangements were related to various key raw materials and components parts. As of December 31, 2007, the Company had approximately $8.1 million of open purchase order arrangements.

Guarantees

The Company enters into indemnification provisions under its agreements with other companies in the ordinary course of business, typically with customers. Under these provisions the Company generally indemnifies and holds harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of the Company's activities, generally limited to personal injury and property damage caused by our employees at a customer's desalination plant in proportion to the employee's percentage of fault for the accident. Damages incurred for these indemnifications would be covered by the Company's general liability insurance to the extent provided by the policy limitations. The Company has not

incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the estimated fair value of these agreements is not material. Accordingly, the Company has no liabilities recorded for these agreements as of December 31, 2007 and 2006.

In certain cases, the Company issues product performance guarantees to its customers for amounts ranging from 10% to 30% of the total sales agreement to endorse the warranty of design work, fabrication and operating performance of the PX device. These guarantees are issued under the Company's credit facility and collateralized by restricted cash (see Note 2). These guarantees typically remain in place for periods ranging from 24 to 36 months, which relates to the underlying product warranty period.

Employee Agreements

The Company has employment agreements with certain executives covering terms of up to 30 months which provide for, among other things, annual base salary.

Litigation

The Company is not party to any material litigation, and the Company is not aware of any pending or threatened litigation against it that the Company believes would adversely affect its business, operating results, financial condition or cash flows. However, in the future, the Company may be subject to legal proceedings in the ordinary course of business.

8. Defined Contribution Plan

The Company has a 401(k) defined contribution plan for all employees over age 18. Generally, employees can defer up to 20% of their compensation through payroll withholdings into the plan. The Company can make discretionary matching contributions. The Company made contributions of $100,000, $68,000 and $45,000 during the years ended December 31, 2007, 2006 and 2005, respectively.

9. Stockholders' Equity

Preferred Stock

The Company has the authority to issue 10,000,000 shares of $0.001 par value preferred stock. The Company's board of directors has the authority, without action by the Company's stockholders, to designate and issue shares of preferred stock in one or more series. The board of directors is also authorized to designate the rights, preferences, and voting powers of each series of preferred stock, any or all of which may be greater than the rights of the common stock including restrictions of dividends on the common stock, dilution of the voting power of the common stock, reduction of the liquidation rights of the common stock, and delaying or preventing a change in control of the Company without further action by the stockholders. To date, the board of directors has not designated any rights, preference or powers of any preferred stock and as of December 31, 2007 and 2006, none was issued or outstanding.

Common Stock

The Company has the authority to issue 45,000,000 shares of $0.001 par value common stock. Subject to the preferred rights of the holders of shares of any class or series of preferred stock as provided by the board of directors with respect to any such class or series of preferred stock, the holders of the common stock shall be entitled to receive dividends, as and when declared by the board of directors. In the event of any liquidation, dissolution or winding up of the Company, whether voluntary or involuntary, after the distribution or payment to the holders of shares of any class or series of preferred stock as provided by the Board of Directors with respect to any such class or series of preferred stock, the remaining assets of the Company available for distribution to stockholder shall be distributed among and paid to the holders of common stock ratably in proportion to the number of shares of common stock held by them respectively. As of December 31, 2007 and 2006, 39,777,446 and 38,222,493 shares were issued and outstanding, respectively.

Private Placement

In June 2007, the Company issued 1,000,000 shares of common stock with an issuance price of $5.00 per share. Net proceeds from the issuance were $5.0 million, less $41,000 in fees.

Stock Option Plans

In April 2001, the Company adopted the 2001 Stock Option Plan under which 2,500,000 shares of the Company's common stock were reserved for issuance to employees, directors and consultants. In April 2002, the Company adopted the 2002 Stock Option/Stock Issuance Plan under which 1,509,375 shares of the Company's common stock were reserved for issuance to employees, directors and consultants. In January 2004, the Company adopted the 2004 Stock Option/Stock Issuance Plan under which 850,000 shares of the Company's common stock were reserved for issuance to employees, directors and consultants. In May 2006, the Company adopted the 2006 Stock Option/Stock Issuance Plan under which 800,000 shares of the Company's common stock were reserved for issuance to employees, directors and consultants.

The option plans provide for the issuance of common stock and the granting of incentive stock options to employees, officers and directors and the granting of non-statutory stock options to employees, officers and directors or consultants of the Company. The Company may grant incentive stock options with exercise prices of not less than the estimated fair value of the stock on the date of grant (85% of the estimated fair value for non-statutory stock options). If, at the time the Company grants an option, the optionee directly owns stock possessing more than 10% of the total combined voting power of all classes of stock of the Company, the option price must be at least 110% of the estimated fair value and are not exercisable more than five years after the date of grant. Options granted under the plans vest at varying rates determined on an individual basis by the Board of Directors, generally over four years. Options generally expire no more than ten years after the date of grant or earlier if employment is terminated.

Options may be exercised prior to vesting, with the underlying shares subject to the Company's right of repurchase, which lapses over the vesting term. At December 31, 2007, 2006 and 2005, 56,879 shares, 279,799 shares and 728,134 shares, respectively, of common stock were outstanding subject to the Company's right of repurchase at prices ranging from $0.20 to $1.00 per share. As of December 31, 2007, 2006 and 2005, the outstanding balances of the full recourse promissory notes were $20,000, $111,000 and $243,000, respectively, as described below. As a result, the promissory notes related to the exercise of the unvested shares and the corresponding aggregate exercise price for these shares have been recorded as notes receivable from stockholders and liability for early exercise of stock options in the accompanying consolidated balance sheet, and are transferred into common stock and additional paid-in capital as the shares vest.

Early Exercise of Employee Options

In accordance with EITF Issue No. 23, Issues Related to the Accounting for Stock Compensation under APB 25 and FIN 44, shares purchased by employees pursuant to the early exercise of stock options are not deemed to be issued until all restrictions on such shares lapse (i.e., the employee is vested in the award). Therefore, consideration received in exchange for exercised and restricted shares related to the early exercise of stock options is recorded as a liability for early exercise of stock options in the accompanying consolidated balance sheets and will be transferred into common stock and additional paid-in capital as the restrictions on such shares lapse.

In February 2005, options to purchase 4,293,958 shares of common stock were exercised by the signing of full recourse promissory notes totaling $948,000. The notes bear interest at 3.76% and are due in February 2010. The interest rate on the notes was deemed to be a below market rate of interest resulting in a deemed modification in exercise price of the options. As a result, the Company is accounting for these options as variable option awards until the employee is vested in the award. Of the $948,000 of promissory notes, notes in an aggregate amount of $552,000 were issued by executive officers and directors. Subsequent to December 31, 2007, these notes were paid in full, including principal and interest, for a total of $606,000. As of December 31, 2006, there were 279,799 shares outstanding as a result of the early exercise of options that were classified as $111,000 in current liabilities. As of December 31, 2007, there were 56,879 shares outstanding as a result of the early exercise of options that were classified as $20,000 in current liabilities. For the years ended December 31, 2007, 2006 and 2005, the Company recorded $783,000, $1.1 million and $1.0 million, respectively, of stock-based compensation related to the options exercised with promissory notes.

As of December 31, 2005, the Company had outstanding 556,042 options that were accounted for using the intrinsic method consistent with APB 25 (FIN 44) whereby there was no stock compensation expense recognized as all of the options were issued at fair market value. For the years ended December 31, 2007 and 2006, the Company adopted SFAS 123R and recognized stock-based compensation of $251,000 and $13,000, respectively.

ENERGY RECOVERY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes the stock option activity for the years ended December 31, 2007, 2006 and 2005 under the Company's stock option plans:

	Options Outstanding			
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)(3)
Balance 12/31/04	**4,300,000**	**$ 0.25**	—	—
Granted	726,042	$ 0.82	—	—
Exercised(1)	(4,293,958)	$ 0.25	—	—
Forfeited	(176,042)	$ 0.34	—	—
Balance 12/31/05	**556,042**	**$ 1.00**	**9.8**	—
Granted	642,000	$ 2.65	—	—
Exercised	(5,000)	$ 1.00	—	—
Forfeited	(25,730)	$ 1.00	—	—
Balance 12/31/06	**1,167,312**	**$ 1.91**	**9.4**	—
Granted	181,900	$ 5.00	—	—
Exercised	(17,083)	$ 1.00	—	—
Forfeited	(51,521)	$ 1.32	—	—
Balance 12/31/07	**1,280,608**	**$ 2.38**	**8.6**	**$ 3,335**
Vested and exercisable as of December 31, 2007	**416,140**	**$ 1.63**	**8.2**	**$ 1,404**
Vested and exercisable as of December 31, 2007 and expected to vest thereafter(2)	**305,000**	**$ 1.71**	**8.3**	**$ 1,005**

(1) These include 1,330,943 options with an average exercise price of $0.31 that were unvested as of the exercise date.
(2) Options that are expected to vest are net of estimated future options forfeitures in accordance with the provisions of SFAS 123R.
(3) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying options and the estimated fair value of the Company's stock as of December 31, 2007.

Shares available for grant under the option plans at December 31, 2007 and 2006 were 53,351 and 133,730, respectively.

The per option fair value of options granted to employees during the years ended December 31, 2007 and 2006 was $2.41 and $1.30, respectively. The aggregate intrinsic value of options exercised during the years ended December 31, 2007, 2006 and 2005 was $62,000, $8,000 and $1.1 million, respectively. As of December 31, 2007, total unrecognized compensation cost, net of forfeitures, related to non-vested options was $902,000, which is expected to be recognized as expense over a weighted-average period of approximately 2.9 years.

The following table summarizes options outstanding after exercises and cancellations:

Range of Exercise Prices	Outstanding and Exercisable	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Vested and Exercisable	Weighted Average Exercise Price
$1.00	466,708	7.8	$ 1.00	258,140	$ 1.00
$2.65	632,000	8.9	$ 2.65	158,000	$ 2.65
$5.00	181,900	9.7	$ 5.00	—	$ 5.00
	1,280,608	8.6	$ 2.38	416,140	$ 1.63

The employee option plans allows for the immediate exercise of granted options, subject to the Company's right of repurchase which lapses over the vesting term.

Stock Based Compensation Before Adoption of SFAS 123R

The fair value of the common stock for options granted was estimated either by the Company's board of directors with input from management or by the stock prices in conjunction with private placements with third parties. The pro forma disclosures under SFAS 123 for the year ended December 31, 2005 have been omitted as the pro forma amounts do not differ materially from actual operating results reported.

Stock-Based Compensation After Adoption of SFAS 123R

On January 1, 2006, the Company adopted the fair value recognition provisions of SFAS 123R, using the prospective transition method. Under this transition method, beginning January 1, 2006, compensation cost recognized includes: (a) compensation cost for all stock-based awards granted prior to, but not yet vested as of December 31, 2005, based on the intrinsic value method and variable method in accordance with the provisions of APB 25, and (b) compensation cost for all stock-based payments granted or modified subsequent to December 31, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R.

Under SFAS 123R, compensation cost for employee stock-based awards is based on the estimated grant-date fair value and is recognized over the vesting period of the applicable award on a straight-line basis. In 2006, the Company issued employee stock-based awards in the form of stock options. See Note 2—Summary of Significant Accounting Policies.

Warrants

In November 2005, the Company issued warrants to purchase 150,000 shares of the Company's common stock at $1.00 per share to an executive of the Company. The warrant has a term of 10 years and was immediately exercisable. The warrant was issued in exchange for future services to the Company and no stock-based compensation expense was recorded during the year since the exercise price of the warrant was equal to the estimated fair value of the Company's common stock at the time of issuance.

In July 2005, the Company issued warrants to purchase 200,000 shares (net of forfeitures) of the Company's common stock at $1.00 per share to an executive/stockholder of the Company. The warrant has a term of 10 years and was immediately exercisable. The warrant was issued in exchange for an irrevocable letter of credit issued by the warrant holder in July 2004 as collateral against the Company's line of credit with a bank. The Company valued the warrant using the Black-Scholes options pricing model with the following assumptions: expected volatility of 50%, an expected term of 10 years, a risk-free interest rate of 4.32% and no dividend yield. The resulting estimated fair value of the warrant of $132,000 was being amortized to interest expense over the expected term of the credit facility, which expired in December 2005.

During the year ended December 31, 2007, warrants to purchase 314,950 shares of common stock were exercised for cash and the proceeds received by the Company from these exercises were $143,000.

There were no warrant exercises during the year ended December 31, 2006.

During the year ended December 31, 2005, warrants to purchase 100,000 shares of common stock were exercised for cash and proceeds received by the Company from these exercises were $20,000.

In February 2005, warrants to purchase 315,974 shares of common stock were exercised by the signing of full recourse promissory notes totaling $63,000. The notes bear interest at 3.76% and are due February 2010. As of December 31, 2007, $43,000 of the notes had been repaid and the balance was repaid in March 2008.

A summary of the Company's warrant activity for the years ended (in thousands, except exercise prices and contractual life data):

	Years Ended December 31,		
	2007	2006	2005
Outstanding, beginning of year	2,389	2,589	2,455
Exercised during the year	(315)	—	(416)
Cancelled during the year	—	(200)	—
Issued during the year	—	—	550
Outstanding, end of year	2,074	2,389	2,589
Weighted average exercise price of warrants outstanding at end of year	$ 0.52	$ 0.52	$ 0.56
Weighted average remaining contractual life, in years, of warrants outstanding at end of year	5.7	6.7	8.1

10. Business Segment and Geographic Information

The Company manufactures and sells high efficiency energy recovery products and related services and operates under one segment. The Company's chief operating decision maker is the chief executive officer ("CEO"). The CEO reviews financial information presented on a consolidated basis, accompanied by desegregated information about revenue by geographic region for purposes of making operating decisions and assessing financial performance. Accordingly, the Company has concluded that it has one reportable segment.

The following geographic information includes net revenue to the Company's domestic and international customers based on the customers' requested delivery locations, except for certain cases in which the customer directed us to deliver the Company's products to a location that differs from the known ultimate location of use. In such cases, the ultimate location of use is reflected in the table below instead of the delivery location.

	Years Ended December 31, (in thousands)		
	2007	2006	2005
Domestic revenue	$ 2,125	$ 1,003	$ 1,710
International revenue	33,289	19,055	8,979
Total revenue	$ 35,414	$ 20,058	$ 10,689
Revenue by country:			
Spain	35%	9%	5%
Saudi Arabia	13	*	*
Algeria	12	30	18
United States	6	5	16
United Arab Emirates	2	10	9
China	8	5	14
Australia	*	9	17
Others	24	32	21
Total	100%	100%	100%

* Less than 1%.

Approximately 90% of the Company's long-lived assets were located in the United States at December 31, 2007, 2006 and 2005.

11. Concentrations

Concentration of Credit Risk

Cash is placed on deposit in major financial institutions in the U.S. Such deposits may be in excess of insured limits. Management believes that the financial institutions that hold the Company's cash are financially sound and, accordingly, minimal credit risk exists with respect to these balances.

The Company's accounts receivable are derived from sales to customers in the water desalination industry located around the world. The Company generally does not require collateral to support customer receivables, but frequently requires letters of credit securing payment. The Company performs ongoing evaluations of its customers' financial condition and periodically reviews credit risk associated with receivables. For sales with customers outside the U.S. (see Note 10—Business Segment and Geographic Information), the Company also obtains credit risk insurance to minimize credit risk exposure. An allowance for doubtful accounts is determined with respect to receivable amounts that the Company has determined to be doubtful of collection using specific identification of doubtful accounts and an aging of receivables analysis based on invoice due dates. Actual collection losses may differ from management's estimates, and such differences could be material to the financial position, results of operations and cash flows. Uncollectible receivables are written off against the allowance for doubtful accounts when all efforts to collect them have been exhausted while recoveries are recognized when they are received.

Accounts receivable concentrations for the years ended December 31, 2007 and 2006 were represented by three different customers totaling approximately 74% and 77%, respectively.

Revenue from customers representing 10% or more of total revenue varies from year to year. For the year ended December 31, 2007, three customers accounted for approximately 56% of the Company's net revenue. Specifically, Acciona Water, Geida and its affiliated entities and Doosan Heavy Industries represented approximately 20%, 23% and 13% of the Company's net revenue in 2007, respectively, and GE Ionics and Geida and its affiliated entities accounted for approximately 18% and 11% of the Company's net revenue in 2006, respectively. In 2005, GE Ionics and Multiplex Degremont JV accounted for 19% and 17% of the Company's net revenue, respectively. No other customer accounted for more than 10% of the Company's net revenue during any of these periods.

Supplier Concentration

Certain of the raw materials and components used by the Company in the manufacture of its products are available from a limited number of suppliers. Shortages could occur in these essential materials and components due to an interruption of supply or increased demand in the industry. If the Company were unable to procure certain of such materials or components, it would be required to reduce its manufacturing operations, which could have a material adverse effect on its results of operations.

For the years ended December 31, 2007, 2006 and 2005, three suppliers represented approximately 66%, 71% and 62%, respectively, of the total purchases of the Company. As of December 31, 2007 and 2006, approximately 60% and 77%, respectively, of the Company's accounts payable were due to these suppliers.

12. Subsequent Events

Facility Lease

In February 2008, the Company entered into a facility lease agreement for additional office space located in Oakland, California. The lease agreement has an original term of two years commencing on April 1, 2008.

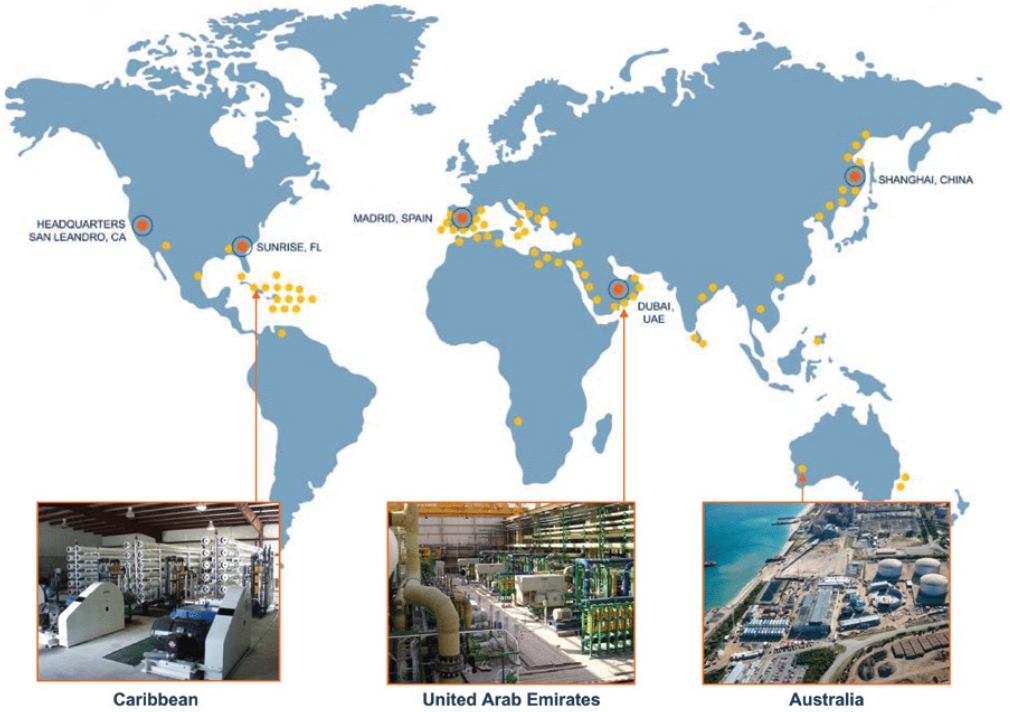
Consulting Agreement

In January 2008, the Company executed a consulting agreement with a member of its board of directors for services related to research and development of new technology. The board member receives compensation of $8,000 per month.

Equity Incentive Plan

In March 2008, the board of directors approved a 2008 Equity Incentive Plan which will become effective immediately preceding the effectiveness of this offering. There are 1,000,000 shares of common stock reserved for future issuance under this plan.

ERI's PX Technology Has a Presence Throughout the World



Caribbean

United Arab Emirates

Australia


ERI

PART II
INFORMATION NOT REQUIRED IN PROSPECTUS

ITEM 13. OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION.

The following table sets forth all expenses to be paid by the registrant, other than estimated underwriting discounts and commissions, in connection with this offering. All amounts shown are estimates except for the SEC registration fee, the FINRA, as applicable, filing fee and NASDAQ, as applicable, listing fee.

SEC registration fee	$ 6,878
FINRA filing fee	18,000
NASDAQ, as applicable, listing fee	5,000
Printing and engraving	*
Legal fees and expenses	*
Accounting fees and expenses	*
Blue sky fees and expenses	*
Transfer agent and registrar fees	*
Miscellaneous	*
Total	$ *

* To be provided by amendment.

ITEM 14. INDEMNIFICATION OF DIRECTORS AND OFFICERS.

Section 145 of the Delaware General Corporation Law authorizes a corporation's board of directors to grant, and authorizes a court to award, indemnity to officers, directors and other corporate agents.

As permitted by Section 102(b)(7) of the Delaware General Corporation Law, the registrant's amended and restated certificate of incorporation that will become effective upon the completion of this offering includes provisions that eliminate the personal liability of its directors and officers for monetary damages for breach of their fiduciary duty as directors and officers.

In addition, as permitted by Section 145 of the Delaware General Corporation Law, the amended and restated bylaws of the registrant that will become effective upon the completion of this offering provide that:

- The registrant shall indemnify its directors and officers for serving the registrant in those capacities or for serving other business enterprises at the registrant's request, to the fullest extent permitted by Delaware law. Delaware law provides that a corporation may indemnify such person if such person acted in good faith and in a manner such person reasonably believed to be in or not opposed to the best interests of the registrant and, with respect to any criminal proceeding, had no reasonable cause to believe such person's conduct was unlawful.
- The registrant may, in its discretion, indemnify employees and agents in those circumstances where indemnification is not required by law.
- The registrant is required to advance expenses, as incurred, to its directors and officers in connection with defending a proceeding, except that such director or officer shall undertake to repay such advances if it is ultimately determined that such person is not entitled to indemnification.
- The registrant will not be obligated pursuant to the bylaws to indemnify a person with respect to proceedings initiated by that person, except with respect to proceedings authorized by the registrant's board of directors or brought to enforce a right to indemnification.
- The rights conferred in the bylaws are not exclusive, and the registrant is authorized to enter into indemnification agreements with its directors, officers, employees and agents and to obtain insurance to indemnify such persons.
- The registrant may not retroactively amend the bylaw provisions to reduce its indemnification obligations to directors, officers, employees and agents.

The registrant intends to enter into separate indemnification agreements with each of its directors and officers upon the effectiveness of this offering that will provide the maximum indemnity allowed to directors and executive officers by

Section 145 of the Delaware General Corporation Law and will also provide for certain additional procedural protections. The registrant also maintains directors and officers insurance to insure such persons against certain liabilities.

These indemnification provisions and the indemnification agreements to be entered into between the registrant and its officers and directors upon the effectiveness of this offering may be sufficiently broad to permit indemnification of the registrant's officers and directors for liabilities (including reimbursement of expenses incurred) arising under the Securities Act.

The underwriting agreement filed as Exhibit 1.1 to this registration statement provides for indemnification by the underwriters of the registrant and its officers and directors for certain liabilities arising under the Securities Act and otherwise.

ITEM 15. RECENT SALES OF UNREGISTERED SECURITIES.

(a) Since January 1, 2005, the registrant has issued unregistered securities to a limited number of persons as described below:

1. Common Stock:

   On June 15, 2007, the registrant issued and sold 1,000,000 shares of common stock to one accredited investor at $5.00 per share, for aggregate proceeds of $5,000,000.

2. Warrants:

   In July 31, 2005 and November 1, 2005, the registrant issued warrants to purchase 550,000 shares of the registrant's common stock to two accredited investors at exercise prices of $1.00 per share.

3. Options:

   On February 1, 2005, the registrant issued and sold an aggregate of 2,500,000 shares of common stock upon the exercise of options issued to certain employees, directors and consultants under the registrant's 2001 Stock Option Plan at exercise prices ranging from $0.20 to $0.50 per share, for an aggregate consideration of $522,500.

4. Options:

   On February 1, 2005, the registrant issued and sold an aggregate of 1,313,958 shares of common stock upon the exercise of options issued to certain employees, directors and consultants under the registrant's 2002 Stock Option/Stock Issuance Plan at exercise prices from $0.20 to $0.50 per share, for an aggregate consideration of $334,728.90.

5. Options:

   From February 1, 2005 through July 12, 2007, the registrant issued and sold an aggregate of 502,083 shares of common stock upon the exercise of options issued to certain employees, directors and consultants under the registrant's 2004 Stock Option/Stock Issuance Plan at exercise prices ranging from $0.25 to $1.00 per share, for an aggregate consideration of $219,583.

None of the foregoing transactions involved any underwriters, underwriting discounts or commissions, or any public offering, and the registrant believes each transaction was exempt from the registration requirements of the Securities Act in reliance on Section 4(2) thereof and Regulation D promulgated thereunder, with respect to items (1) and (2) above, as transactions by an issuer not involving a public offering, and Rule 701 promulgated thereunder, with respect to item (3), (4) and (5) above, as transactions pursuant to compensatory benefit plans and contracts relating to compensation as provided under such Rule 701. The recipients of securities in such transactions represented their intention to acquire the securities for investment only and not with a view to or for sale in connection with any distribution thereof, and appropriate legends were affixed to the share certificates and instruments issued in such transactions.

(b) Since January 1, 2005, the registrant has granted the following options to purchase common stock to its employees, directors and consultants:

1. On January 16, 2005, the registrant granted stock options covering an aggregate of 170,000 shares of its common stock at an exercise price of $0.25 per share and an aggregate price of $42,500 under the registrant's 2004 Stock Option/Stock Issuance Plan.

2. On April 5, 2005, the registrant granted stock options covering an aggregate of 115,000 shares of its common stock at an exercise price of $1.00 per share and an aggregate price of $115,000 under the registrant's 2002 Stock Option/Stock Issuance Plan.

3. On October 14, 2005, the registrant granted stock options covering an aggregate of 100,000 shares of its common stock at an exercise price of $1.00 per share and an aggregate price of $100,000 under the registrant's 2004 Stock Option/Stock Issuance Plan.

4. On December 15, 2005, the registrant granted stock options covering an aggregate of 71,042 shares of its common stock at an exercise price of $1.00 per share and an aggregate price of $71,042 under the registrant's 2002 Stock Option/Stock Issuance Plan.

5. On December 15, 2005, the registrant granted stock options covering an aggregate of 270,000 shares of its common stock at an exercise price of $1.00 per share and an aggregate price of $270,000 under the registrant's 2004 Stock Option/Stock Issuance Plan.

6. On December 9, 2006, the registrant granted stock options covering an aggregate of 642,000 shares of its common stock at an exercise price of $2.65 per share and an aggregate price of $1,701,300 under the registrant's 2006 Stock Option/Stock Issuance Plan.

7. On June 28, 2007, the registrant granted stock options covering an aggregate of 69,200 shares of its common stock at an exercise price of $5.00 per share and an aggregate price of $346,000 under the registrant's 2006 Stock Option/Stock Issuance Plan.

8. On October 1, 2007, the registrant granted stock options covering an aggregate of 6,200 shares of its common stock at an exercise price of $5.00 per share and an aggregate price of $31,000 under the registrant's 2006 Stock Option/Stock Issuance Plan.

9. On November 1, 2007, the registrant granted stock options covering an aggregate of 100,200 shares of its common stock at an exercise price of $5.00 per share and an aggregate price of $501,000 under the registrant's 2006 Stock Option/Stock Issuance Plan.

10. On November 12, 2007, the registrant granted stock options covering an aggregate of 300 shares of its common stock at an exercise price of $5.00 per share and an aggregate price of $1,500 under the registrant's 2006 Stock Option/Stock Issuance Plan.

11. On November 19, 2007, the registrant granted stock options covering an aggregate of 6,000 shares of its common stock at an exercise price of $5.00 per share and an aggregate price of $30,000 under the registrant's 2006 Stock Option/Stock Issuance Plan.

None of the foregoing transactions involved any underwriters, underwriting discounts or commissions, or any public offering, and the registrant believes each transaction was exempt from the registration requirements of the Securities Act in reliance on Rule 701 promulgated thereunder as transactions pursuant to compensatory benefit plans and contracts relating to compensation as provided under such Rule 701. The recipients of securities in such transactions represented their intention to acquire the securities for investment only and not with a view to or for sale in connection with any distribution thereof, and appropriate legends were affixed to the share certificates and instruments issued in such transactions.

ITEM 16. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(a) Exhibits. The following exhibits are included herein or incorporated herein by reference:

Exhibit	Description
1.1*	Form of Underwriting Agreement
3.1	Amended and Restated Certificate of Incorporation of the Registrant, as currently in effect
3.1.1*	Form of Amended and Restated Certificate of Incorporation of Registrant, to be in effect upon the completion of this offering
3.2	Bylaws of Registrant
3.2.1	Amendment to Bylaws of Registrant
3.2.2*	Form of Amended and Restated Bylaws of the Registrant, to be effective upon closing of the offering
4.1*	Specimen Common Stock Certificate of the Registrant
5.1*	Opinion of Baker & McKenzie LLP
10.1*	Form of Indemnification Agreement between Registrant and its directors and officers
10.2	2001 Stock Option Plan of Registrant and form of Stock Option Agreement thereunder
10.3	2002 Stock Option/Stock Issuance Plan of Registrant and forms of Stock Option and Stock Purchase Agreements thereunder
10.4	2004 Stock Option/Stock Issuance Plan of Registrant and forms of Stock Option and Stock Purchase Agreements thereunder
10.5	2006 Stock Option/Stock Issuance Plan of Registrant and forms of Stock Option and Stock Purchase Agreements thereunder
10.5.1	Amendment to 2006 Stock Option/Stock Issuance Plan of Registrant
10.5.2	Second Amendment to 2006 Stock Option/Stock Issuance Plan of Registrant
10.6*	2008 Equity Incentive Plan of Registrant, to be in effect upon the completion of this offering, and form of Stock Option Agreement thereunder
10.7	Employment Agreement dated March 1, 2006 between Registrant and G.G. Pique
10.7.1	Amendment to Employment Agreement dated January 1, 2008 between Registrant and G.G. Pique
10.8	Employment Agreement dated November 1, 2007 between Registrant and Thomas Willardson
10.8.1	Amendment to Employment Agreement dated February 25, 2008 between Registrant and Thomas Willardson
10.9	Employment Agreement dated July 1, 2006 between Registrant and Richard Stover
10.9.1	Amendment to Employment Agreement dated February 25, 2008 between Registrant and Richard Stover
10.10	Employment Agreement dated July 1, 2006 between Registrant and Terrill Sandlin
10.10.1	Amendment to Employment Agreement dated February 25, 2008 between Registrant and Terrill Sandlin
10.11	Employment Agreement dated July 1, 2006 between Registrant and MariaElena Ross
10.11.1	Amendment to Employment Agreement dated February 25, 2008 between Registrant and MariaElena Ross
10.12	Independent Contractor Agreement dated January 23, 2008 between Registrant and Darby Engineering LLC
10.13	Lease Agreement dated February 28, 2005 between Registrant and 2101 Williams Associates, LLC
10.13.1	Amendment to Lease Agreement dated October 3, 2005 between Registrant and 2101 Williams Associates, LLC

10.13.2	Second Amendment to Lease Agreement dated January 4, 2006 between Registrant and 2101 Williams Associates, LLC
10.13.3	Third Amendment to Lease Agreement dated September 26, 2006 between Registrant and 2101 Williams Associates, LLC
10.14	Lease Agreement dated February 15, 2008 between Registrant and Beretta Investment Group
10.15	Lease Agreement dated August 7, 2006 between Energy Recovery Iberia, S.L. and REGUS Business Centre
21.1	List of subsidiaries of Registrant
23.1	Consent of BDO Seidman LLP, Independent Registered Public Accounting Firm
23.2*	Consent of Baker & McKenzie, LLP (included in Exhibit 5.01)
24.1	Power of Attorney (see page II-8 to this registration statement on Form S-1)
99.1	Consent of Person About to Become Director, executed by Dominique Trempont

*To be filed by amendment.

(b) Financial Statement Schedules. The following financial statement schedule is included herewith:

SCHEDULE II
VALUATION AND QUALIFYING ACCOUNTS
(in thousands)

Description	Balance at Beginning of Period	Additions Charged Costs and Expenses	Deductions	Balance at End of Period
Year Ended December 31, 2005				
Allowance for doubtful accounts	$ 46	$ 104	$ —	$ 150
Reserve for obsolete inventory	20	77	—	97
Income tax valuation allowance	1,395	—	(856)	539
Reserve for patent impairment	—	—	—	—
Warranty reserve	90	161	(141)	110
Year Ended December 31, 2006				
Allowance for doubtful accounts	150	80	—	230
Reserve for obsolete inventory	97	30	(72)	55
Income tax valuation allowance	539	—	(539)	—
Reserve for patent impairment	—	—	—	—
Warranty reserve	110	61	(86)	85
Year Ended December 31, 2007				
Allowance for doubtful accounts	230	(109)	—	121
Reserve for obsolete inventory	55	47	—	102
Income tax valuation allowance	—	—	—	—
Reserve for patent impairment	—	31	—	31
Warranty reserve	$ 85	$ 850	$ (67)	$ 868

All other schedules have been omitted because the information required to be presented in them is not applicable or is shown in the consolidated financial statements or related notes.

ITEM 17. UNDERTAKINGS.

The undersigned registrant hereby undertakes to provide to the underwriters at the closing specified in the underwriting agreement certificates in such denominations and registered in such names as required by the underwriters to permit prompt delivery to each purchaser.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

The undersigned registrant hereby undertakes that:

(1) For purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective.

(2) For the purpose of determining any liability under the Securities Act of 1933, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the Registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of San Leandro, State of California, on the 1st day of April, 2008.

ENERGY RECOVERY, INC.

By: /s/ G.G. PIQUE
G.G. Pique
President and Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below hereby constitutes and appoints G.G. Pique as his true and lawful attorney-in-fact and agent with full power of substitution, for him in any and all capacities, to sign any and all amendments to this registration statement (including post-effective amendments or any abbreviated registration statement and any amendments thereto filed pursuant to Rule 462(b) increasing the number of securities for which registration is sought), and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney-in-fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully for all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent, or his substitute, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1933, this registration statement has been signed by the following persons in the capacities and on the 1st day of April, 2008.

Signature	Title
/s/ G.G. PIQUE G.G. Pique	President and Chief Executive Officer (Principal Executive Officer)
/s/ THOMAS D. WILLARDSON Thomas D. Willardson	Chief Financial Officer (Principal Financial Officer)
/s/ MARILYN A. LOBEL Marilyn A. Lobel	Chief Accounting Officer and Corporate Controller (Principal Accounting Officer)
/s/ HANS PETER MICHELET Hans Peter Michelet	Executive Chairman
/s/ OLE PETER LORENTZEN Ole Peter Lorentzen	Director
/s/ ARVE HANSTVEIT Arve Hanstveit	Director
/s/ PETER DARBY Peter Darby	Director
/s/ MARIUS SKAUGEN Marius Skaugen	Director

Signature	Title
/s/ FRED OLAV JOHANNESSEN Fred Olav Johannessen	Director
/s/ JAMES MEDANICH James Medanich	Director

EXHIBIT INDEX

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23.2*	Consent of Baker & McKenzie, LLP (included in Exhibit 5.01)
24.1	Power of Attorney (see page II-8 to this registration statement on Form S-1)
99.1	Consent of Person About to Become Director, executed by Dominique Trempont

*To be filed by amendment.

Exhibit 3.1

State of Delaware
Secretary of State
Division of Corporations
Delivered 08:00 AM 10/17/2003
FILED 08:00 AM 10/17/2003
SRV 030668580 — 3366214 FILE

STATE of DELAWARE
RESTATED CERTIFICATE OF INCORPORATION

1. The present name of this Corporation is Energy Recovery, Inc. The name of this Corporation under which it was originally incorporated was ERI Acquisition Corp. The date of filing of the original Certificate of Incorporation with the Secretary of State of the State of Delaware was the 8th day of March, 2001.

2. The change of name to Energy Recovery, Inc. from ERI Corp. was duly adopted by the Board of Directors and by the stockholders of the Corporation. This change of name was filed with the Secretary of State of the State of Delaware as a Certificate of Amendment of Certificate of Incorporation on the 11th day of August, 2003.

3. The restated Certificate of Incorporation of Energy Recovery, Inc. was duly adopted by its Board of Directors and by a vote of its stockholders in accordance with § 242 and § 245 of the General Corporation Law of the State of Delaware. This Restated Certificate of Incorporation restates and integrates and further amends the provisions of the Corporation's Certificate of Incorporation as theretofore amended or supplemented and there is no discrepancy between those provisions and the provisions of the restated Certificate.

4. The Certificate of Incorporation is restated as follows:

CERTIFICATE of INCORPORATION

OF

ENERGY RECOVERY, INC.

Under Section 245 of the
Delaware General Corporation Law

ARTICLE ONE

The name of the Corporation is: Energy Recovery, Inc.

ARTICLE TWO

The address of the Corporation's registered office in the State of Delaware is 1201 Orange Street, Suite 600, in the City of Wilmington, County of New Castle, 19889-0511. The name of its registered agent at such address is Agents and Corporations, Inc.

ARTICLE THREE

The purpose of the Corporation is to engage in any lawful act or activity for which corporations may be organized under the Delaware General Corporation Law.

ARTICLE FOUR

The total number of shares of all classes of stock which the Corporation shall have authority to issue is Fifty-Five Million (55,000,000) shares, of which Ten Million (10,000,000) shares, designated as Preferred Stock shall have a par value of One Tenth of One Cent ($.001) per share (the "Preferred Stock"), and Forty-Five Million (45,000,000) shares, designated as Common Stock, shall have a par value of One Tenth of One Cent ($.001) per share (the "Common Stock").

A statement of the powers, preferences and rights, and the qualifications, limitations or restrictions thereof, in respect of each class of stock of the Corporation is as follows:

A. Preferred Stock. The Preferred Stock may be issued from time to time by the Board of Directors as shares of one or more classes or series. Subject to the provisions of this Certificate of Incorporation and the limitations prescribed by law, the Board of Directors is expressly authorized by adopting resolutions to issue the shares, fix the number of shares and change the number of shares constituting any series, and to provide for or change the voting powers, designations preferences and relative, participating, optional or other special rights, qualifications, limitations or restrictions thereof, including dividend rights (and whether dividends are cumulative), dividend rates, terms of redemption (including sinking fund provisions), a redemption price or prices, conversion rights and liquidation preferences of the shares constituting any class or series of the Preferred Stock, without any further action or vote by the stockholders.

B. Common Stock.

1. Dividends. Subject to the preferred rights of the holders of shares of any class or series of Preferred Stock as provided by the Board of Directors with respect to any such class or series of Preferred Stock, the holders of the Common Stock shall be entitled to receive, as and when declared by the Board of Directors out of the funds of the Corporation legally available therefor, such dividends (payable in cash, stock or otherwise) as the Board of Directors may from time to time determine, payable to stockholders of record on such dates, not exceeding 60 days preceding the dividend payment dates, as shall be fixed for such purpose by the Board of Directors in advance of payment of each particular dividend.

2. Liquidation. In the event of any liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary, after the distribution or payment to the holders of shares of any class or series of Preferred Stock as provided by the Board of Directors with respect to any such class or series of Preferred Stock, the remaining assets of the Corporation available for distribution to stockholders shall be distributed among and paid to the holders of Common Stock ratably in proportion to the number of shares of Common Stock held by them respectively.

3. Voting Rights. Except as otherwise required by law or as provided by the Board of Directors with respect to any class or series of Preferred Stock, the entire voting power and all voting rights shall be vested exclusively in the Common Stock. Each holder of shares of Common Stock shall be entitled to one vote for each share standing in his or her name on the books of the Corporation.

ARTICLE FIVE

A. Board of Directors. The number of directors of the Corporation shall consist of not less than one, the exact number to be fixed from time to time by the Board of Directors pursuant to a resolution adopted by the affirmative vote of a majority of the entire Board of Directors. No director need be a stockholder. The Directors shall be elected at each annual meeting of stockholders to hold office until their successors have been duly elected and qualified. At each annual meeting of stockholders at which a quorum is present, the persons receiving a plurality of the votes cast shall be directors.

B. Vacancies. Any vacancy on the Board of Directors resulting from death, retirement, resignation, disqualification or removal from office or other cause, as well as any vacancy resulting from an increase in the number of directors which occurs between annual meetings of the stockholders at which directors are elected, shall be filled only by a majority vote of the remaining directors then in office, though less than a quorum, except that those vacancies resulting from removal from office by a vote of the stockholders may be filled by a vote of the stockholders at the same meeting at which such removal occurs. The directors chosen to fill vacancies shall hold office for a term expiring at the end of the next annual meeting of stockholders. No decrease in the number of directors constituting the Board of Directors shall shorten the term of any incumbent director.

Notwithstanding the foregoing, whenever the holders of one or more classes or series of Preferred Stock shall have the right, voting separately, as a class or series, to elect directors, the electoral term of office, filling of vacancies, removal and other features of such directorships shall be governed by the terms of the resolution or resolutions adopted by the Board of Directors pursuant to ARTICLE FOUR applicable thereto, and each director so elected shall not be subject to the provisions of this ARTICLE FIVE unless otherwise provided therein.

C. Power to Make, Alter and Repeal By-laws. In furtherance and not in limitation of the power conferred by statute, the Board of Directors is expressly authorized to make, alter and repeal the By-laws of the Corporation.

ARTICLE SIX

The Corporation reserves the right to amend, alter, change or repair any provision in this Certificate of Incorporation, in the manner now or hereafter prescribed by statute.

ARTICLE SEVEN

No director of the Corporation shall be liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except for liability (i) for any breach of the director's duty of loyalty to the Corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of the Delaware General Corporation Law or (iv) for any transaction from which the director derived an improper personal benefit

ARTICLE EIGHT

The Corporation shall, to the fullest extent permitted by Section 145 of the Delaware General Corporation Law, as the same may be amended and supplemented, indemnify each director and officer of the Corporation from and against any and all of the expenses, liabilities or other matters referred to in or covered by said section and the indemnification provided for herein shall not be deemed exclusive of any other rights to which those indemnified may be entitled under any By-law, agreement, vote of stockholders, vote of disinterested directors or otherwise, and shall continue as to a person who has ceased to be a director or officer and shall inure to the benefit of the heirs, executors and administrators of such persons and the Corporation may purchase and maintain insurance on behalf of any director or officer to the extent permitted by Section 145 of the Delaware General Corporation Law.

ARTICLE NINE

Whenever a compromise or arrangement is proposed between the Corporation and its creditors or any class of them and/or between the Corporation and its stockholders or any class of them, any court of equitable jurisdiction within the State of Delaware may, on the application in a summary way of the Corporation or of any creditor or stockholder thereof or on the application of any receiver or receivers appointed for the Corporation under the provisions of section 291 of Title 8 of the Delaware Code or on the application of trustees in dissolution or of any receiver or receivers appointed for the Corporation under the provisions of section 279 of Title 8 of the Delaware Code order a meeting of the creditors or class of creditors, and/or of the stockholders or class of stockholders of the Corporation, as the case may be, to be summoned in such manner as the said court directs. If a majority in number representing three-fourths in value of the creditors or class of creditors, and/or of the stockholders or class of stockholders of the Corporation as the case may be, agree to any compromise or arrangement and to any reorganization of the Corporation as a consequence of such compromise or arrangement, the said compromise or arrangement and the said reorganization shall, if sanctioned by the court to which the said application has been made, be binding on all the creditors or class of creditors, and/or on

all the stockholders or class of stockholders, of the Corporation, as the case may be, and also on the Corporation.

* * * * * * * * *

IN WITNESS WHEREOF, the Corporation has caused this Certificate to be executed by its duly authorized officer this 26th day of September, 2003.

Energy Recovery, Inc.

/s/ Lowell M. Dicke
Lowell M. Dicke, Secretary

Exhibit 3.2

BY- LAWS
of
ENERGY RECOVERY INC.
(adopted April 18, 2001)
(restated February 2, 2004)

Incorporated under the Laws of the State of Delaware

ARTICLE I

OFFICES AND RECORDS

SECTION 1.1 Delaware Office. The principal office of the Corporation in the State of Delaware shall be located in the City of Wilmington, County of New Castle, and the name and address of its registered agent is the Agents and Corporations, Inc., Twelfth and Orange Streets, Wilmington, Delaware 19889-0511.

SECTION 1.2 Other Offices. The Corporation may have such other offices, either within or without the State of Delaware, as the Board of Directors may designate or as the business of the Corporation may from time to time require.

SECTION 1.3 Books and Records. The books and records of the Corporation may be kept outside the State of Delaware at such place or places as may from time to time be designated by the Board of Directors.

ARTICLE II

STOCKHOLDERS

SECTION 2.1 Annual Meeting. The annual meeting of the stockholders of the Corporation shall be held on such date and at such place and time as may be fixed by resolution of the Board of Directors.

SECTION 2.2 Special Meeting. Except as otherwise provided in the Certificate of Incorporation, a special meeting of the stockholders of the Corporation may be called at any time by the Board of Directors, the Chairman of the Board or the President and shall be called by the Chairman of the Board, the President or the Secretary at the request in writing of stockholders holding together at least twenty-five percent of the number of shares of stock outstanding and entitled to vote at such meeting. Any special meeting of the stockholders shall be held on such date, at such time and at such place within or without the State of Delaware as the Board of Directors or the officer calling the meeting may designate.

SECTION 2.3 Place of Meeting. The Board of Directors or the Chairman of the Board, as the case may be, may designate the place of meeting for any annual meeting or for any special meeting of the stockholders called by the Board of Directors or the Chairman of the

Board. If no designation is so made, the place of meeting shall be the principal office of the Corporation.

SECTION 2.4 Notice of Meeting. Written or printed notice, stating the place, day and hour of the meeting and the purpose or purposes for which the meeting is called, shall be delivered by the Corporation not less than ten (10) days nor more than sixty (60) days before the date of the meeting, either personally or by mail, to each stockholder of record entitled to vote at such meeting. If mailed, such notice shall be deemed to be delivered when deposited in the United States mail with postage thereon prepaid, addressed to the stockholder at his, her or its address as it appears on the stock transfer books of the Corporation. Such further notice shall be given as may be required by law. Meetings may be held without notice if all stockholders entitled to vote are present, or if notice is waived by those not present in accordance with Section 6.4 of these By-Laws.

SECTION 2.5 Quorum and Adjournment. Except as otherwise provided by law or by the Certificate of Incorporation, the holders of a majority of the outstanding shares of the Corporation entitled to vote generally in the election of directors (the "Voting Stock"), represented in person or by proxy, shall constitute a quorum at a meeting of stockholders, except that when specified business is to be voted on by a class or series of stock voting as a class, the holders of a majority of the shares of such class or series shall constitute a quorum of such class or series for the transaction of such business. A majority of the shares so represented may adjourn the meeting from time to time, whether or not there is such a quorum. No notice of the time and place of adjourned meetings need be given except as required by law. The stockholders present at a duly called meeting at which a quorum is present may continue to transact business until adjournment, notwithstanding the withdrawal of enough stockholders to leave less than a quorum.

SECTION 2.6 Proxies. At all meetings of stockholders, a stockholder may vote by proxy executed in writing (or in such manner prescribed by the General Corporation Law of the State of Delaware) by the stockholder, or by his duly authorized attorney in fact.

SECTION 2.7 Procedure for Election of Directors; Required Vote. Election of directors at all meetings of the stockholders at which directors are to be elected shall be by ballot, and, subject to the rights of the holders of any series of Preferred Stock to elect directors under specified circumstances, a plurality of the votes cast thereat shall elect directors. Except as otherwise provided by law, the Certificate of Incorporation, or these By-Laws, in all matters other than the election of directors, the affirmative vote of a majority of the shares present in person or represented by proxy at the meeting and entitled to vote on the matter shall be the act of the stockholders.

SECTION 2.8 Inspectors of Elections; Opening and Closing the Polls. The Board of Directors by resolution shall appoint one or more inspectors, which inspector or inspectors may include individuals who serve the Corporation in other capacities, including, without limitation, as officers, employees, agents or representatives, to act at the meetings of stockholders and make a written report thereof. One or more persons may be designated as alternate inspectors to replace any inspector who fails to act. If no inspector or alternate has been

appointed to act or is able to act at a meeting of stockholders, the Chairman of the meeting shall appoint one or more inspectors to act at the meeting. Each inspector, before discharging his or her duties, shall take and sign an oath faithfully to execute the duties of inspector with strict impartiality and according to the best of his or her ability. The inspectors shall have the duties prescribed by law.

The Chairman of the meeting shall fix and announce at the meeting the date and time of the opening and the closing of the polls for each matter upon which the stockholders will vote at a meeting.

SECTION 2.9 Record Date for Action by Written Consent. In order that the Corporation may determine the stockholders entitled to consent to corporate action in writing without a meeting, the Board of Directors may fix a record date, which record date shall not precede the date upon which the resolution fixing the record date is adopted by the Board of Directors, and which date shall not be more than 10 days after the date upon which the resolution fixing the record date is adopted by the Board of Directors. Any stockholder of record seeking to have the stockholders authorize or take corporate action by written consent shall, by written notice to the Secretary, request the Board of Directors to fix a record date. The Board of Directors shall promptly, but in all events within 10 days after the date on which such a request is received, adopt a resolution fixing the record date. If no record date has been fixed by the Board of Directors within 10 days of the date on which such a request is received, the record date for determining stockholders entitled to consent to corporate action in writing without a meeting, when no prior action by the Board of Directors is required by applicable law, shall be the first date on which a signed written consent setting forth the action taken or proposed to be taken is delivered to the Corporation by delivery to its registered office in Delaware, its principal place of business or to any officer or agent of the Corporation having custody of the book in which proceedings of meetings of stockholders are recorded. Delivery made to the Corporation's registered office shall be by hand or by certified or registered mail, return receipt requested. If no record date has been fixed by the Board of Directors and prior action by the Board of Directors is required by applicable law, the record date for determining stockholders entitled to consent to corporate action in writing without a meeting shall be at the close of business on the date on which the Board of Directors adopts the resolution taking such prior action.

SECTION 2.10 Inspectors of Written Consent. In the event of the delivery, in the manner provided by Section 2.9, to the Corporation of the requisite written consent or consents to take corporate action and/or any related revocation or revocations, the Corporation shall engage nationally recognized independent inspectors of elections for the purpose of promptly performing a ministerial review of the validity of the consents and revocations. For the purpose of permitting the inspectors to perform such review, no action by written consent without a meeting shall be effective until such date as the independent inspectors certify to the Corporation that the consents delivered to the Corporation in accordance with Section 2.9 represent at least the minimum number of votes that would be necessary to take the corporate action. Nothing contained in this paragraph shall in any way be construed to suggest or imply that the Board of Directors or any stockholder shall not be entitled to contest the validity of any consent or revocation thereof, whether before or after such certification by the independent inspectors, or to take any other action (including, without limitation, the commencement,

prosecution or defense of any litigation with respect thereto, and the seeking of injunctive relief in such litigation).

SECTION 2.11 Effectiveness of Written Consent. Every written consent shall bear the date of signature of each stockholder who signs the consent and no written consent shall be effective to take the corporate action referred to therein unless, within 60 days of the date the earliest dated written consent was received in accordance with Section 2.9, a written consent or consents signed by a sufficient number of holders to take such action are delivered to the Corporation in the manner prescribed in Section 2.9.

ARTICLE III

BOARD OF DIRECTORS

SECTION 3.1 General Powers. The business and affairs of the Corporation shall be managed under the direction of the Board of Directors. In addition to the powers and authorities by these By-Laws expressly conferred upon them, the Board of Directors may exercise all such powers of the Corporation and do all such lawful acts and things as are not by statute or by the Certificate of Incorporation or by these By-Laws required to be exercised or done by the stockholders.

SECTION 3.2 Number, Tenure and Qualifications. The number of directors constituting the Board of Directors shall be fixed from time to time by resolution passed by a majority of the Board of Directors. The directors shall, except as hereinafter otherwise provided for filling vacancies, be elected at the annual meeting of stockholders, and shall hold office until their respective successors are elected and qualified or until their earlier resignation or removal. Directors need not be stockholders of the Corporation.

SECTION 3.3 Regular Meetings. A regular meeting of the Board of Directors shall be held without other notice than this By-Law immediately after, and at the same place as, the Annual Meeting of Stockholders. The Board of Directors may, by resolution, provide the time and place for the holding of additional regular meetings without other notice than such resolution.

SECTION 3.4 Special Meetings. Special meetings of the Board of Directors shall be called at the request of the Chairman of the Board, the President or a majority of the Board of Directors then in office. The person or persons authorized to call special meetings of the Board of Directors may fix the place and time of the meetings.

SECTION 3.5 Notice. Notice of any special meeting of directors shall be given to each director at his business or residence in writing by hand delivery, first-class or overnight mail or courier service, telegram or facsimile transmission, or orally by telephone. If mailed by first-class mail, such notice shall be deemed adequately delivered when deposited in the United States mails so addressed, with postage thereon prepaid, at least five (5) days before such meeting. If by telegram, overnight mail or courier service, such notice shall be deemed adequately delivered when the telegram is delivered to the telegraph company or the notice is

delivered to the overnight mail or courier service company at least twenty-four (24) hours before such meeting. If by facsimile transmission, such notice shall be deemed adequately delivered when the notice is transmitted at least twelve (12) hours before such meeting. If by telephone or by hand delivery, the notice shall be given at least twelve (12) hours prior to the time set for the meeting. Neither the business to be transacted at, nor the purpose of, any regular or special meeting of the Board of Directors need be specified in the notice of such meeting, except for amendments to these By-Laws, as provided under Section 8.1. A meeting may be held at any time without notice if all the directors are present or if those not present waive notice of the meeting in accordance with Section 6.4 of these By-Laws.

SECTION 3.6 Action by Consent of Board of Directors. Any action required or permitted to be taken at any meeting of the Board of Directors or of any committee thereof may be taken without a meeting if all members of the Board or committee, as the case may be, consent thereto in writing, and the writing or writings are filed with the minutes of proceedings of the Board or committee.

SECTION 3.7 Conference Telephone Meetings. Members of the Board of Directors, or any committee thereof, may participate in a meeting of the Board of Directors or such committee by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other, and such participation in a meeting shall constitute presence in person at such meeting.

SECTION 3.8 Quorum. Subject to Section 3.9, a whole number of directors equal to at least a majority of the total number of directors which the Corporation would have if there were no vacancies ("Whole Board") shall constitute a quorum for the transaction of business, but if at any meeting of the Board of Directors there shall be less than a quorum present, a majority of the directors present may adjourn the meeting from time to time without further notice. The act of the majority of the directors present at a meeting at which a quorum is present shall be the act of the Board of Directors. The directors present at a duly organized meeting may continue to transact business until adjournment, notwithstanding the withdrawal of enough directors to leave less than a quorum.

SECTION 3.9 Vacancies. Subject to applicable law and the rights of the holders of any series of Preferred Stock with respect to such series of Preferred Stock, and unless the Board of Directors otherwise determines, vacancies resulting from death, resignation, retirement, disqualification, removal from office or other cause, and newly created directorships resulting from any increase in the authorized number of directors, may be filled only by the affirmative vote of a majority of the remaining directors, though less than a quorum of the Board of Directors, and directors so chosen shall hold office for a term expiring at the next annual meeting of stockholders and until such director's successor shall have been duly elected and qualified. No decrease in the number of authorized directors constituting the Whole Board shall shorten the term of any incumbent director.

SECTION 3.10 Committees. The Board of Directors may, by resolution adopted by a majority of the Whole Board, designate one or more committees. Each such committee shall consist of two or more directors of the Corporation. The Board may designate

one or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. Any such committee may to the extent permitted by law exercise such powers and shall have such responsibilities as shall be specified in the designating resolution. In the absence or disqualification of any member of such committee or committees, the member or members thereof present at any meeting and not disqualified from voting, whether or not constituting a quorum, may unanimously appoint another member of the Board to act at the meeting in the place of any such absent or disqualified member. Each committee shall keep written minutes of its proceedings and shall report such proceedings to the Board when required.

A majority of any committee may determine its action and fix the time and place of its meetings, unless the Board shall otherwise provide. Notice of such meetings shall be given to each member of the committee in the manner provided for in Section 3.5 of these By-Laws. The Board shall have power at any time to fill vacancies in, to change the membership of, or to dissolve any such committee. Nothing herein shall be deemed to prevent the Board from appointing one or more committees consisting in whole or in part of persons who are not directors of the Corporation; provided, however, that no such committee shall have or may exercise any authority of the Board.

No committee shall have the power or authority in reference to amending the Certificate of Incorporation, adopting an agreement of merger or consolidation, recommending to the stockholders the sale, lease or exchange of all or substantially all of the Corporation's property and assets, recommending to the stockholders a dissolution of the Corporation or a revocation of a dissolution, or amending these By-Laws. Unless a resolution adopted by the Board of Directors, these By-laws, or the Certificate of Incorporation expressly so provide, no such committee shall have the power or authority to declare a dividend or to authorize the issuance of stock.

SECTION 3.11 Records. The Board of Directors shall cause to be kept a record containing the minutes of the proceedings of the meetings of the Board and of the stockholders, appropriate stock books and registers and such books of records and accounts as may be necessary for the proper conduct of the business of the Corporation.

ARTICLE IV

OFFICERS

SECTION 4.1 Elected Officers. The elected officers of the Corporation shall be a Chairman of the Board of Directors, a President, a Secretary, a Treasurer, and such other officers (including, without limitation, a Chief Operating Officer and Chief Financial Officer) as the Board of Directors from time to time may deem proper. The Chairman of the Board shall be chosen from among the directors. All officers elected by the Board of Directors shall each have such powers and duties as generally pertain to their respective offices, subject to the specific provisions of this ARTICLE IV. Such officers shall also have such powers and duties as from time to time may be conferred by the Board of Directors or by any committee thereof. The Board or any committee thereof may from time to time elect, or the Chairman of the Board or

President may appoint, such other officers (including one or more Assistant Vice Presidents, Assistant Secretaries, Assistant Treasurers, and Assistant Controllers) and such agents, as may be necessary or desirable for the conduct of the business of the Corporation. Such other officers and agents shall have such duties and shall hold their offices for such terms as shall be provided in these By-Laws or as may be prescribed by the Board or such committee or by the Chairman of the Board or President, as the case may be.

SECTION 4.2 Election and Term of Office. The elected officers of the Corporation shall be elected annually by the Board of Directors at the regular meeting of the Board of Directors held after the annual meeting of the stockholders. If the election of officers shall not be held at such meeting, such election shall be held as soon thereafter as convenient. Each officer shall hold office until his successor shall have been duly elected and shall have qualified or until his death or until he shall resign, but any officer may be removed from office at any time by the affirmative vote of a majority of the Whole Board or, except in the case of an officer or agent elected by the Board, by the Chairman of the Board or President. Such removal shall be without prejudice to the contractual rights, if any, of the person so removed.

SECTION 4.3 Chairman of the Board. The Chairman of the Board shall preside at all meetings of the stockholders and of the Board of Directors. The Chairman of the Board shall perform all duties incidental to his office which may be required by law and all such other duties as are properly required of him by the Board of Directors. He shall make reports to the Board of Directors and the stockholders, and shall see that all orders and resolutions of the Board of Directors and of any committee thereof are carried into effect. The Chairman of the Board may also serve as President, if so elected by the Board.

SECTION 4.4 President. The President shall act in a general executive capacity and shall be the Chief Executive Officer of the Company. The President shall be responsible for the administration and operation of the Corporation's business and general supervision of its policies and affairs. The President shall, in the absence of or because of the inability to act of the Chairman of the Board, perform all duties of the Chairman of the Board and preside at all meetings of stockholders and of the Board of Directors.

SECTION 4.5 Chief Operating Officer. The Chief Operating Officer (if any) shall be a Vice President and act in an executive capacity with respect to the Corporation's operations. He shall assist the President in the general supervision of the Corporation's operations and affairs.

SECTION 4.6 Chief Financial Officer. The Chief Financial Officer (if any) shall be a Vice President and act in an executive financial capacity. He shall assist the President in the general supervision of the Corporation's financial policies and affairs.

SECTION 4.7 Treasurer. The Treasurer shall exercise general supervision over the receipt, custody and disbursement of corporate funds. The Treasurer shall cause the funds of the Corporation to be deposited in such banks as may be authorized by the Board of Directors, or in such banks as may be designated as depositaries in the manner provided by resolution of the Board of Directors. He shall have such further powers and duties and shall be

subject to such directions as may be granted or imposed upon him from time to time by the Board of Directors, the Chairman of the Board or the President.

SECTION 4.8 Secretary. The Secretary shall keep or cause to be kept in one or more books provided for that purpose, the minutes of all meetings of the Board, the committees of the Board and the stockholders; he shall see that all notices are duly given in accordance with the provisions of these By-Laws and as required by law; he shall be custodian of the records and the seal of the Corporation and affix and attest the seal to all stock certificates of the Corporation (unless the seal of the Corporation on such certificates shall be a facsimile, as hereinafter provided) and affix and attest the seal to all other documents to be executed on behalf of the Corporation under its seal; and he shall see that the books, reports, statements, certificates and other documents and records required by law to be kept and filed are properly kept and filed; and in general, he shall perform all the duties incident to the office of Secretary and such other duties as from time to time may be assigned to him by the Board, the Chairman of the Board or the President.

SECTION 4.9 Removal. Any officer elected, or agent appointed, by the Board of Directors may be removed by the affirmative vote of a majority of the Whole Board whenever, in their judgment, the best interests of the Corporation would be served thereby. Any officer or agent appointed by the Chairman of the Board or the President may be removed by him whenever, in his judgment, the best interests of the Corporation would be served thereby. No elected officer shall have any contractual rights against the Corporation for compensation by virtue of such election beyond the date of the election of his successor, his death, his resignation or his removal, whichever event shall first occur, except as otherwise provided in an employment contract or under an employee deferred compensation plan.

SECTION 4.10 Vacancies. A newly created elected office and a vacancy in any elected office because of death, resignation, or removal may be filled by the Board of Directors for the unexpired portion of the term at any meeting of the Board of Directors. Any vacancy in an office appointed by the Chairman of the Board or the President because of death, resignation, or removal may be filled by the Chairman of the Board or the President.

ARTICLE V

STOCK CERTIFICATES AND TRANSFERS

SECTION 5.1 Stock Certificates and Transfers. The interest of each stockholder of the Corporation shall be evidenced by certificates for shares of stock in such form as the appropriate officers of the Corporation may from time to time prescribe. The shares of the stock of the Corporation shall be transferred on the books of the Corporation by the holder thereof in person or by his attorney, upon surrender for cancellation of certificates for at least the same number of shares, with an assignment and power of transfer endorsed thereon or attached thereto, duly executed, with such proof of the authenticity of the signature as the Corporation or its agents may reasonably require.

The certificates of stock shall be signed, countersigned and registered in such manner as the Board of Directors may by resolution prescribe, which resolution may permit all or any of the signatures on such certificates to be in facsimile. In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed upon a certificate has ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the Corporation with the same effect as if he were such officer, transfer agent or registrar at the date of issue.

SECTION 5.2 Lost, Stolen or Destroyed Certificates. No certificate for shares of stock in the Corporation shall be issued in place of any certificate alleged to have been lost, destroyed or stolen, except on production of such evidence of such loss, destruction or theft and on delivery to the Corporation of a bond of indemnity in such amount, upon such terms and secured by such surety, as the Board of Directors or any financial officer may in its or his discretion require.

ARTICLE VI

MISCELLANEOUS PROVISIONS

SECTION 6.1 Fiscal Year. The fiscal year of the Corporation shall end on December 31st of each year.

SECTION 6.2 Dividends. The Board of Directors may from time to time declare, and the Corporation may pay, dividends on its outstanding shares in the manner and upon the terms and conditions provided by law and the Certificate of Incorporation.

SECTION 6.3 Seal. The corporate seal shall have inscribed thereon the words “Corporate Seal”, the year of incorporation and around the margin thereof the words “Energy Recovery, Inc. * Delaware *.”

SECTION 6.4 Waiver of Notice. Whenever any notice is required to be given to any stockholder or director of the Corporation under the provisions of the General Corporation Law of the State of Delaware or these By-Laws, a waiver thereof in writing, signed by the person or persons entitled to such notice, whether before or after the time stated therein, shall be deemed equivalent to the giving of such notice. Neither the business to be transacted at, nor the purpose of, any annual or special meeting of the stockholders or the Board of Directors or committee thereof need be specified in any waiver of notice of such meeting.

SECTION 6.5 Audits. The accounts, books and records of the Corporation shall be audited upon the conclusion of each fiscal year by an independent certified public accountant selected by the Board of Directors, and it shall be the duty of the Board of Directors to cause such audit to be done annually.

SECTION 6.6 Resignations. Any director or any officer, whether elected or appointed, may resign at any time by giving written notice of such resignation to the Chairman

of the Board, the President, or the Secretary, and such resignation shall be deemed to be effective as of the close of business on the date said notice is received by the Chairman of the Board, the President, or the Secretary, or at such later time as is specified therein. No formal action shall be required of the Board of Directors or the stockholders to make any such resignation effective.

SECTION 6.7 Indemnification and Insurance.

(A) Nature of Indemnity. The Corporation shall indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that he or she is or was or has agreed to become a director or officer of the Corporation, or is or was serving or has agreed to serve at the request of the Corporation as a director or officer of another corporation, limited liability company, partnership, joint venture, trust or other enterprise, or by reason of any action alleged to have been taken or omitted in such capacity, and may indemnify any person who was or is a party or is threatened to be made a party to such an action, suit or proceeding by reason of the fact that he or she is or was or has agreed to become an employee or agent of the Corporation, or is or was serving or has agreed to serve at the request of the Corporation as an employee or agent of another corporation, limited liability company, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him or on his or her behalf in connection with such action, suit or proceeding and any appeal therefrom, if he or she acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interests of the Corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his or her conduct was unlawful; except that in the case of an action or suit by or in the right of the Corporation to procure a judgment in its favor (1) such indemnification shall be limited to expenses (including attorneys' fees) actually and reasonably incurred by such person in the defense or settlement of such action or suit, and (2) no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the Corporation unless and only to the extent that the Delaware Court of Chancery or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Delaware Court of Chancery or such other court shall deem proper.

The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of *nolo contendere* or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which he or she reasonably believed to be in or not opposed to the best interests of the Corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe that his conduct was unlawful.

(B) Successful Defense. To the extent that a director, officer, employee or agent of the Corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in (A) of this Section 6.7 or in defense of any claim, issue or matter therein, he or she shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by him in connection therewith.

(C) Determination that Indemnification is Proper. Any indemnification of a director or officer of the Corporation under (A) of this Section 6.7 (unless ordered by a court) shall be made by the Corporation unless a determination is made that indemnification of the director or officer is not proper in the circumstances because he or she has not met the applicable standard of conduct set forth in (A). Any indemnification of an employee or agent of the Corporation under (A) (unless ordered by a court) may be made by the Corporation upon a determination that indemnification of the employee or agent is proper in the circumstances because he or she has met the applicable standard of conduct set forth in (A). Any such determination shall be made (1) by the Board of Directors by a majority vote of a quorum consisting of directors who were not parties to such action, suit or proceeding, or (2) if such a quorum is not obtainable, or, even if obtainable a quorum of disinterested directors so directs, by independent legal counsel in a written opinion, or (3) by the stockholders.

(D) Advance Payment of Expenses. Unless the Board of Directors otherwise determines in a specific case, expenses incurred by a director or officer in defending a civil or criminal action, suit or proceeding shall be paid by the Corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of the director or officer to repay such amount if it shall ultimately be determined that he or she is not entitled to be indemnified by the Corporation as authorized in this Section 6.7. Such expenses incurred by other employees and agents may be so paid upon such terms and conditions, if any, as the Board of Directors deems appropriate. The Board of Directors may authorize the Corporation's legal counsel to represent such director, officer, employee or agent in any action, suit or proceeding, whether or not the Corporation is a party to such action, suit or proceeding.

(E) Survival; Preservation of Other Rights. The foregoing indemnification provisions shall be deemed to be a contract between the Corporation and each director, officer, employee and agent who serves in any such capacity at any time while these provisions as well as the relevant provisions of the Delaware General Corporation Law are in effect and any repeal or modification thereof shall not affect any right or obligation then existing with respect to any state of facts then or previously existing or any action, suit, or proceeding previously or thereafter brought or threatened based in whole or in part upon any such state of facts. Such a contract right may not be modified retroactively without the consent of such director, officer, employee or agent.

The indemnification provided by this Section 6.7 shall not be deemed exclusive of any other rights to which those indemnified may be entitled under any by-law, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in his or her official capacity and as to action in another capacity while holding such office, and shall continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of the heirs, executors and administrators of such a person. The Corporation may enter into an agreement with any of its directors, officers, employees or agents providing for indemnification and advancement of expenses, including attorneys fees, that may change, enhance, qualify or limit any right to indemnification or advancement of expenses created by this Section 6.7.

(F) Severability. If this Section 6.7 or any portion hereof shall be invalidated on any ground by any court of competent jurisdiction, then the Corporation shall nevertheless indemnify each director or officer and may indemnify each employee or agent of the Corporation as to costs, charges and expenses (including attorneys' fees), judgment, fines and amounts paid in settlement with respect to any action, suit or proceeding, whether civil, criminal, administrative or investigative, including an action by or in the right of the Corporation, to the fullest extent permitted by any applicable portion of this Section 6.7 that shall not have been invalidated and to the fullest extent permitted by applicable law.

(G) Subrogation. In the event of payment of indemnification to a person described in (A) of this Section 6.7 the Corporation shall be subrogated to the extent of such payment to any right of recovery such person may have and such person as a condition of receiving indemnification from the Corporation, shall execute all documents and do all things that the Corporation may deem necessary or desirable to perfect such right of recovery, including the execution of such documents necessary to enable the Corporation effectively to enforce any such recovery.

(H) No Duplication of Payments. The Corporation shall not be liable under this Section 6.7 to make any payment in connection with any claim made against a person described in (A) of this Section 6.7 to the extent such person has otherwise received payment (under any insurance policy, by-law or otherwise) of the amounts otherwise indemnifiable hereunder.

(I) Insurance. The Corporation may maintain insurance, at its expense, to protect itself and any director, officer, employee or agent of the Corporation or another corporation, limited liability company, partnership, joint venture, trust or other enterprise against any expense, liability or loss, whether or not the Corporation would have the power to indemnify such person against such expense, liability or loss under the General Corporation Law of the State of Delaware. To the extent that the Corporation maintains any policy or policies providing such insurance, each such director or officer, and each such agent or employee to which rights to indemnification have been granted, shall be covered by such policy or policies in accordance with its or their terms to the maximum extent of the coverage thereunder for any such director, officer, employee or agent.

ARTICLE VII

CONTRACTS, PROXIES, ETC.

SECTION 7.1. Contracts. Except as otherwise required by law, the Certificate of Incorporation or these By-Laws, any contracts or other instruments may be executed and delivered in the name and on the behalf of the Corporation by such officer or officers of the Corporation as the Board of Directors may from time to time direct. Such authority may be general or confined to specific instances as the Board may determine. The Chairman of the Board, the President or any Vice President may execute bonds, contracts, deeds, leases and other instruments to be made or executed for or on behalf of the Corporation. Subject to any restrictions imposed by the Board of Directors, the President or any Vice President of the

Corporation may delegate contractual powers to others under his or her jurisdiction, it being understood, however, that any such delegation of power shall not relieve such officer of responsibility with respect to the exercise of such delegated power.

SECTION 7.2 Proxies. Unless otherwise provided by resolution adopted by the Board of Directors, the Chairman of the Board, the President or any Vice President may from time to time appoint an attorney or attorneys or agent or agents of the Corporation, in the name and on behalf of the Corporation, to cast the votes which the Corporation may be entitled to cast as the holder of stock or other securities or membership interests in any other corporation or limited liability company, any of whose stock or other securities or membership interests may be held by the Corporation, at meetings of the holders of the stock or other securities or membership interests of such other corporation or limited liability company, or to consent in writing, in the name of the Corporation as such holder, to any action by such other corporation or limited liability company, and may instruct the person or persons so appointed as to the manner of casting such votes or giving such consent, and may execute or cause to be executed in the name and on behalf of the Corporation and under its corporate seal or otherwise, all such written proxies or other instruments as he may deem necessary or proper in the premises.

ARTICLE VIII

AMENDMENTS

SECTIONS 8.1 Amendments. These By-Laws may be altered, amended, or repealed at any meeting of the Board of Directors or of the stockholders, provided notice of the proposed change was given in the notice of the meeting and, in the case of a meeting of the Board of Directors, in a notice given not less than two days prior to the meeting.

SECRETARY'S CERTIFICATE OF RESTATEMENT OF

THE BY-LAWS OF ENERGY RECOVERY, INC.

I hereby certify:

That I am the duly appointed Secretary of Energy Recovery, Inc., a Delaware corporation;

That the foregoing By-Laws comprising thirteen (13) pages, constitute the By-Laws of said corporation as duly adopted by the Board of Directors of the Corporation on April 18, 2001 when it was known as ERI Corp., and restated on February 2, 2004 and now known as Energy Recovery, Inc.

IN WITNESS WHEREOF, I have hereunder subscribed my name this 2nd day of February, 2004.

/s/ Lowell M. Dicke
Lowell M. Dicke, Secretary

Exhibit 3.2.1

CERTIFICATE OF SECRETARY
OF
ENERGY RECOVERY, INC.

The undersigned, MariaElena Ross, Secretary of Energy Recovery, Inc. (the "Corporation"), a Delaware corporation, hereby certifies that the attached document is a Certificate of Amendment as adopted by the Board of Directors on August 31, 2006. The Amendment is effective as of August 31, 2006.

IN WITNESS WHEREOF, the undersigned has executed this certificate as of September 1, 2006.

/s/ MariaElena Ross
MariaElena Ross,
Secretary

AMENDMENT TO

BY-LAWS OF

Energy Recovery, Inc.

The By-laws of Energy Recovery, Inc. (the "By-Laws") are hereby amended as follows:

1. Article III; Section 5 of the By-Laws is hereby amended and restated in its entirety to read as follows:

"SECTION 3.5 Notice. Notice of special meetings of the board of directors shall be given to each director at his business or residence in writing by hand delivery, first-class or overnight mail or courier service, telegram or facsimile transmission, orally by telephone, or as provided in Sections 6.8 and 6.9 of these By-Laws. If mailed by first-class mail, such notice shall be deemed adequately delivered when deposited in the United States mails so addressed, with postage thereon prepaid, at least five (5) days before such meeting. If by telegram, overnight mail or courier service, such notice shall be deemed adequately delivered when the telegram is delivered to the telegraph company or the notice is delivered to the overnight mail or courier service company at least twenty-four (24) hours before such meeting. If by facsimile transmission, such notice shall be deemed adequately delivered when the notice is transmitted at least twelve (12) hours before such meeting. If by telephone or by hand delivery, the notice shall be given at least twelve (12) hours prior to the time set for the meeting. Neither the business to be transacted, nor the purpose of, any regular or special meeting of the Board of Directors need be specified in the notice of such meeting, except for amendments to these By-Laws, as provided under Section 8.1. A meeting may be held at any time without notice if all the directors are present or if those not present waive notice of the meeting in accordance with Section 6.4 of these By-Laws."

2. The following new Sections 6.8 and 6.9 hereby are inserted into the By-Laws immediately following existing Section 6.7:

"SECTION 6.8 Notice by Electronic Mail. Whenever under applicable law, the certificate of incorporation or these bylaws notice is required to be given to any stockholder, director or member of any committee of the board of directors, such notice also may be given by electronic mail.

Without limiting the manner by which notice otherwise may be given effectively to stockholders, any notice to stockholders given by electronic mail by the corporation shall be effective if consented to by the stockholder to whom notice is given. Any such consent shall be revocable by the stockholder by written notice to the corporation. Any such consent shall be deemed revoked if (a) the corporation is unable to deliver by electronic mail two consecutive notices given by the corporation in accordance with such consent and (b) such inability becomes known to the secretary or an assistant secretary of the corporation or the transfer agent, or other person responsible for giving of notice; provided, however, the inadvertent failure to treat such inability as a revocation shall not invalidate any meeting or other action.

SECTION 6.9 Effectiveness of Notice by Electronic Mail. Notice given by electronic mail shall be deemed given when directed to an electronic mail address at which the recipient has

consented to receive notice. An affidavit of the secretary or an assistant secretary or of the transfer agent or other agent of the corporation that the notice has been given by electronic mail shall, in the absence of fraud, be prima facie evidence of the facts stated therein. The requirement for notice shall be deemed satisfied, except in the case of a stockholder meeting with respect to which written notice is required by law, if actual notice is received orally or in writing by the person entitled thereto as far in advance of the event with respect to which notice is given as the minimum notice period required by law or these bylaws."

3. Except as set forth above, the Bylaws shall remain in full force and effect

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Exhibit 10.2

ATTACHMENT A
ERI CORP.

2001 STOCK OPTION PLAN

1. **Establishment, Purpose and Term of Plan.**

1.1 ***Establishment.*** The ERI Corp. 2001 Stock Option Plan (the "**Plan**") is hereby established effective as of April 18, 2001 (the "**Effective Date**").

1.2 ***Purpose***. The purpose of the Plan is to advance the interests of ERI Corp. ("ERI" or the "Company") and its stockholders by providing an incentive to attract, retain and reward persons performing services for ERI and by motivating such persons to contribute to the growth and profitability of ERI.

1.3 ***Term of Plan***. The Plan shall continue in effect until the earlier of its termination by the Board or the date on which all of the shares of Stock available for issuance under the Plan have been issued and all restrictions on such shares under the terms of the Plan and the agreements evidencing Options granted under the Plan have lapsed. However, all Options shall be granted, if at all, within ten (10) years from the earlier of the date the Plan is adopted by the Board or the date the Plan is duly approved by the stockholders of the Company.

2. **Definitions and Construction.**

2.1 ***Definitions***. Whenever used herein, the following terms shall have their respective meanings set forth below:

(a) "**Board**" means the Board of Directors of the Company. If one or more Committees have been appointed by the Board to administer the Plan, "Board" also means such Committee(s).

(b) "**Code**" means the Internal Revenue Code of 1986, as amended, and all applicable regulations promulgated thereunder.

(c) "**Committee**" means the Compensation Committee or other committee of the Board duly appointed to administer the Plan and having such powers as shall be specified by the Board. Unless the powers of the Committee have been specifically limited, the Committee shall have all of the powers of the Board granted herein, including, without limitation, the power to amend or terminate the Plan at any time, subject to the terms of the Plan and any applicable limitations imposed by law.

(d) "**Company**" means ERI Corp., a Delaware corporation, or any successor corporation thereto.

(e) "**Consultant**" means any person, including an advisor, engaged by

ERI to render services other than as an Employee or a Director.

(f) "**Director**" means a member of the Board or of the board of directors of any other ERI parent, subsidiary or sister company.

(g) "**Employee**" means any person treated as an employee (including an officer or a Director who is also treated as an employee) in the records of ERI; provided, however, that neither service as a Director nor payment of a director's fee shall be sufficient to constitute employment for purposes of the Plan.

(h) "**Exchange Act**" means the Securities Exchange Act of 1934, as amended.

(i) "**Fair Market Value**" means, as of any date, the value of a share of Stock or other property as determined by the Board, in its sole discretion, or by the Company, in its sole discretion, if such determination is expressly allocated to the Company herein, subject to the following:

(i) If, on such date, there is a public market for the Stock, the Fair Market Value of a share of Stock shall be the closing sale price of a share of Stock (or the mean of the closing bid and asked prices of a share of Stock if the Stock is so quoted instead) as quoted on the Nasdaq National Market, the Nasdaq Small-Cap Market or such other national or regional securities exchange or market system constituting the primary market for the Stock, as reported in the Wall Street Journal or such other source as the Company deems reliable. If the relevant date does not fall on a day on which the Stock has traded on such securities exchange or market system, the date on which the Fair Market Value shall be established shall be the last day on which the Stock was so traded prior to the relevant date, or such other appropriate day as shall be determined by the Board, in its sole discretion.

(ii) If, on such date, there is no public market for the Stock, the Fair Market Value of a share of Stock shall be as determined by the Board without regard to any restriction other than a restriction which, by its terms, will never lapse.

(j) "**Incentive Stock Option**" means an Option intended to be (as set forth in the Option Agreement) and which qualifies as an incentive stock option within the meaning of Section 422(b) of the Code.

(k) "**Insider**" means an Officer or a Director of the Company or any other person whose transactions in Stock are subject to Section 16 of the Exchange Act.

(l) "**Nonstatutory Stock Option**" means an Option not intended to be (as set forth in the Option Agreement) or which does not qualify as an Incentive Stock Option.

(m) "**Option**" means a right to purchase Stock (subject to adjustment as

provided in Section 4.2) pursuant to the terms and conditions of the Plan. An Option may be either an Incentive Stock Option or a Nonstatutory Stock Option.

(n) "**Option Agreement**" means a written agreement between the Company and an Optionee setting forth the terms, conditions and restrictions of the Option granted to the Optionee and any shares acquired upon the exercise thereof.

(o) "**Optionee**" means a person who has been granted one or more Options.

(p) "**Parent Corporation**" means any present or future "parent corporation" of the Company, as denned in Section 424(e) of the Code.

(q) "**Participating Company**" means the Company or any Parent Corporation or Subsidiary Corporation.

(r) "**Participating Company Group**" means, at any point in time, all corporations collectively which are then Participating Companies.

(s) "**Rule 16b-3**" means Rule 16b-3 under the Exchange Act, as amended from time to time, or any successor rule or regulation.

(t) "**Stock**" means the common stock of the Company, as adjusted from time to time in accordance with Section 4.2.

(u) "**Subsidiary Corporation**" means any present or future "subsidiary corporation" of the Company, as defined in Section 424(f) of the Code.

(v) "**Ten Percent Owner Optionee**" means an Optionee who, at the time an Option is granted to the Optionee, owns stock possessing more than ten percent (10%) of the total combined voting power of all classes of stock of a Participating Company within the meaning of Section 422(b)(6) of the Code.

2.2 ***Construction***. Captions and titles contained herein are for convenience only and shall not affect the meaning or interpretation of any provision of the Plan. Except when otherwise indicated by the context, the singular shall include the plural and the plural shall include the singular. Use of the term "or" is not intended to be exclusive, unless the context clearly requires otherwise.

3. **Administration.**

3.1 ***Administration by the Board.*** The Plan shall be administered by the Board. All questions of interpretation of the Plan or of any Option shall be determined by the Board, and such determinations shall be final and binding upon all persons having an interest in the Plan or such Option. Any officer of a Participating Company shall have the authority to act on behalf of the Company in respect of any matter, right, obligation, determination or election which is the responsibility of or which is allocated to the Company herein, provided the officer has apparent authority in respect of such matter, right, obligation, determination or election.

3.2 ***Administration in Respect of Insiders.*** In respect of participation by Insiders in the Plan, at any time that any class of equity security of the Company is registered pursuant to Section 12 of the Exchange Act, the Plan shall be administered in compliance with the requirements, if any, of Rule 16b-3.

3.3 ***Powers of the Board.*** In addition to any other powers set forth in the Plan and subject to the provisions of the Plan, the Board shall have the full and final power and authority, in its sole discretion:

(a) to determine the persons to whom; and the time or times at which, Options shall be granted and the number of shares of Stock to be subject to each Option;

(b) to designate Options as Incentive Stock Options or Nonstatutory Stock Options;

(c) to determine the Fair Market Value of shares of Stock or other property;

(d) to determine the terms, conditions and restrictions applicable to each Option (which need not be identical) and any shares acquired upon the exercise thereof, including, without limitation, (i) the exercise price of the Option, (ii) the method of payment for shares purchased upon the exercise of the Option, (iii) the method for satisfaction of any tax withholding obligation arising in connection with the Option or such shares, including by the withholding or delivery of shares of stock, (iv) the timing, terms and conditions of the exercisability of the Option or the vesting of any shares acquired upon the exercise thereof, (v) the time of the expiration of the Option, (vi) the effect of the Optionee's termination of employment or service with the Participating Company Group on any of the foregoing, and (vii) all other terms, conditions and restrictions applicable to the Option or such shares not inconsistent with the terms of the Plan;

(e) to approve one or more forms of Option Agreement;

(f) to amend, modify, extend, renew, or grant a new Option in substitution for, any Option or to waive any restriction or condition applicable to any Option or

any shares acquired upon the exercise thereof,

(g) to amend the exercisability of any Option or the vesting of any shares acquired upon the exercise thereof, including in respect of the period following an Optionee's termination of employment or service with the Participating Company Group;

(h) to prescribe, amend or rescind rules, guidelines and policies relating to the Plan, or to adopt supplements to, or alternative versions of, the Plan, including, without limitation, as the Board deems necessary or desirable to comply with the laws of, or to accommodate the tax policy or custom of, foreign jurisdictions whose citizens may be granted Options; and

(i) to correct any defect, rectify any omission or reconcile any inconsistency in the Plan or any Option Agreement and to make all other determinations and take such other actions in respect of the Plan or any Option as the Board may deem advisable to the extent consistent with the Plan and applicable law.

4. **Shares Subject to Plan**.

4.1 ***Maximum Number of Shares Issuable***. Subject to adjustment as provided in Section 4.2, the maximum aggregate number of shares of Stock that may be issued under the Plan shall be two and a half million (2,500,000) and shall consist of authorized but unissued or reacquired shares of Stock or any combination thereof. If an outstanding Option for any reason expires or is terminated or canceled, or if shares of Stock acquired, subject to repurchase, upon the exercise of an Option are repurchased by the Company, the shares of Stock allocable to the unexercised portion of such Option or such repurchased shares of Stock shall again be available for issuance under the Plan.

4.2 ***Adjustments for Changes in Capital Structure***. In the event of any stock dividend, stock split, reverse stock split, recapitalization, combination, reclassification or similar change in the capital structure of the Company, appropriate adjustments shall be made in the number and class of shares subject to the Plan and to any outstanding Options and in the exercise price per share of any outstanding Options. If a majority of the shares which are of the same class as the shares that are subject to outstanding Options are exchanged for, converted into, or otherwise become (whether or not pursuant to an Ownership Change Event, as defined in Section 8.1) shares of another corporation (the "**New Shares**"), the Board may unilaterally amend the outstanding Options to provide that such Options are exercisable for New Shares. In the event of any such amendment the number of shares subject to, and the exercise price per share of, the outstanding Options shall be adjusted in a fair and equitable manner as determined by the Board, in its sole discretion. Notwithstanding the foregoing, any fractional share resulting from an adjustment pursuant to this Section 4.2 shall be rounded up or down to the nearest whole number, as determined by the Board, and in no event may the exercise price of any Option be decreased to an amount less than the par value, if any, of the stock subject to the Option. The adjustments determined by the Board pursuant to this Section 4.2 shall be final, binding and conclusive.

5. **Eligibility and Option Limitations.**

5.1 ***Persons Eligible for Options.*** Options may be granted only to Employees, Consultants, and Directors. For purposes of the foregoing sentence, "Employees," "Consultants" and "Directors" shall include prospective Employees, prospective Consultants and prospective Directors to whom Options are granted in connection with written offers of employment or other service relationship with the Participating Company Group. Eligible persons may be granted more than one (1) Option.

5.2 ***Option Grant Restrictions.*** Any person who is not an Employee on the effective date of the grant of an Option to such person may be granted only a Nonstatutory Stock Option. An Incentive Stock Option granted to a prospective Employee upon the condition that such person become an Employee shall be deemed granted effective on the date such person commences service with a Participating Company, with an exercise price determined as of such date in accordance with Section 6.1.

5.3 ***Fair Market Value Limitation.*** To the extent that Options designated as Incentive Stock Options (granted under all stock option, plans of the Participating Company Group, including the Plan) become exercisable by an Optionee for the first time during any calendar year for Stock having an aggregate Fair Market Value greater than One Hundred Thousand Dollars ($100,000), the portion of such Options which exceeds such amount shall be treated as Nonstatutory Stock Options. For purposes of this Section 5.3, Options designated as Incentive Stock Options shall be taken into account in the order in which they were granted, and the Fair Market Value of Stock shall be determined as of the time the Option in respect of such Stock is granted. If the Code is amended to provide for a different limitation from that set forth in this Section 5.3, such different limitation shall be deemed incorporated herein effective as of the date and in respect of such Options as required or permitted by such amendment to the Code. If an Option is treated as an Incentive Stock Option in part and as a Nonstatutory Stock Option in part by reason of the limitation set forth in this Section 5.3, the Optionee may designate which portion of such Option the Optionee is exercising. In the absence of such designation, the Optionee shall be deemed to have exercised the Incentive Stock Option portion of the Option first. Separate certificates representing each such portion shall be issued upon the exercise of the Option.

6. **Terms and Conditions of Options.** Options shall be evidenced by Option Agreements specifying the number of shares of Stock covered thereby, in such form as the Board shall from time to time establish. Option Agreements may incorporate all or any of the terms of the Plan by reference and shall comply with and be subject to the following terms and conditions:

6.1 ***Exercise Price.*** The exercise price for each Option shall be established in the sole discretion of the Board; provided, however, that (a) the exercise price per share for an Incentive Stock Option shall be not less than the Fair Market Value of a share of Stock on the effective date of grant of the Option, (b) the exercise price per share for a Nonstatutory Stock

Option shall be not less than eighty-five percent (85%) of the Fair Market Value of a share of Stock on the effective date of grant of the Option, and (c) no Option granted to a Ten Percent Owner Optionee shall have an exercise price per share less than one hundred ten percent (110%) of the Fair Market Value of a share of Stock on the effective date of grant of the Option. Notwithstanding the foregoing, an Option (whether an Incentive Stock Option or a Nonstatutory Stock Option) may be granted with an exercise price lower than the minimum exercise price set forth above if such Option is granted pursuant to an assumption or substitution for another option in a manner qualifying under the provisions of Section 424(a) of the Code.

6.2 ***Exercise Period.*** Options shall be exercisable at such time or times, or upon such event or events, and subject to such terms, conditions, performance criteria, and restrictions as shall be determined by the Board and set forth in the Option Agreement evidencing such Option; provided, however, that (a) no Option shall be exercisable after the expiration of ten (10) years after the effective date of grant of such Option, (b) no Incentive Stock Option granted to a Ten Percent Owner Optionee shall be exercisable after the expiration of five (5) years after the effective date of grant of such Option, and (c) no Option granted to a prospective Employee, prospective Consultant or prospective Director may become exercisable prior to the date on which such person commences service with a Participating Company.

6.3 ***Payment of Exercise Price.***

(a) **Forms of Consideration Authorized.** Except as otherwise provided below, payment of the exercise price for the number of shares of Stock being purchased pursuant to any Option shall be made (i) in cash by check, or cash equivalent, (ii) by tender to the Company of shares of Stock owned by the Optionee having a Fair Market Value (as determined by the Company without regard to any restrictions on transferability applicable to such stock by reason of federal or state securities laws or agreements with an underwriter for the Company) not less than the exercise price, (iii) by the assignment of the proceeds of a sale or loan in respect of some or all of the shares being acquired upon the exercise of the Option (including, without limitation, through an exercise complying with the provisions of Regulation T as promulgated from time to time by the Board of Governors of the Federal Reserve System) (a "**Cashless Exercise**"), (iv) by the Optionee's promissory note in a form approved by the Company, (v) by such other consideration as may be approved by the Board from time to time to the extent permitted by applicable law, or (vi) by any combination thereof. The Board may at any time or from time to time, by adoption of or by amendment to the standard forms of Option Agreement described in Section 7, or by other means, grant Options which do not permit all of the foregoing forms of consideration to be used in payment of the exercise price or which otherwise restrict one or more forms of consideration.

(b) **Tender of Stock.** Notwithstanding the foregoing, an Option may not be exercised by tender to the Company of shares of Stock to the extent such tender of Stock would constitute a violation of the provisions of any law, regulation or agreement restricting the redemption of the Company's stock. Unless otherwise provided by the Board, an Option may not be exercised by tender to the Company of shares of Stock unless such shares either have been

owned by the Optionee for more than six (6) months or were not acquired directly from the Company.

(c) **Cashless Exercise.** The Company reserves, at any and all times, the right, in the Company's sole and absolute discretion, to establish, decline to approve or terminate any program or procedures for the exercise of Options by means of a Cashless Exercise.

(d) **Payment by Promissory Note.** No promissory note shall be permitted if the exercise of an Option using a promissory note would be a violation of any law. Any permitted promissory note shall be on such terms as the Board shall determine at the time the Option is granted. The Board shall have the authority to permit or require the Optionee to secure any promissory note used to exercise an Option with the shares of Stock acquired upon the exercise of the Option or with other collateral acceptable to the Company. Unless otherwise provided by the Board, if the Company at any time is subject to the regulations promulgated by the Board of Governors of the Federal Reserve System or any other governmental entity affecting the extension of credit in connection with the Company's securities any promissory note shall comply with such applicable regulations, and the Optionee shall pay the unpaid principal and accrued interest, if any, to the extent necessary to comply with such applicable regulations.

6.4 ***Tax Withholding.*** The Company shall have the right, but not the obligation, to deduct from the shares of Stock issuable upon the exercise of an Option, or to accept from the Optionee the tender of a number of whole shares of Stock having a Fair Market Value, as determined by the Company, equal to all or any part of the federal, state, local and foreign taxes, if any, required by law to be withheld by the Participating Company Group in respect of such Option or the shares acquired upon the exercise thereof. Alternatively or in addition, in its sole discretion, the Company shall have the right to require the Optionee, through payroll withholding, cash payment or otherwise, including by means of a Cashless Exercise, to make adequate provision for any such tax withholding obligations of the Participating Company Group arising in connection with the Option or the shares acquired upon the exercise thereof. The Company shall have no obligation to deliver shares of Stock or to release shares of Stock from an escrow established pursuant to the Option Agreement until the Participating Company Group's tax withholding obligations have been satisfied by the Optionee.

6.5 ***Repurchase Rights.*** Shares issued under the Plan may be subject to a right of first refusal, one or more repurchase options, or other conditions and restrictions as determined by the Board, in its sole discretion, at the time the Option is granted. The Company shall have the right to assign at any time any repurchase right it may have, whether or not such right is then exercisable, to one or more persons as may be selected by the Company. Upon request by the Company, each Optionee shall execute any agreement evidencing such transfer restrictions prior to the receipt of shares of Stock hereunder and shall promptly present to the Company any and all certificates representing shares of Stock acquired hereunder for the placement on such certificates of appropriate legends evidencing any such transfer restrictions.

7. **Standard Forms of Option Agreement.**

7.1 ***Incentive Stock Options.*** Unless otherwise provided by the Board at the time the Option is granted, an Option designated as an "Incentive Stock Option" shall comply with and be subject to the terms and conditions set forth in the form of Immediately Exercisable Incentive Stock Option Agreement adopted by the Board concurrently with its adoption of the Plan and as amended from time to time.

7.2 ***Nonstatutory Stock Options.*** Unless otherwise provided by the Board at the time the Option is granted, an Option designated as a "Nonstatutory Stock Option" shall comply with and be subject to the terms and conditions set forth in the form of Immediately Exercisable Nonstatutory Stock Option Agreement adopted by the Board concurrently with its adoption of the Plan and as amended from time to time.

7.3 ***Standard Term of Options.*** Except as otherwise provided in Section 6.2 or by the Board in the grant of an Option, any Option granted hereunder shall have a term of ten (10) years from the effective date of grant of the Option.

7.4 ***Authority to Vary Terms.*** The Board shall have the authority from time to time to vary the terms of any of the standard forms of Option Agreement described in this Section 7 either in connection with the grant or amendment of an individual Option or in connection with the authorization of a new standard form or forms; provided, however, that the terms and conditions of any such new, revised or amended standard form or forms of Option Agreement are not inconsistent with the terms of the Plan. Such authority shall include, but not by way of limitation, the authority to grant Options which are not immediately exercisable.

8. **Transfer of Control.**

8.1 ***Definitions.***

(a) An **"Ownership Change Event"** shall be deemed to have occurred if any of the following occurs in respect of the Company:

(i) the direct or indirect sale or exchange in a single or series of related transactions by the stockholders of the Company of more than fifty percent (50%) of the voting stock of the Company;

(ii) a merger or consolidation in which the Company is a party;

(iii) the sale, exchange, or transfer of all or substantially all of the assets of the Company; or

(iv) a liquidation or dissolution of the Company.

(b) **A "Transfer of Control"** shall mean an Ownership Change Event or a series of related Ownership Change Events (collectively, the "**Transaction**") wherein the stockholders of the Company immediately before the Transaction do not retain immediately after the Transaction, in substantially the same proportions as their ownership of shares of the Company's voting stock immediately before the Transaction, direct or indirect beneficial ownership of more than fifty percent (50%) of the total combined voting power of the outstanding voting stock of the Company or the corporation or corporations to which the assets of the Company were transferred (the "**Transferee Corporation(s)**"), as the case may be. For purposes of the preceding sentence, indirect beneficial ownership shall include, without limitation, an interest resulting from ownership of the voting stock of one or more corporations which, as a result of the Transaction, own the Company or the Transferee Corporation(s), as the case may be, either directly or through one or more subsidiary corporations. The Board shall have the right to determine whether multiple sales or exchanges of the voting stock of the Company or multiple Ownership Change Events are related, and its determination shall be final, binding and conclusive.

8.2 ***Effect of Transfer of Control on Options.*** In the event of a Transfer of Control, the surviving, continuing, successor, or purchasing corporation or parent corporation thereof, as the case may be (the "**Acquiring Corporation**"), must either assume the Company's rights and obligations under outstanding Options or substitute for outstanding Options substantially equivalent options for the Acquiring Corporation's stock. For purposes of this Section 8.2, an Option shall be deemed assumed if, following the Transfer of Control, the Option confers the right to purchase in accordance with its terms and conditions, for each share of Stock subject to the Option immediately prior to the Transfer of Control, the consideration (whether stock, cash or other securities or property) to which a holder of a Share of Stock on the effective date of the Transfer of Control was entitled. Notwithstanding the foregoing, shares acquired upon exercise of an Option prior to the Transfer of Control and any consideration received pursuant to the Transfer of Control in respect of such shares shall continue to be subject to all applicable provisions of the Option Agreement evidencing such Option except as otherwise provided in such Option Agreement. Furthermore, notwithstanding the foregoing, if the corporation the stock of which is subject to the outstanding Options immediately prior to an Ownership Change Event described in Section 8.1(a)(i) constituting a Transfer of Control is the surviving or continuing corporation and immediately after such Ownership Change Event less than fifty percent (50%) of the total combined voting power of its voting stock is held by another corporation or by other corporations that are members of an affiliated group within the meaning of Section 1504(a) of the Code without regard to the provisions of Section 1504(b) of the Code, the outstanding Options shall not terminate unless the Board otherwise provides in its sole discretion.

9. **Provision of Information.** At least annually, copies of the Company's balance sheet and income statement for the just completed fiscal year shall be made available to each Optionee and purchaser of shares of Stock upon the exercise of an Option. The Company shall not be required to provide such information to persons whose duties in connection with the Company assure them access to equivalent information.

10. **Nontransferability of Options.** During the lifetime of the Optionee, an Option shall be exercisable only by the Optionee or the Optionee's guardian or legal representative. No Option shall be assignable or transferable by the Optionee, except by will or by the laws of descent and distribution.

11. **Transfer of Company's Rights.** In the event any Participating Company assigns, other than by operation of law, to a third person, other than another Participating Company, any of the Participating Company's rights to repurchase any shares of Stock acquired upon the exercise of an Option, the assignee shall pay to the assigning Participating Company the value of such right as determined by the Company in the Company's sole discretion. Such consideration shall be paid in cash. In the event such repurchase right is exercisable at the time of such assignment, the value of such right shall be not less than the Fair Market Value of the shares of Stock which may be repurchased under such right (as determined by the Company) minus the repurchase price of such shares. The requirements of this Section 11 regarding the minimum consideration to be received by the assigning Participating Company shall not inure to the benefit of the Optionee whose shares of Stock are being repurchased. Failure of a Participating Company to comply with the provisions of this Section 11 shall not constitute a defense or otherwise prevent the exercise of the repurchase right by the assignee of such right.

12. **Indemnification.** In addition to such other rights of indemnification as they may have as members of the Board or officers or employees of the Participating Company Group, members of the Board and any officers or employees of the Participating Company Group to whom authority to act for the Board or the Company is delegated shall be indemnified by the Company against all reasonable expenses, including attorneys' fees, actually and necessarily incurred in connection with the defense of any action, suit or proceeding, or in connection with any appeal therein, to which they or any of them may be a party by reason of any action taken or failure to act under or in connection with the Plan, or any right granted hereunder, and against all amounts paid by them in settlement thereof (provided such settlement is approved by independent legal counsel selected by the Company) or paid by them in satisfaction of a judgment in any such action, suit or proceeding, except in relation to matters as to which it shall be adjudged in such action, suit or proceeding that such person is liable for gross negligence, bad faith or intentional misconduct in duties; provided, however, that within sixty (60) days after the institution of such action, suit or proceeding, such person shall offer to the Company, in writing, the opportunity at its own expense to handle and defend the same.

13. **Termination or Amendment Plan.** The Board may terminate or amend the Plan at any time. However, subject to changes in applicable law, regulations or rules that would permit otherwise, without the approval of the Company's stockholders there shall be (a) no increase in the maximum aggregate number of shares of Stock that may be issued under the Plan (except by operation of the provisions of Section 4.2), (b) no change in the class of persons eligible to receive Incentive Stock Options, and (c) no other amendment of the Plan that would require approval of the Company's stockholders under any applicable law, regulation or rule. In any event, no termination or amendment of the Plan may adversely affect any then outstanding

Option or any unexercised portion thereof, without the consent of the Optionee, unless such termination or amendment is required to enable an Option designated as an Incentive Stock Option to qualify as an Incentive Stock Option or is necessary to comply with any applicable law, regulation or rule.

14. **Stockholder Approval.** The Plan or any increase in the maximum number of shares of Stock issuable thereunder as provided in Section 4.1 (the **"Maximum Shares"**) shall be approved by the stockholders of the Company within twelve (12) months of the date of adoption thereof by the Board. Options granted prior to stockholder approval of the Plan or in excess of the Maximum Shares previously approved by the stockholders shall become exercisable no earlier than the date of stockholder approval of the Plan or such increase in the Maximum Shares, as the case may be.

IN WITNESS WHEREOF, the undersigned Secretary of the Company certifies that the foregoing ERI CORP. 2001 Stock Option Plan was duly adopted by the Board on April 18, 2001.

Hans Peter MICHELET, Secretary

#674632 vl-ERI 2000 STOCK OPTION PLAN

PLAN HISTORY

Stockholders ratified the Plan and form of Agreement on 18 April 2001.

Directors adopted and approved the Plan and form of Agreement by unanimous resolution on 18 April 2001.

THE SECURITIES WHICH ARE THE SUBJECT OF THIS AGREEMENT HAVE NOT BEEN QUALIFIED WITH THE STATE CORPORATION COMMISSION OF THE COMMONWEALTH OF VIRGINIA AND THE ISSUANCE OF SUCH SECURITIES OR THE PAYMENT OR RECEIPT OF ANY PART OF THE CONSIDERATION THEREFOR PRIOR TO SUCH QUALIFICATION IS UNLAWFUL, UNLESS THE SALE OF SECURITIES IS EXEMPT FROM QUALIFICATION BY THE VIRGINIA SECURITIES ACT, CODE OF VIRGINIA § 13.1 – 501 *ET SEQ*. THE RIGHTS OF ALL PARTIES TO THIS AGREEMENT ARE EXPRESSLY CONDITIONED UPON SUCH QUALIFICATION BEING OBTAINED, UNLESS THE SALE IS SO EXEMPT.

THE SECURITY REPRESENTED BY THIS CERTIFICATE HAS BEEN ACQUIRED FOR INVESTMENT AND NOT WITH A VIEW TO, OR IN CONNECTION WITH, THE SALE OR DISTRIBUTION THEREOF. NO SUCH SALE OR DISPOSITION MAY BE EFFECTED WITHOUT AN EFFECTIVE REGISTRATION STATEMENT RELATED THERETO OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY THAT SUCH REGISTRATION IS NOT REQUIRED UNDER THE SECURITIES ACT OF 1933.

ERI CORP.

IMMEDIATELY EXERCISABLE

INCENTIVE STOCK OPTION AGREEMENT

THIS IMMEDIATELY EXERCISABLE INCENTIVE STOCK OPTION AGREEMENT (the "**Option Agreement**") is made and entered into as of _____ 2001, by and between ERI Corp. ("**ERI**" or the "**Company**") and _____ (the "**Optionee**").

The Company has granted to the Optionee pursuant to the ERI Corp. 2001 Stock Option Plan (the "**Plan**") an option to purchase certain shares of Stock, upon the terms and conditions set forth in this Option Agreement (the "**Option**"). The Option shall in all respects be subject to the terms and conditions of the Plan, the provisions of which are incorporated herein by reference.

1. **Definitions and Construction.**

1.1 ***Definitions*.** Unless otherwise defined herein, capitalized terms shall have the meanings assigned to such terms in the Plan. Whenever used herein, the following terms shall have their respective meanings set forth below:

(a) "**Date of Option Grant**" means _____ 2001.

(b) "**Number of Option Shares**" means _____ (_____) shares of the common stock of the Company (the '**Stock**"), as adjusted from time to time pursuant to Section 9.

(c) "**Exercise Price**" means $ _____ per share of Stock, as adjusted from time to time pursuant to Section 9.

(d) "**Initial Exercise Date**" means the Date of Option Grant.

(e) "**Initial Vesting Date**" is coterminous with the Date of Option Grant, or _____.

(f) "**Vested Ratio**" means, on any relevant date, the ratio determined as follows:

	Vested Ratio
Prior to Initial Vesting Date	0
On Initial Vesting Date, provided the Optionee's Service has not terminated prior to such date	—/—
Plus	
For each full year of the Optionee's continuous Service from the Initial Vesting Date until the Vested Ratio equals 1/1, an additional	—/—

(g) "**Option Expiration Date**" means the date ten (10) years after the Date of Option Grant.

(h) "**Company**" means ERI Corp., a Delaware corporation, or any successor corporation thereto and as that term is defined in the ERI Corp. 2001 Option Plan.

(i) "**Disability**" means the inability of the Optionee, in the opinion of a qualified physician acceptable to the Company, to perform the major duties of the Optionee's position with the Participating Company Group because of the sickness or injury of the Optionee.

(j) "**Securities Act**" means the Securities Act of 1933, as amended.

(k) "**Service**" means the Optionee's employment or service with the Participating Company Group, whether in the capacity of an Employee, a Director or a Consultant. The Optionee's Service shall not be deemed to have terminated merely because of a change in the capacity in which the Optionee renders Service to the Participating Company Group or a change in the Participating Company for which the Optionee renders such Service, provided that there is no interruption or termination of the Optionee's Service. Furthermore, the Optionee's Service with the Participating Company Group shall not be deemed to have terminated if the Optionee takes any military leave, sick leave, or other bona fide leave of absence approved by the Company; provided, however, that if any such leave exceeds ninety (90) days, on the ninety-first (91st) day of such leave the Optionee's Service shall be deemed to have terminated unless the Optionee's right to return to Service with the Participating Company Group is guaranteed by statute or contract. Notwithstanding the foregoing, unless otherwise designated by the Company or required by law, a leave of absence shall not be treated as Service for purposes of determining the Optionee's Vested Ratio. The Optionee's Service shall be deemed to have terminated either upon an actual termination of Service or when the corporation for which the Optionee performs Service ceases to be a Participating Company. Subject to the foregoing, the Company, in its sole discretion, shall determine whether the Optionee's Service has terminated and the effective date of such termination.

1.2 ***Construction*.** Captions and titles contained herein are for convenience only and shall not affect the meaning of interpretation of any provision of this Option Agreement. Except when otherwise indicated by the context, the singular shall include the plural and the plural shall include the singular. Use of the term "or" is not intended to be exclusive, unless the context clearly requires otherwise.

2. **Tax Consequences.**

2.1 ***Tax Status of Option*.** This Option is intended to be an Incentive Stock Option within the meaning of Section 422(b) of the Code, but the Company does not represent or warrant that this Option qualifies as such. The Optionee should consult with the Optionee's own tax advisor regarding the tax effects of this Option and the requirements necessary to obtain favorable income tax treatment under Section 422 of the Code, including, but not limited to, holding period requirements. (NOTE: If the aggregate Exercise Price of the Option (that is, the Exercise Price multiplied by the Number of Option Shares) plus the aggregate exercise price of any other Incentive Stock Options held by the Optionee (whether granted pursuant to the Plan or any other stock option plan of the Participating Company Group) is greater than One Hundred Thousand Dollars ($100,000), the Optionee should contact the President of the Company to ascertain whether the entire Option qualifies as an Incentive Stock Option.)

2.2 ***Election Under Section 83(b) of the Code.*** If the Optionee exercises this Option to purchase shares of Stock that are both nontransferable and subject to a substantial risk of forfeiture, the Optionee understands that the Optionee should consult with the Optionee's tax advisor regarding the advisability of filing with the Internal Revenue Service an election under Section 83(b) of the Code, which must be

filed no later than thirty (30) days after the date on which the Optionee exercises the Option. Shares acquired upon exercise of the Option are nontransferable and subject to a substantial risk of forfeiture if, for example, (a) they are unvested and are subject to a right of the Company to repurchase such shares at the Optionee's original purchase price if the Optionee's Service terminates, (b) the Optionee is an Insider and exercises the Option within six (6) months of the Date of Option Grant (if a class of equity security of the Company is registered under Section 12 of the Exchange Act), or (c) the Optionee is subject to a restriction on transfer to comply with "Pooling-of-Interests Accounting" rules. Failure to file an election under Section 83(b), if appropriate, may result in adverse tax consequences to the Optionee. The Optionee acknowledges that the Optionee has been advised to consult with a tax advisor prior to the exercise of the Option regarding the tax consequences to the Optionee of the exercise of the Option. AN ELECTION UNDER SECTION 83(b) MUST BE FILED WITHIN 30 DAYS AFTER THE DATE ON WHICH THE OPTIONEE PURCHASES SHARES. THIS TIME PERIOD CANNOT BE EXTENDED. THE OPTIONEE ACKNOWLEDGES THAT TIMELY FILING OF A SECTION 83(b) ELECTION IS THE OPTIONEE'S SOLE RESPONSIBILITY, EVEN IF THE OPTIONEE REQUESTS THE COMPANY OR ITS REPRESENTATIVE TO FILE SUCH ELECTION ON HIS OR HER BEHALF.

3. **Administration.** All questions of interpretation concerning this Option Agreement shall be determined by the Board. All determinations by the Board shall be final and binding upon all persons having an interest in the Option. Any officer of a Participating Company shall have the authority to act on behalf of the Company in respect of any matter, right, obligation, or election which is the responsibility of or which is allocated to the Company herein, provided the officer has apparent authority in respect of such matter, right, obligation, or election.

4. **Exercise of the Option.**

4.1 ***Right to Exercise.***

(a) Except as otherwise provided herein, the Option shall be exercisable on and after the Initial Exercise Date and prior to the termination of the Option (as provided in Section 6) in an amount not to exceed the Number of Option Shares less the number of shares previously acquired upon exercise of the Option, subject to the Optionee's agreement that any shares purchased upon exercise are subject to the Company's repurchase rights set forth in Section 11 and Section 12. Notwithstanding the foregoing, except as provided in Section 4.1(b), the aggregate Fair Market Value of the shares of Stock in respect of which the Optionee may exercise the Option for the first time during any calendar year, when added to the aggregate Fair Market Value of the shares subject to any other options designated as Incentive Stock Options granted to the Optionee under all stock option plans of the Participating Company Group prior to the Date of Option Grant in respect of which such options are exercisable for the first time during the same calendar year, shall not exceed One Hundred Thousand Dollars ($100,000). For purposes of the preceding sentence, options designated as Incentive Stock Options shall be taken into account in the order in which they were granted, and the Fair Market Value of shares of stock shall be determined as of the time the option in respect of such shares is granted. Such limitation on exercise shall be referred to in this Option Agreement as the "**ISO Exercise Limitation**" If Section 422 of the Code is amended to provide for a different limitation from that set forth in this Section 4.1(a), the ISO Exercise Limitation shall be deemed amended effective as of the date required or permitted by such amendment to the Code. The ISO Exercise Limitation shall terminate upon the earlier of (i) the Optionee's termination of Service, (ii) the day immediately prior to the effective date of a Transfer of Control in which the Option is not assumed or substituted for by the Acquiring Corporation as provided in Section 8, or (iii) the day ten (10) days prior to the Option Expiration Date. Upon such termination of the ISO Exercise Limitation, the Option shall be deemed a Nonstatutory Stock Option to the extent of the number of shares subject to the Option which would otherwise exceed the ISO Exercise Limitation.

(b) Notwithstanding any other provision of this Option Agreement, if compliance with the ISO Exercise Limitation as set forth in Section 4.1(a) will result in the exercisability of any Vested Shares (as defined in Section 11.2) being delayed more than thirty (30) days beyond the date such shares become Vested Shares (the "**Vesting Date**"), the Option shall be deemed to be two (2) options. The first option shall be for the maximum portion of the Number of Option Shares that can comply with the ISO Exercise Limitation without causing the Option to be unexercisable in the aggregate as to Vested Shares on the Vesting Date for such shares. The second option, which shall not be treated as an Incentive Stock Option as described in section 422(b) of the Code, shall be for the balance of the Number of Option Shares; that is, those such shares which, on the respective Vesting Date for such shares, would be unexercisable if included in the first option and thereby made subject to the ISO Exercise Limitation. Shares treated as subject to the second option shall be exercisable on the same terms and

at the same time as set forth in this Option Agreement; provided, however, that (i) the second sentence of Section 4.1 (a) shall not apply to the second option and (ii) each such share shall become a Vested Share on the Vesting Date on which such share must first be allocated to the second option pursuant to the preceding sentence. Unless the Optionee specifically elects to the contrary in the Optionee's written notice of exercise, the first option shall be deemed to be exercised first to the maximum possible extent and then the second option shall be deemed to be exercised.

4.2 ***Method of Exercise.*** Exercise of the Option shall be by written notice to the Company which must state the election to exercise the Option, the number of whole shares of Stock for which the Option is being exercised and such other representations and agreements as to the Optionee's investment intent in respect of such shares as may be required pursuant to the provisions of this Option Agreement. The written notice must be signed by the Optionee and must be delivered in person, by certified or registered mail, return receipt requested, by confirmed facsimile transmission, or by such other means as the Company may permit, to the President of the Company, or other authorized representative of the Participating Company Group, prior to the termination of the Option as set forth in Section 6, accompanied by (i) full payment of the aggregate Exercise Price for the number of shares of Stock being purchased and (ii) an executed copy, if required herein, of the then current forms of escrow and security agreement referenced below. The Option shall be deemed to be exercised upon receipt by the Company of such written notice, the aggregate Exercise Price, and, if required by the Company, such executed agreements.

4.3 ***Payment of Exercise Price.***

(a) **Forms of Consideration Authorized.** Except as otherwise provided below, payment of the aggregate Exercise Price for the number of shares of Stock for which the Option is being exercised shall be made (i) in cash, by check, or cash equivalent, (ii) by tender to the Company of whole shares of Stock owned by the Optionee having a Fair Market Value (as determined by the Company without regard to any restrictions on transferability applicable to such stock by reason of federal or state securities laws or agreements with an underwriter for the Company) not less than the aggregate Exercise Price, (iii) by means of a Cashless Exercise, as defined in Section 4.3(c), (iv) in the Company's sole discretion at the time the Option is exercised, by cash for a portion of the aggregate Exercise Price not less than the par value of the shares being acquired and the Optionee's promissory note for the balance of the aggregate Exercise Price, or (v) by any combination of the foregoing.

(b) **Tender of Stock.** Notwithstanding the foregoing, the Option may not be exercised by tender to the Company of shares of Stock to the extent such tender of Stock would constitute a violation of the provisions of any law, regulation or agreement restricting the redemption of the Company's stock. The Option may not be exercised by tender to the Company of shares of Stock unless such shares either have been owned by the Optionee for more than six (6) months or were not acquired, directly or indirectly, from the Company.

(c) **Cashless Exercise. A "Cashless Exercise"** means the assignment in a form acceptable to the Company of the proceeds of a sale or loan in respect of some or all of the shares of Stock acquired upon the exercise of the Option pursuant to a program or procedure approved by the Company (including, without limitation, through an exercise complying with the provisions of Regulation T as promulgated from time to time by the Board of Governors of the Federal Reserve System). The Company reserves, at any and all times, the right, in the Company's sole and absolute discretion, to decline to approve or terminate any such program or procedure.

(d) **Payment by Promissory Note.** No promissory note shall be permitted if an exercise of the Option using a promissory note would be a violation of any law. The promissory note permitted in clause (iv) of Section 4.3(a) shall be a full recourse note in a form satisfactory to the Company, with principal payable no more than four (4) years after the date the Option is exercised. Interest on the principal balance of the promissory note shall be payable in annual installments at the minimum interest rate necessary to avoid imputed interest pursuant to all applicable sections of the Code. Such recourse promissory note shall be secured by the shares of Stock acquired pursuant to the then current form of security agreement as approved by the Company. At any time the Company is subject to the regulations promulgated by the Board of Governors of the Federal Reserve System or any other governmental entity affecting the extension of credit in connection with the Company's securities, any promissory note shall comply with such applicable regulations, and the Optionee shall pay the unpaid principal and accrued interest, if any, to the extent necessary to comply with such applicable regulations. Except as the Company in its sole discretion shall determine, the Optionee shall pay the unpaid principal balance of the promissory note and any accrued interest thereon upon termination of the Optionee's Service with the Participating Company Group for any reason, with or without cause.

4.4 ***Tax Withholding.*** At the time the Option is exercised, in whole or in part, or at any time thereafter as requested by the Company, the Optionee hereby authorizes withholding from payroll and any other amounts payable to the Optionee, and otherwise agrees to make adequate provision for (including by means of a Cashless Exercise to the extent permitted by the Company), any sums required to satisfy the federal, state, local and foreign tax withholding obligations of the Participating Company Group, if any, which arise in connection with the Option, including, without limitation, obligations arising upon (i) the exercise, in whole or in part, of the Option, (ii) the transfer, in whole or in part, of any shares acquired upon exercise of the Option, (iii) the operation of any law or regulation providing for the imputation of interest, or (iv) the lapsing of any restriction in respect of any shares acquired upon exercise of the Option. The Optionee is cautioned that the Option is not exercisable unless the tax withholding obligations of the Participating Company Group are satisfied. Accordingly, the Optionee may not be able to exercise the Option when desired even though the Option is vested, and the Company shall have no obligation to issue a certificate for such shares or release such shares from any escrow provided for herein.

4.5 ***Certificate Registration*****.** Except in the event the Exercise Price is paid by means of a Cashless Exercise, the certificate for the shares as to which the Option is exercised shall be registered in the name of the Optionee, or, if applicable, in the names of the heirs of the Optionee.

4.6 ***Restrictions on Grant of the Option and Issuance of Shares.*** The grant of the Option and the issuance of shares of Stock upon exercise of the Option shall be subject to compliance with all applicable requirements of federal, state or foreign law in respect of such securities. The Option may not be exercised if the issuance of shares of Stock upon exercise would constitute a violation of any applicable federal, state or foreign securities laws or other law or regulations or the requirements of any stock exchange or market system upon which the Stock may then be listed. In addition, the Option may not be exercised unless (i) a registration statement under the Securities Act shall at the time of exercise of the Option be in effect in respect of the shares issuable upon exercise of the Option or (ii) in the opinion of legal counsel to the Company, the shares issuable upon exercise of the Option may be issued in accordance with the terms of an applicable exemption from the registration requirements of the Securities Act. THE OPTIONEE IS CAUTIONED THAT THE OPTION MAY NOT BE EXERCISED UNLESS THE FOREGOING CONDITIONS ARE SATISFIED. ACCORDINGLY, THE OPTIONEE MAY NOT BE ABLE TO EXERCISE THE OPTION WHEN DESIRED EVEN THOUGH THE OPTION IS VESTED. Questions concerning this restriction should be directed to the President of the Company. The inability of the Company to obtain from any regulatory body having jurisdiction the authority, if any, deemed by the Company's legal counsel to be necessary to the lawful issuance and sale of any shares subject to the Option shall relieve the Company of any liability in respect of the failure to issue or sell such shares as to which such requisite authority shall not have been obtained. As a condition to the exercise of the Option, the Company may require the Optionee to satisfy any qualifications that may be necessary or appropriate, to evidence compliance with any applicable law or regulation and to make any representation or warranty with respect thereto as may be requested by the Company.

4.7 ***Fractional Shares*****.** The Company shall not be required to issue fractional shares upon the exercise of the Option.

5. **Nontransferability of the Option.** The Option may be exercised during the lifetime of the Optionee only by the Optionee or the Optionee's guardian or legal representative and may not be assigned or transferred in any manner except by will or by the laws of descent and distribution. Following the death of the Optionee, the Option, to the extent provided in Section 7, may be exercised by the Optionee's legal representative or by any person empowered to do so under the deceased Optionee's will or under the then applicable laws of descent and distribution.

6. **Termination of the Option.** The Option shall terminate and may no longer be exercised on the first to occur of (a) the Option Expiration Date, (b) the last

date for exercising the Option following termination of the Optionee's Service as described in Section 7, or (c) a Transfer of Control to the extent provided in Section 8.

7. **Effect of Termination of Service.**

7.1 ***Option Exercisability.***

(a) **Disability.** If the Optionee's Service with the Participating Company Group is terminated because of the Disability of the Optionee, the Option, to the extent unexercised and exercisable on the date on which the Optionee's Service terminated, may be exercised by the Optionee (or the Optionee's guardian or legal representative at any time prior to the expiration of six (6) months after the date on which the Optionee's Service terminated, but in any event no later than the Option Expiration Date. (NOTE: If the Option is exercised more than three (3) months after the date on which the Optionee's Service as an Employee terminated as a result of a Disability other than a permanent and total disability as defined in Section 22(e)(3) of the Code, the Option will be treated as a Nonstatutory Stock Option and not as an Incentive Stock Option to the extent required by Section 422 of the Code.)

(b) **Death.** If the Optionee's Service with the Participating Company Group is terminated because of the death of the Optionee, the Option, to the extent unexercised and exercisable on the date on which the Optionee's Service terminated, may be exercised by the Optionee's legal representative or other person who acquired the right to exercise the Option by reason of the Optionee's death at any time prior to the expiration of six (6) months after the date on which the Optionee's Service terminated, but in any event no later than the Option Expiration Date. The Optionee's Service shall be deemed to have terminated on account of death if the Optionee dies within thirty (30) days after the Optionee's termination of Service.

(c) **Other Termination of Service.** If the Optionee's Service with the Participating Company Group terminates for any reason, except Disability or death, the Option, to the extent unexercised and exercisable by the Optionee on the date on which the Optionee's Service terminated, may be exercised by the Optionee within thirty (30) days (or such other longer period of time as determined by the Board, in its sole discretion) after the date on which the Optionee's Service terminated, but in any event no later than the Option Expiration Date.

7.2 ***Additional Limitations on Option Exercise.*** Notwithstanding the provisions of Section 7.1, the Option may not be exercised after the Optionee's termination of Service to the extent that the shares to be acquired upon exercise of the Option would be subject to the Unvested Share Repurchase Option as provided in Section 11. Except as the Company and the Optionee otherwise agree, exercise of the Option pursuant to Section 7.1 following termination of the Optionee's Service may not be made by delivery of a promissory note as provided in Section 4.3(a).

7.3 ***Extension if Exercise Prevented by Law.*** Notwithstanding the foregoing, if the exercise of the Option within the applicable time periods set forth in Section 7.1 is prevented by the provisions of Section 4.6, the Option shall remain exercisable until three (3) months after the date the Optionee is notified by the Company that the Option is exercisable, but in any event no later than the Option Expiration Date. The Company makes no representation as to the tax consequences of any such delayed exercise. The Optionee should consult with the Optionee's own tax advisor as to the tax consequences to the Optionee of any such delayed exercise.

7.4 ***Extension if Optionee Subject to Section 16(b).*** Notwithstanding the foregoing, if a sale within the applicable time periods set forth in Section 7.1 of shares acquired upon the exercise of the Option would subject the Optionee to suit under Section 16(b) of the Exchange Act, the Option shall remain exercisable until the earliest to occur of (i) the tenth (10th) day following the date on which a sale of such shares by the Optionee would no longer be subject to such suit, (ii) the one hundred and ninetieth (190th) day after the Optionee's termination of Service, or (iii) the Option Expiration Date. The Company makes no representation as to the tax consequences of any such delayed exercise. The Optionee should consult with the Optionee's own tax advisor as to the tax consequences to the Optionee of any such delayed exercise.

8. **Transfer of Control.**

8.1 ***Definitions.***

(a) An "**Ownership Change Event**" shall be deemed to have occurred if any of the following occurs in respect of the Company:

(i) the direct or indirect sale or exchange in a single or series of related transactions by the stockholders of the Company of more than fifty percent (50%) of the voting stock of the Company;

(ii) a merger or consolidation in which the Company is a party;

(iii) the sale, exchange, or transfer of all or substantially all of the assets of the Company; or

(iv) a liquidation or dissolution of the Company.

(b) A "**Transfer of Control**" shall mean an Ownership Change Event or a series of related Ownership Change Events (collectively the "**Transaction**") wherein the stockholders of the Company immediately before the Transaction do not retain immediately after the Transaction, in substantially the same proportions as their ownership of shares of the Company's voting stock immediately before the Transaction, direct or indirect beneficial ownership of more than fifty percent (50%) of the total combined voting power of the outstanding voting stock of the Company or the

corporation or corporations to which the assets of the Company were transferred (the "**Transferee Corporation(s)**"), as the case may be. For purposes of the preceding sentence, indirect beneficial ownership shall include, without limitation, an interest resulting from ownership of the voting stock of one or more corporations which, as a result of the Transaction, own the Company or the Transferee Corporation(s), as the case may be, either directly or through one or more subsidiary corporations. The Board shall have the right to determine whether multiple sales or exchanges of the voting stock of the Company or multiple Ownership Change Events are related, and its determination shall be final, binding and conclusive.

8.2 ***Effect of Transfer of Control on Option.*** In the event of a Transfer of Control, any unvested Stock acquired by the Optionee under the Option shall vest immediately. In respect of any portion of the Option which remains unexercised at the time of Transfer of Control, the surviving, continuing, successor, or purchasing corporation or parent corporation thereof, as the case may be (the "**Acquiring Corporation**"), must either assume the Company's rights and obligations under the Option or substitute for the Option a substantially equivalent option for the Acquiring Corporation's stock. For purposes of this Section 8.2, the Option shall be deemed assumed if, following the Transfer of Control, the Option confers the right to purchase in accordance with its terms and conditions, for each share of Stock subject to the Option immediately prior to the Transfer of Control, the consideration (whether stock, cash or other securities or property) to which a holder of a share of Stock on the effective date of the Transfer of Control was entitled. Notwithstanding the foregoing, shares acquired upon exercise of the Option prior to the Transfer of Control and any consideration received pursuant to the Transfer of Control in respect of such shares shall continue to be subject to all applicable provisions of this Option Agreement except as otherwise provided herein. Furthermore, notwithstanding the foregoing, if the corporation the stock of which is subject to the Option immediately prior to an Ownership Change Event described in Section 8.1(a)(i) constituting a Transfer of Control is the surviving or continuing corporation and immediately after such Ownership Change Event less than fifty percent (50%) of the total combined voting power of its voting stock is held by another corporation or by other corporations that are members of an affiliated group within the meaning of Section 1504(a) of the Code without regard to the provisions of Section 1504(b) of the Code, the Option shall not terminate unless the Board otherwise provides in its sole discretion.

9. **Adjustments for Changes in Capital Structure.** In the event of any stock dividend, stock split, reverse stock split, recapitalization, combination, reclassification, or similar change in the capital structure of the Company, appropriate adjustments shall be made in the number, Exercise Price and class of shares of stock subject to the Option. If a majority of the shares which are of the same class as the shares that are subject to the Option are exchanged for, converted into, or otherwise become (whether or not pursuant to an Ownership Change Event) shares of another corporation (the "**New Shares**"), the Board may unilaterally amend the Option to provide that the Option is exercisable for New Shares. In the event of any such amendment, the Number of Option Shares and the Exercise Price shall be adjusted in a fair and equitable manner,

as determined by the Board, in its sole discretion. Notwithstanding the foregoing, any fractional share resulting from an adjustment pursuant to this Section 9 shall be rounded up or down to the nearest whole number, as determined by the Board, and in no event may the Exercise Price be decreased to an amount less than the par value, if any, of the stock subject to the Option. The adjustments determined by the Board pursuant to this Section 9 shall be final, binding and conclusive.

10. **Rights as a Stockholder Employee or Consultant.** The Optionee shall have no rights as a stockholder in respect of any shares covered by the Option until the date of the issuance of a certificate for the shares for which the Option has been exercised (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company). No adjustment shall be made for dividends, distributions or other rights for which the record date is prior to the date such certificate is issued, except as provided in Section 9. If the Optionee is an Employee, the Optionee understands and acknowledges that, except as otherwise provided in a separate, written employment agreement between a Participating Company and the Optionee, the Optionee's employment is "at will" and is for no specified term. Nothing in this Option Agreement shall confer upon the Optionee, whether an Employee or Consultant, any right to continue in the Service of a Participating Company or interfere in any way with any right of the Participating Company Group to terminate the Optionee's Service as an Employee or Consultant, as the case may be, at any time.

11. **Unvested Share Repurchase Option.**

11.1 ***Grant of Unvested Share Repurchase Option.*** In the event the Optionee's Service with the Participating Company Group is terminated for any reason or no reason, with or without cause, or if the Optionee, the Optionee's legal representative, or other holder of shares acquired upon exercise of the Option attempts to sell, exchange, transfer, pledge, or otherwise dispose of (other than pursuant to an Ownership Change Event) any shares acquired upon exercise of the Option which exceed the Vested Shares as defined in Section 11.2 below (the "**Unvested Shares**"), the Company shall have the right to repurchase the Unvested Shares under the terms and subject to the conditions set forth in this Section 11 (the "**Unvested Share Repurchase Option**").

11.2 ***Vested Shares and Unvested Shares Defined.*** The "**Vested Shares**" shall mean, on any given date, a number of shares of Stock equal to the Number of Option Shares multiplied by the Vested Ratio determined as of such date and rounded down to the nearest whole share. On such given date, the "**Unvested Shares**" shall mean the number of shares of Stock acquired upon exercise of the Option which exceed the Vested Shares determined as of such date.

11.3 ***Exercise of Unvested Share Repurchase Option.*** The Company may exercise the Unvested Share Repurchase Option by written notice to the Optionee within sixty (60) days after (a) termination of the Optionee's Service (or exercise of the Option, if later) or (b) the Company has received notice of the attempted disposition of Unvested Shares. If the Company fails to give notice within such sixty (60) day period,

the Unvested Share Repurchase Option shall terminate unless the Company and the Optionee have extended the time for the exercise of the Unvested Share Repurchase Option. The Unvested Share Repurchase Option must be exercised, if at all, for all of the Unvested Shares, except as the Company and the Optionee otherwise agree.

11.4 ***Payment for Shares and Return of Shares to Company.*** The purchase price per share being repurchased by the Company shall be an amount equal to the Optionee's original cost per share, as adjusted pursuant to Section 9 (the "**Repurchase Price**"). The Company shall pay the aggregate Repurchase Price to the Optionee in cash within thirty (30) days after the date of the written notice to the Optionee of the Company's exercise of the Unvested Share Repurchase Option. For purposes of the foregoing, cancellation of any indebtedness of the Optionee to any Participating Company shall be treated as payment to the Optionee in cash to the extent of the unpaid principal and any accrued interest canceled. The shares being repurchased shall be delivered to the Company by the Optionee at the same time as the delivery of the Repurchase Price to the Optionee.

11.5 ***Assignment of Unvested Share Repurchase Option.*** The Company shall have the right to assign the Unvested Share Repurchase Option at any time, whether or not such option is then exercisable, to one or more persons as may be selected by the Company.

11.6 ***Ownership Change Event.*** Upon the occurrence of an Ownership Change Event, any and all new, substituted or additional securities or other property to which the Optionee is entitled by reason of the Optionee's ownership of Unvested Shares shall be immediately subject to the Unvested Share Repurchase Option and included in the terms "Stock" and "Unvested Shares" for all purposes of the Unvested Share Repurchase Option with the same force and effect as the Unvested Shares immediately prior to the Ownership Change Event. While the aggregate Repurchase Price shall remain the same after such Ownership Change Event, the Repurchase Price per Unvested Share upon exercise of the Unvested Share Repurchase Option following such Ownership Change Event shall be adjusted as appropriate. For purposes of determining the Vested Ratio following an Ownership Change Event, credited Service shall include all Service with any corporation which is a Participating Company at the time the Service is rendered, whether or not such corporation is a Participating Company both before and after the Ownership Change Event.

12. **Right of First Refusal.**

12.1 ***Grant of Right of First Refusal.*** Except as provided in Section 12.7 below, in the event the Optionee, the Optionee's legal representative, or other holder of shares acquired upon exercise of the Option proposes to sell, exchange, transfer, pledge, or otherwise dispose of any Vested Shares (the "**Transfer Shares**") to any person or entity, including, without limitation, any stockholder of the Participating Company Group, the Company shall have the right to repurchase the Transfer Shares under the terms and subject to the conditions set forth in this Section 12 (the "**Right of First Refusal**").

12.2 ***Notice of Proposed Transfer.*** Prior to any proposed transfer of the Transfer Shares, the Optionee shall deliver written notice (the "**Transfer Notice**") to the Company describing fully the proposed transfer, including the number of Transfer Shares, the name and address of the proposed transferee (the "**Proposed Transferee**") and, if the transfer is voluntary, the proposed transfer price, and containing such information necessary to show the bona fide nature of the proposed transfer. In the event of a bona fide gift or involuntary transfer, the proposed transfer price shall be deemed to be the Fair Market Value of the Transfer Shares, as determined by the Board in good faith. If the Optionee proposes to transfer any Transfer Shares to more than one Proposed Transferee, the Optionee shall provide a separate Transfer Notice for the proposed transfer to each Proposed Transferee. The Transfer Notice shall be signed by both the Optionee and the Proposed Transferee and must constitute a binding commitment of the Optionee and the Proposed Transferee for the transfer of the Transfer Shares to the Proposed Transferee subject only to the Right of First Refusal.

12.3 ***Bona Fide Transfer.*** If the Company determines that the information provided by the Optionee in the Transfer Notice is insufficient to establish the bona fide nature of a proposed voluntary transfer, the Company shall give the Optionee written notice of the Optionee's failure to comply with the procedure described in this Section 12, and the Optionee shall have no right to transfer the Transfer Shares without first complying with the procedure described in this Section 12. The Optionee shall not be permitted to transfer the Transfer Shares if the proposed transfer is not bona fide.

12.4 ***Exercise of Right of First Refusal.*** If the Company determines the proposed transfer to be bona fide, the Company shall have the right to purchase all, but not less than all, of the Transfer Shares (except as the Company and the Optionee otherwise agree) at the purchase price and on the terms set forth in the Transfer Notice by delivery to the Optionee of a notice of exercise of the Right of First Refusal within thirty (30) days after the date the Transfer Notice is delivered to the Company. The Company's exercise or failure to exercise the Right of First Refusal in respect of any proposed transfer described in a Transfer Notice shall not affect the Company's right to exercise the Right of First Refusal in respect of any proposed transfer described in any other Transfer Notice, whether or not such other Transfer Notice is issued by the Optionee or issued by a person other than the Optionee in respect of a proposed transfer to the same

Proposed Transferee. If the Company exercises the Right of First Refusal, the Company and the Optionee shall thereupon consummate the sale of the Transfer Shares to the Company on the terms set forth in the Transfer Notice within thirty (30) days after the date the Transfer Notice is delivered to the Company (unless a longer period is offered by the Proposed Transferee); provided, however, that in the event the Transfer Notice provides for the payment for the Transfer Shares other than in cash, the Company shall have the option of paying for the Transfer Shares by the present value cash equivalent of the consideration described in the Transfer Notice as reasonably determined by the Company. For purposes of the foregoing, cancellation of any indebtedness of the Optionee to any Participating Company shall be treated as payment to the Optionee in cash to the extent of the unpaid principal and any accrued interest canceled.

12.5 ***Failure to Exercise Right of First Refusal.*** If the Company fails to exercise the Right of First Refusal in full (or to such lesser extent at the Company and the Optionee otherwise agree) within the period specified in Section 12.4 above, the Optionee may conclude a transfer to the Proposed Transferee of the Transfer Shares on the terms and conditions described in the Transfer Notice, provided such transfer occurs not later than ninety (90) days following delivery to the Company of the Transfer Notice. The Company shall have the right to demand further assurances from the Optionee and the Proposed Transferee (in a form satisfactory to the Company) that the transfer of the Transfer Shares was actually carried out on the terms and conditions described in the Transfer Notice. No Transfer Shares shall be transferred on the books of the Company until the Company has received such assurances, if so demanded, and has approved the proposed transfer as bona fide. Any proposed transfer on terms and conditions different from those described in the Transfer Notice, as well as any subsequent proposed transfer by the Optionee, shall again be subject to the Right of First Refusal and shall require compliance by the Optionee with the procedure described in this Section 12.

12.6 ***Transferees of Transfer Shares.*** All transferees of the Transfer Shares or any interest therein, other than the Company, shall be required as a condition of such transfer to agree in writing (in a form satisfactory to the Company) that such transferee shall receive and hold such Transfer Shares or interest therein subject to all of the terms and conditions of this Option Agreement, including this Section 12 providing for the Right of First Refusal in respect of any subsequent transfer. Any sale or transfer of any shares acquired upon exercise of the Option shall be void unless the provisions of this Section 12 are met.

12.7 ***Transfers Not Subject to Right of First Refusal.*** The Right of First Refusal shall not apply to any transfer or exchange of the shares acquired upon exercise of the Option if such transfer or exchange is in connection with an Ownership Change Event. If the consideration received pursuant to such transfer or exchange consists of stock of a Participating Company, such consideration shall remain subject to the Right of First Refusal unless the provisions of Section 12.9 below result in a termination of the Right of First Refusal.

12.8 ***Assignment of Right of First Refusal.*** The Company shall have the right to assign the Right of First Refusal at any time, whether or not there has been an attempted transfer, to one or more persons as may be selected by the Company.

12.9 ***Early Termination of Right of First Refusal.*** The other provisions of this Option Agreement notwithstanding, the Right of First Refusal shall terminate and be of no further force and effect upon (a) the occurrence of a Transfer of Control, unless the Acquiring Corporation assumes the Company's rights and obligations under the Option or substitutes a substantially equivalent option for the Acquiring Corporation's stock for the Option, or (b) the existence of a public market for the class of shares subject to the Right of First Refusal. A "**public market**" shall be deemed to exist if (i) such stock is listed on a national securities exchange (as that term is used in the Exchange Act) or (ii) such stock is traded on the over-the-counter market and prices therefor are published daily on business days in a recognized financial journal.

13. **Escrow.**

13.1 ***Establishment of Escrow.*** To ensure that shares subject to the Unvested Share Repurchase Option or the Right of First Refusal or securing any promissory note will be available for repurchase, the Company may require the Optionee to deposit the certificate evidencing the shares which the Optionee purchases upon exercise of the Option with an escrow agent designated by the Company under the terms and conditions of escrow and security agreements approved by the Company. If the Company does not require such deposit as a condition of exercise of the Option, the Company reserves the right at any time to require the Optionee to so deposit the certificate in escrow. Upon the occurrence of an Ownership Change Event or a change, as described in Section 9, in the character or amount of any of the outstanding stock of the corporation the stock of which is subject to the provisions of this Option Agreement, any and all new substituted or additional securities or other property to which the Optionee is entitled by reason of the Optionee's ownership of shares of Stock acquired upon exercise of the Option that remain, following such Ownership Change Event or change described in Section 9, subject to the Unvested Share Repurchase Option, the Right of First Refusal or any security interest held by the Company shall be immediately subject to the escrow to the same extent as such shares of Stock immediately before such event. The Company shall bear the expenses of the escrow.

13.2 ***Delivery of Shares to Optionee.*** As soon as practicable after the expiration of the Unvested Share Repurchase Option and the Right of First Refusal and after full repayment of any promissory note secured by the shares or other property in escrow but not more frequently than twice each calendar year, the escrow agent shall deliver to the Optionee the shares and any other property no longer subject to such restrictions and no longer securing any promissory note.

13.3 ***Notices and Payments.*** In the event the shares and any other property held in escrow are subject to the Company's exercise of the Unvested Share Repurchase Option or the Right of First Refusal, the notices required to be given to the

Optionee shall be given to the escrow agent, and any payment required to be given to the Optionee shall be given to the escrow agent. Within thirty (30) days after payment by the Company, the escrow agent shall deliver the shares and any other property which the Company has purchased to the Company and shall deliver the payment received from the Company to the Optionee.

14. **Stock Distributions Subject to Option Agreement.** If, from time to time, there is any stock dividend, stock split or other change, as described in Section 9, in the character or amount of any of the outstanding stock of the corporation the stock of which is subject to the provisions of this Option Agreement, them in such event any and all new, substituted or additional securities to which the Optionee is entitled by reason of the Optionee's ownership of the shares acquired upon exercise of the Option shall be immediately subject to the Unvested Share Repurchase Option, the Right of First Refusal, and any security interest held by the Company with the same force and effect as the shares subject to the Unvested Share Repurchase Option, the Right of First Refusal, and such security interest immediately before such event.

15. **Notice of Sales Upon Disqualifying Disposition.** The Optionee shall dispose of the shares acquired pursuant to the Option only in accordance with the provisions of this Option Agreement. In addition, the Optionee shall promptly notify the President of the Company if the Optionee disposes of any of the shares acquired pursuant to the Option within one (1) year after the date the Optionee exercises all or part of the Option or within two (2) years after the Date of Option Grant and shall provide the Company with a description of the terms and circumstances of such disposition. Until such time as the Optionee disposes of such shares in a manner consistent with the provisions of this Option Agreement, unless otherwise expressly authorized by the Company, the Optionee shall hold all shares acquired pursuant to the Option in the Optionee's name (and not in the name of any nominee) for the one-year period immediately after the exercise of the Option and the two-year period immediately after Date of Option Grant. At any time during the one-year or two-year periods set forth above, the Company may place a legend on any certificate representing shares acquired pursuant to the Option requesting the transfer agent for the Company's stock to notify the Company of any such transfers. The obligation of the Optionee to notify the Company of any such transfer shall continue notwithstanding that a legend has been placed on the certificate pursuant to the preceding sentence.

16. **Legends.** The Company may at any time place legends referencing the Unvested Share Repurchase Option, the Right of First Refusal and any applicable federal, state or foreign securities law restrictions on all certificates representing shares of stock subject to the provisions of this Option Agreement. The Optionee shall, at the request of the Company, promptly present to the Company any and all certificates representing shares acquired pursuant to the Option in the possession of the Optionee in order to carry out the provisions of this Section. Unless otherwise specified by the Company, legends placed on such certificates may include, but shall not be limited to, the following:

16.1 “THE SECURITIES EVIDENCED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND MAY NOT BE SOLD, TRANSFERRED, ASSIGNED OR HYPOTHECATED UNLESS THERE IS AN EFFECTIVE REGISTRATION STATEMENT UNDER SUCH ACT COVERING SUCH SECURITIES, THE SALE IS MADE IN ACCORDANCE WITH RULE 144 OR RULE 701 UNDER THE ACT, OR THE COMPANY RECEIVES AN OPINION OF COUNSEL FOR THE HOLDER OF THESE SECURITIES REASONABLY SATISFACTORY TO THE COMPANY, STATING THAT SUCH SALE, TRANSFER, ASSIGNMENT OR HYPOTHECATION IS EXEMPT FROM THE REGISTRATION AND PROSPECTUS DELIVERY REQUIREMENTS OF SUCH ACT.”

16.2 “THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO AN UNVESTED SHARE REPURCHASE OPTION IN FAVOR OF THE CORPORATION OR ITS ASSIGNEE SET FORTH IN AN AGREEMENT BETWEEN THE CORPORATION AND THE REGISTERED HOLDER, OR SUCH HOLDER’S PREDECESSOR IN INTEREST, A COPY OF WHICH IS ON FILE AT THE PRINCIPAL OFFICE OF THIS CORPORATION.”

16.3 “THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO A RIGHT OF FIRST REFUSAL OPTION IN FAVOR OF THE CORPORATION OR ITS ASSIGNEE SET FORTH IN AN AGREEMENT BETWEEN THE CORPORATION AND THE REGISTERED HOLDER, OR SUCH HOLDER’S PREDECESSOR IN INTEREST, A COPY OF WHICH IS ON FILE AT THE PRINCIPAL OFFICE OF THIS CORPORATION.”

16.4 “THE SHARES EVIDENCED BY THIS CERTIFICATE WERE ISSUED BY THE CORPORATION TO THE REGISTERED HOLDER UPON EXERCISE OF AN INCENTIVE STOCK OPTION AS DEFINED IN SECTION 422 OF THE INTERNAL REVENUE CODE OF 1986, AS AMENDED (“ISO”). IN ORDER TO OBTAIN THE PREFERENTIAL TAX TREATMENT AFFORDED TO ISOs, THE SHARES SHOULD NOT BE TRANSFERRED PRIOR TO ___. SHOULD THE REGISTERED HOLDER ELECT TO TRANSFER ANY OF THE SHARES PRIOR TO THIS DATE AND FOREGO ISO TAX TREATMENT, THE TRANSFER AGENT FOR THE SHARES SHALL NOTIFY THE CORPORATION IMMEDIATELY. THE REGISTERED HOLDER SHALL HOLD ALL SHARES PURCHASED UNDER THE INCENTIVE STOCK OPTION IN THE REGISTERED HOLDER’S NAME (AND NOT IN THE NAME OF ANY NOMINEE) PRIOR TO THIS DATE OR UNTIL TRANSFERRED AS DESCRIBED ABOVE.”

17. **Public Offering.** The Optionee hereby agrees that in the event of any underwritten public offering of stock, including an initial public offering of stock, made by the Company pursuant to an effective registration statement filed under the Securities Act, the Optionee shall not offer, sell, contract to sell, pledge, hypothecate, grant any option to purchase or make any short sale of, or otherwise dispose of any shares of stock of the Company or any rights to acquire stock of the Company for such period of time

from and after the effective date of such registration statement as may be established by the underwriter for such public offering; provided, however, that such period of time shall not exceed one hundred eighty (180) days from the effective date of the registration statement to be filed in connection with such public offering. The foregoing limitation shall not apply to shares registered in the public offering under the Securities Act. The Optionee shall be subject to this Section provided and only if the officers and directors of the Company are also subject to similar arrangements.

18. **Restrictions on Transfer of Shares.** No shares acquired upon exercise of the Option may be sold, exchanged, transferred (including, without limitation, any transfer to a nominee or agent of the Optionee), assigned, pledged, hypothecated or otherwise disposed of, including by operation of law, in any manner which violates any of the provisions of this Option Agreement and, except pursuant to an Ownership Change, until the date on which such shares become Vested Shares, and any such attempted disposition shall be void. The Company shall not be required (a) to transfer on its books any shares which will have been transferred in violation of any of the provisions set forth in this Option Agreement or (b) to treat as owner of such shares or to accord the right to vote as such owner or to pay dividends to any transferee to whom such shares will have been so transferred.

19. **Binding Effect.** Subject to the restrictions on transfer set forth herein, this Option Agreement shall inure to the benefit of and be binding upon the parties hereto and their respective heirs, executors, administrators, successors and assigns.

20. **Termination or Amendment.** The Board may terminate or amend the Plan or the Option at any time; provided, however, that except as provided in Section 8.2 in connection with a Transfer of Control, no such termination or amendment may adversely affect the Option or any unexercised portion hereof without the consent of the Optionee unless such termination or amendment is necessary to comply with any applicable law or government regulation or is required to enable the Option to qualify as an Incentive Stock Option. No amendment or addition to this Option Agreement shall be effective unless in writing.

21. **Notices.** Any notice required or permitted hereunder shall be given in writing and shall be deemed effectively given (except to the extent that this Option Agreement provides for effectiveness only upon actual receipt of such notice) upon personal delivery or upon deposit in the United States Post Office, by registered or certified mail, with postage and fees prepaid, addressed to the other party at the address shown below that party's signature or at such other address as such party may designate in writing from time to time to the other party.

22. **Integrated Agreement.** This Option Agreement and the Plan constitute the entire understanding and agreement of the Optionee and the Participating Company Group in respect of the subject matter contained herein or therein, and there are no agreements understandings, restrictions, representations, or warranties among the Optionee and the Participating Company Group in respect of such subject matter other

than those as set forth or provided for herein or therein. To the extent contemplated herein or therein, the provisions of this Option Agreement shall survive any exercise of the Option and shall remain in full force and effect.

23. **Applicable Law.** This Option Agreement shall be governed by the laws of the State of Virginia as such laws are applied to agreements between Virginia residents entered into and to be performed entirely within the State of Virginia.

ERI CORP.

By: _____

Title: _____

Address : 1908 Doolittle Drive
San Leandro, CA 94577

The Optionee represents that the Optionee is familiar with the terms and provisions of this Option Agreement, including the Unvested Share Repurchase Option set forth in Section 11 and the Right of First Refusal set forth in Section 12 and hereby accepts the Option subject to all of the terms and provisions thereof. The Optionee hereby agrees to accept as binding, conclusive and final all decisions or interpretations of the Board upon any questions arising under this Option Agreement. The undersigned acknowledges receipt of a copy of the Plan.

OPTIONEE

Date: _____ _____

Optionee Address:

Exhibit 10.3

ERI CORP.
2002 STOCK OPTION/STOCK ISSUANCE PLAN

ARTICLE ONE
GENERAL PROVISIONS

I. PURPOSE OF THE PLAN

This 2002 Stock Option/Stock Issuance Plan is intended to promote the interests of ERI Corp., a Delaware corporation, by providing eligible persons in the Corporation's employ or service with the opportunity to acquire a proprietary interest, or otherwise, increase their proprietary interest, in the Corporation as an incentive for them to continue in such employ or service.

Capitalized terms herein shall have the meanings assigned to such terms in the attached Appendix.

II. STRUCTURE OF THE PLAN

A. The Plan shall be divided into two (2) separate equity programs:

(i) the Option Grant Program under which eligible persons may, at the discretion of the Plan Administrator, be granted options to purchase shares of Common Stock, and

(ii) the Stock Issuance Program under which eligible persons may, at the discretion of the Plan Administrator, be issued shares of Common Stock directly, either through the immediate purchase of such shares or as a bonus for services rendered the Corporation (or any Parent or Subsidiary).

B. The provisions of Articles One and Four shall apply to both equity programs under the Plan and shall accordingly govern the interests of all persons under the Plan.

III. ADMINISTRATION OF THE PLAN

A. The Plan shall be administered by the Board. However, any or all administrative functions otherwise exercisable by the Board may be delegated to the Committee. Members of the Committee shall serve for such period of time as the Board may determine and shall be subject to removal by the Board at any time. The Board may also at any time terminate the functions of the Committee and reassume all powers and authority previously delegated to the Committee.

B. The Plan Administrator shall have full power and authority (subject to the provisions of the Plan) to establish such rules and regulations as it may deem appropriate for proper administration of the Plan and to make such determinations under, and issue such interpretations of, the Plan and any outstanding options or stock issuances thereunder as it may deem necessary or advisable. Decisions of the Plan Administrator shall be final and binding on all parties who have an interest in the Plan or any option or stock issuance thereunder.

IV. ELIGIBILITY

A. The persons eligible to participate in the Plan are as follows:

(i) Employees,

(ii) non-employee members of the Board or the non-employee members of the board of directors of any Parent or Subsidiary, and

(iii) consultants and other independent advisors who provide services to the Corporation (or any Parent or Subsidiary).

B. The Plan Administrator shall have full authority to determine, (i) in respect of the grants under the Option Grant Program, which eligible persons are to receive the option grants, the time or times when those grants are to be made, the number of shares to be covered by each such grant, the status of the granted option as either an Incentive Option or a Non-Statutory Option, the time or times when each option is to become exercisable, the vesting schedule (if any) applicable to the option shares and the maximum term for which the option is to remain outstanding, and (ii) in respect of stock issuances under the Stock Issuance Program, which eligible persons are to receive stock issuances, the time or times when those issuances are to be made, the number of shares to be issued to each Participant, the vesting schedule (if any) applicable to the issued shares and the consideration to be paid by the Participant for such shares.

C. The Plan Administrator shall have the absolute discretion either to grant options in accordance with the Option Grant Program or to effect stock issuances in accordance with the Stock Issuance Program.

V. STOCK SUBJECT TO THE PLAN

A. The stock issuable under the Plan shall be shares of authorized but unissued or reacquired Common Stock. The maximum number of shares of Common Stock which may be issued over the term of the Plan shall not exceed one million five hundred thousand (1,500,000) shares.

B. Shares of Common Stock subject to outstanding options shall be available for subsequent issuance under the Plan to the extent (i) the options expire or terminate for any reason prior to exercise in full or (ii) the options are cancelled in accordance with the cancellation-regrant provisions of Article Two. Unvested shares issued under the Plan and subsequently repurchased by the Corporation, at the option exercise or direct issue price paid per share, pursuant to the Corporation's repurchase rights under the Plan shall be added back to the number of shares of Common Stock reserved for issuance under the Plan and shall accordingly be available for reissuance through one or more subsequent option grants or direct stock issuances under the Plan.

C. Should any change be made to the Common Stock by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration, appropriate adjustments shall be made to (i) the maximum number and/or class of

securities issuable under the Plan and (ii) the number and/or class of securities and the exercise price per share in effect under each outstanding option in order to prevent the dilution or enlargement of benefits thereunder. The adjustments determined by the Plan Administrator shall be final, binding and conclusive. In no event shall any such adjustments be made in connection with the conversion of one or more outstanding shares of the Corporation's preferred stock into shares of Common Stock.

ARTICLE TWO
OPTION GRANT PROGRAM

I. OPTION TERMS

Each option shall be evidenced by one or more documents in the form approved by the Plan Administrator; provided, however, that each such document shall comply with the terms specified below. Each document evidencing an Incentive Option shall, in addition, be subject to the provisions of the Plan applicable to such options.

A. **Exercise Price**.

1. The exercise price per share shall be fixed by the Plan Administrator in accordance with the following provisions:

(i) The exercise price per share shall not be less than eighty-five percent (85%) of the Fair Market Value per share of Common Stock on the option grant date.

(ii) If the person to whom the option is granted is a 10% Stockholder, then the exercise price per share shall not be less than one hundred ten percent (110%) of the Fair Market Value per share of Common Stock on the option grant date.

2. The exercise price shall become immediately due upon exercise of the option and shall, subject to the provisions of Section I of Article Four and the documents evidencing the option, be payable in cash or check made payable to the Corporation. Should the Common Stock be registered under Section 12 of the 1934 Act at the time the option is exercised, then the exercise price may also be paid as follows:

(i) in shares of Common Stock held for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at Fair Market Value on the Exercise Date, or

(ii) to the extent the option is exercised for vested shares, through a special sale and remittance procedure pursuant to which the Optionee shall concurrently provide irrevocable instructions (A) to a Corporation-designated brokerage firm to effect the immediate sale of the purchased shares and remit to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate exercise price payable for the purchased shares plus all applicable Federal, state and local income and employment taxes required to be withheld by the Corporation by reason of such exercise and (B) to the Corporation to deliver the certificates for the purchased shares directly to such brokerage firm in order to complete the sale.

Except to the extent such sale and remittance procedure is utilized, payment of the exercise price for the purchased shares must be made on the Exercise Date.

B. **Exercise and Term of Options**. Each option shall be exercisable at such time or times, during such period and for such number of shares as shall be determined by the Plan Administrator and set forth in the documents evidencing the option grant. However, no option shall have a term in excess of ten (10) years measured from the option grant date.

C. **Effect of Termination of Service**.

1. The following provisions shall govern the exercise of any options held by the Optionee at the time of cessation of Service or death:

(i) Should the Optionee cease to remain in Service for any reason other than death, Disability or Misconduct, then the Optionee shall have a period of one (1) month following the date of such cessation of Service during which to exercise each outstanding option held by such Optionee.

(ii) Should Optionee's Service terminate by reason of Disability, then the Optionee shall have a period of twelve (12) months following the date of such cessation of Service during which to exercise each outstanding option held by such Optionee.

(iii) If the Optionee dies while holding an outstanding option, then the personal representative of his or her estate or the person or persons to whom the option is transferred pursuant to the Optionee's will or the laws of inheritance shall have a twelve (12)-month period following the date of the Optionee's death to exercise such option.

(iv) Under no circumstances, however, shall any such option be exercisable after the specified expiration of the option term.

(v) During the applicable post-Service exercise period, the option may not be exercised in the aggregate for more than the number of vested shares for which the option is exercisable on the date of the Optionee's cessation of Service. Upon the expiration of the applicable exercise period or (if earlier) upon the expiration of the option term, the option shall terminate and cease to be outstanding for any vested shares for which the option has not been exercised. However, the option shall, immediately upon the Optionee's cessation of Service, terminate and cease to be outstanding in respect of any and all option shares for which the option is not otherwise at the time exercisable or in which the Optionee is not otherwise at that time vested.

(vi) Should Optionee's Service be terminated for Misconduct, then all outstanding options held by the Optionee shall terminate immediately and cease to remain outstanding.

2. The Plan Administrator shall have the discretion, exercisable either at the time an option is granted or at any time while the option remains outstanding, to:

(i) extend the period of time for which the option is to remain exercisable following Optionee's cessation of Service or death from the limited period otherwise in effect for that option to such greater period of time as the Plan Administrator shall deem appropriate, but in no event beyond the expiration of the option term, and/or

(ii) permit the option to be exercised, during the applicable post-Service exercise period, not only in respect of the number of vested shares of Common Stock for which such option is exercisable at the time of the Optionee's cessation of Service but also in respect of one or more additional installments in which the Optionee would have vested under the option had the Optionee continued in Service.

D. **Stockholder Rights**. The holder of an option shall have no stockholder rights in respect of the shares subject to the option until such person shall have exercised the option, paid the exercise price and become the recordholder of the purchased shares.

E. **Unvested Shares**. The Plan Administrator shall have the discretion to grant options which are exercisable for unvested shares of Common Stock. Should the Optionee cease Service while holding such unvested shares, the Corporation shall have the right to repurchase, at the exercise price paid per share, any or all of those unvested shares. The terms upon which such repurchase right shall be exercisable (including the period and procedure for exercise and the appropriate vesting schedule for the purchased shares) shall be established by the Plan Administrator and set forth in the document evidencing such repurchase right. The Plan Administrator may not impose a vesting schedule upon the option grant or any shares of Common Stock subject to that option which is more restrictive than twenty percent (20%) per year vesting, with the initial vesting to occur not later than one (1) year after the option grant date. However, such limitation shall not be applicable to any option grants made to individuals who are officers of the Corporation, non-employee Board members or independent consultants.

F. **First Refusal Rights**. Until such time as the Common Stock is first registered under Section 12 of the 1934 Act, the Corporation shall have the right of first refusal in respect of any proposed disposition by the Optionee (or any successor in interest) of any shares of Common Stock issued under the Plan. Such right of first refusal shall be exercisable in accordance with the terms established by the Plan Administrator and set forth in the document evidencing such right.

G. **Limited Transferability of Options**. During the lifetime of the Optionee, the option shall be exercisable only by the Optionee and shall not be assignable or transferable other than by will or by the laws of descent and distribution following the Optionee's death.

H. **Withholding**. The Corporation's obligation to deliver shares of Common Stock upon the exercise of any options granted under the Plan shall be subject to the satisfaction of all applicable Federal, state and local income and employment tax withholding requirements.

II. INCENTIVE OPTIONS

The terms specified below shall be applicable to all Incentive Options. Except as modified by the provisions of this Section II, all the provisions of the Plan shall be applicable to Incentive Options. Options which are specifically designated as Non-Statutory Options shall not be subject to the terms of this Section II.

A. **Eligibility**. Incentive Options may only be granted to Employees.

B. **Exercise Price**. The exercise price per share shall not be less than one hundred percent (100%) of the Fair Market Value per share of Common Stock on the option grant date.

C. **Dollar Limitation**. The aggregate Fair Market Value of the shares of Common Stock (determined as of the respective date or dates of grant) for which one or more options granted to any Employee under the Plan (or any other option plan of the Corporation or any Parent or Subsidiary) may for the first time become exercisable as Incentive Options during any one (1) calendar year shall not exceed the sum of One Hundred Thousand Dollars ($100,000). To the extent the Employee holds two (2) or more such options which become exercisable for the first time in the same calendar year, the foregoing limitation on the exercisability of such options as Incentive Options shall be applied on the basis of the order in which such options are granted.

D. **10% Stockholder**. If any Employee to whom an Incentive Option is granted is a 10% Stockholder, then the option term shall not exceed five (5) years measured from the option grant date.

III. CORPORATE TRANSACTION

A. The shares subject to each option outstanding under the Plan at the time of a Corporate Transaction shall automatically vest in full so that each such option shall, immediately prior to the effective date of the Corporate Transaction, become fully exercisable for all of the shares of Common Stock at the time subject to that option and may be exercised for any or all of those shares as fully-vested shares of Common Stock. However, the shares subject to an outstanding option shall not vest on such an accelerated basis if and to the extent: (i) such option is assumed by the successor corporation (or parent thereof) in the Corporate Transaction and the Corporation's repurchase rights in respect of the unvested option shares are concurrently assigned to such successor corporation (or parent thereof) or (ii) such option is to be replaced with a cash incentive program of the successor corporation which preserves the spread existing on the unvested option shares at the time of the Corporate Transaction and provides for subsequent payout in accordance with the same vesting schedule applicable to those unvested option shares or (iii) the acceleration of such option is subject to other limitations imposed by the Plan Administrator at the time of the option grant.

B. All outstanding repurchase rights shall also terminate automatically, and the shares of Common Stock subject to those terminated rights shall immediately vest in full, in the event of any Corporate Transaction, except to the extent: (i) those repurchase rights are assigned to the successor corporation (or parent thereof) in connection with such Corporate

Transaction or (ii) such accelerated vesting is precluded by other limitations imposed by the Plan Administrator at the time the repurchase right is issued.

C. Immediately following the consummation of the Corporate Transaction, all outstanding options shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation (or parent thereof).

D. Each option which is assumed in connection with a Corporate Transaction shall be appropriately adjusted, immediately after such Corporate Transaction to apply to the number and class of securities which would have been issuable to the Optionee in consummation of such Corporate Transaction, had the option been exercised immediately prior to such Corporate Transaction. Appropriate adjustments shall also be made to (i) the number and class of securities available for issuance under the Plan following the consummation of such Corporate Transaction and (ii) the exercise price payable per share under each outstanding option, provided the aggregate exercise price payable for such securities shall remain the same.

E. The Plan Administrator shall have the discretion exercisable either at the time the option is granted or at any time while the option remains outstanding, to provide for the automatic acceleration (in whole or in part) of one or more outstanding options (and the immediate termination of the Corporation's repurchase rights in respect of the share subject to those options) upon the occurrence of a Corporate Transaction, whether or not those options are to be assumed in the Corporate Transaction.

F. The Plan Administrator shall also have full power and authority, exercisable either at the time the option is granted or at any time while the option remains outstanding, to structure such option so that the shares subject to that option will automatically vest on an accelerated basis should the Optionee's Service terminate by reason of an Involuntary Termination within a designated period (not to exceed eighteen (18) months) following the effective date of any Corporate Transaction in which the option is assumed and the repurchase rights applicable to those shares do not otherwise terminate. Any option so accelerated shall remain exercisable for the fully-vested option shares until the earlier of (i) the expiration of the option term or (ii) the expiration of the one (l)-year period measured from the effective date of the Involuntary Termination. In addition, the Plan Administrator may provide that one or more of the Corporation's outstanding repurchase rights in respect of shares held by the Optionee at the time of such Involuntary Termination shall immediately terminate on an accelerated basis, and the shares subject to those terminated rights shall accordingly vest at that time.

G. The portion of any Incentive Option accelerated in connection with a Corporate Transaction shall remain exercisable as an Incentive Option only to the extent the applicable One Hundred Thousand Dollar limitation is not exceeded. To the extent such dollar limitation is exceeded the accelerated portion of such option shall be exercisable as a Non-Statutory Option under the Federal tax laws.

H. The grant of options under the Plan shall in no way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

IV. CANCELLATION AND REGRANT OF OPTIONS

The Plan Administrator shall have the authority to effect, at any time and from time to time, with the consent of the affected option holders, the cancellation of any or all outstanding options under the Plan and to grant in substitution therefor new options covering the same or different number of shares of Common Stock but with an exercise price per share based on the Fair Market Value per share of Common Stock on the new option grant date.

ARTICLE THREE
STOCK ISSUANCE PROGRAM

I. STOCK ISSUANCE TERMS

Shares of Common Stock may be issued under the Stock Issuance Program through direct and immediate issuances without any intervening option grants. Each such stock issuance shall be evidenced by a Stock Issuance Agreement which complies with the terms specified below.

A. **Purchase Price.**

1. The purchase price per share shall be fixed by the Plan Administrator but shall not be less than eighty-five percent (85%) of the Fair Market Value per share of Common Stock on the issue date. However, the purchase price per share of Common Stock issued to a 10% Stockholder shall not be less than one hundred and ten percent (110%) of such Fair Market Value.

2. Subject to the provisions of Section I of Article Four, shares of Common Stock may be issued under the Stock Issuance Program for any of the following items of consideration which the Plan Administrator may deem appropriate in each individual instance:

(i) cash or check made payable to the Corporation, or

(ii) past services rendered to the Corporation (or any Parent or Subsidiary).

B. **Vesting Provisions.**

1. Shares of Common Stock issued under the Stock Issuance Program may, in the discretion of the Plan Administrator, be fully and immediately vested upon issuance or may vest in one or more installments over the Participant's period of Service or upon attainment of specified performance objectives. However, the Plan Administrator may not impose a vesting schedule upon any stock issuance effected under the Stock Issuance Program which is more restrictive than twenty percent (20%) per year vesting, with initial vesting to occur not later than one (1) year after the issuance date. Such limitation shall not apply to any Common Stock issuances made to the officers of the Corporation, non-employee Board members or independent consultants.

2. Any new, substituted or additional securities or other property (including money paid other than as a regular cash dividend) which the Participant may have the right to receive in respect of the Participant's unvested shares of Common Stock by reason of any stock dividend, stock split, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration shall be issued subject to (i) the same vesting requirements applicable to the Participant's unvested shares of Common Stock and (ii) such escrow arrangements as the Plan Administrator shall deem appropriate.

3. The Participant shall have full stockholder rights in respect of any shares of Common Stock issued to the Participant under the Stock Issuance Program, whether or not the Participant's interest in those shares is vested. Accordingly, the Participant shall have the right to vote such shares and to receive any regular cash dividends paid on such shares.

4. Should the Participant cease to remain in Service while holding one or more unvested shares of Common Stock issued under the Stock Issuance Program or should the performance objectives not be attained in respect of one or more such unvested shares of Common Stock, then those shares shall be immediately surrendered to the Corporation for cancellation and the Participant shall have no further stockholder rights in respect of those shares. To the extent the surrendered shares were previously issued to the Participant for consideration paid in cash or cash equivalent (including the Participant's purchase-money indebtedness), the Corporation shall repay to the Participant the cash consideration paid for the surrendered shares and shall cancel the unpaid principal balance of any outstanding purchase-money note of the Participant attributable to such surrendered shares.

5. The Plan Administrator may in its discretion waive the surrender and cancellation of one or more unvested shares of Common Stock (or other assets attributable thereto) which would otherwise occur upon the non-completion of the vesting schedule applicable to such shares. Such waiver shall result in the immediate vesting of the Participant's interest in the shares of Common Stock as to which the waiver applies. Such waiver may be effected at any time, whether before or after the Participant's cessation of Service or the attainment or non-attainment of the applicable performance objectives.

C. **First Refusal Rights**. Until such time as the Common Stock is first registered under Section 12 of the 1934 Act, the Corporation shall have the right of first refusal in respect of any proposed disposition by the Participant (or any successor in interest) of any shares of Common Stock issued under the Stock Issuance Program. Such right of first refusal shall be exercisable in accordance with the terms established by the Plan Administrator and set forth in the document evidencing such right.

II. CORPORATE TRANSACTION

A. Upon the occurrence of a Corporate Transaction, all outstanding repurchase rights under the Stock Issuance Program shall terminate automatically, and the shares of Common Stock subject to those terminated rights shall immediately vest in full, except to the extent: (i) those repurchase rights are assigned to the successor corporation (or parent thereof) in connection with such Corporate Transaction or (ii) such accelerated vesting is precluded by other limitations imposed by the Plan Administrator at the time the repurchase right is issued.

B. The Plan Administrator shall have the discretionary authority, exercisable either at the time the unvested shares are issued or any time while the Corporation's repurchase rights in respect of those shares remain outstanding, to provide that those rights shall automatically terminate on an accelerated basis, and the shares of Common Stock subject to those terminated rights shall immediately vest, in the event the Participant's Service should subsequently terminate by reason of an Involuntary Termination within a designated period (not

to exceed eighteen (18) months) following the effective date of any Corporate Transaction in which those repurchase rights are assigned to the successor corporation (or parent thereof).

III. SHARE ESCROW/LEGENDS

Unvested shares may, in the Plan Administrator's discretion, be held in escrow by the Corporation until the Participant's interest in such shares vests or may be issued directly to the Participant with restrictive legends on the certificates evidencing those unvested shares.

ARTICLE FOUR
MISCELLANEOUS

I. FINANCING

The Plan Administrator may permit any Optionee or Participant to pay the option exercise price or the purchase price for shares issued to such person under the Plan by delivering a full-recourse, interest-bearing promissory note payable in one or more installments and secured by the purchased shares. However, any promissory note delivered by a consultant must be secured by collateral in addition to the purchased shares of Common Stock. In no event shall the maximum credit available to the Optionee or Participant exceed the sum of (i) the aggregate option exercise price or purchase price payable for the purchased shares plus (ii) any Federal, state and local income and employment tax liability incurred by the Optionee or the Participant in connection with the option exercise or share purchase.

II. EFFECTIVE DATE AND TERM OF PLAN

A. The Plan shall become effective when adopted by the Board, but no option granted under the Plan may be exercised, and no shares shall be issued under the Plan, until the Plan is approved by the Corporation's stockholders. If such stockholder approval is not obtained within twelve (12) months after the date of the Board's adoption of the Plan, then all options previously granted under the Plan shall terminate and cease to be outstanding, and no further options shall be granted and no shares shall be issued under the Plan. Subject to such limitation, the Plan Administrator may grant options and issue shares under the Plan at any time after the effective date of the Plan and before the date fixed herein for termination of the Plan.

B. The Plan shall terminate upon the earliest of (i) the expiration of the ten (10)-year period measured from the date the Plan is adopted by the Board, (ii) the date on which all shares available for issuance under the Plan shall have been issued as vested shares or (iii) the termination of all outstanding options in connection with a Corporate Transaction. All options and unvested stock issuances outstanding at that time under the Plan shall continue to have full force and effect in accordance with the provisions of the documents evidencing such options or issuances.

III. AMENDMENT OF THE PLAN

A. The Board shall have complete and exclusive power and authority to amend or modify the Plan in any or all respects. However, no such amendment or modification shall adversely affect the rights and obligations in respect of options or unvested stock issuances at the time outstanding under the Plan unless the Optionee or the Participant consents to such amendment or modification. In addition, certain amendments may require stockholder approval pursuant to applicable laws and regulations.

B. Options may be granted under the Option Grant Program and shares may be issued under the Stock Issuance Program which are in each instance in excess of the number of shares of Common Stock then available for issuance under the Plan, provided any excess shares actually issued under those programs shall be held in escrow until there is obtained stockholder approval of an amendment sufficiently increasing the number of shares of Common

Stock available for issuance under the Plan. If such stockholder approval is not obtained within twelve (12) months after the date the first such excess issuances are made, then (i) any unexercised options granted on the basis of such excess shares shall terminate and cease to be outstanding and (ii) the Corporation shall promptly refund to the Optionees and the Participants the exercise or purchase price paid for any excess shares issued under the Plan and held in escrow, together with interest (at the applicable Short Term Federal Rate) for the period the shares were held in escrow, and such shares shall thereupon be automatically cancelled and cease to be outstanding.

IV. USE OF PROCEEDS

Any cash proceeds received by the Corporation from the sale of shares of Common Stock under the Plan shall be used for general corporate purposes.

V. WITHHOLDING

The Corporation's obligation to deliver shares of Common Stock upon the exercise of any options or upon the issuance or vesting of any shares issued under the Plan shall be subject to the satisfaction of all applicable Federal, state and local income and employment tax withholding requirements.

VI. REGULATORY APPROVALS

The implementation of the Plan, the granting of any options under the Plan and the issuance of any shares of Common Stock (i) upon the exercise of any option or (ii) under the Stock Issuance Program shall be subject to the Corporation's procurement of all approvals and permits required by regulatory authorities having jurisdiction over the Plan, the options granted under it and the shares of Common Stock issued pursuant to it.

VII. NO EMPLOYMENT OR SERVICE RIGHTS

Nothing in the Plan shall confer upon the Optionee or the Participant any right to continue in Service for any period of specific duration or interfere with or otherwise restrict in any way the rights of the Corporation (or any Parent or Subsidiary employing or retaining such person) or of the Optionee or the Participant, which rights are hereby expressly reserved by each, to terminate such person's Service at any time for any reason, with or without cause.

VIII. FINANCIAL REPORTS

The Corporation shall deliver a balance sheet and an income statement at least annually to each individual holding an outstanding option under the Plan, unless such individual is a key Employee whose duties in connection with the Corporation (or any Parent or Subsidiary) assure such individual access to equivalent information.

APPENDIX

The following definitions shall be in effect under the Plan:

A. **Board** shall mean the Corporation's Board of Directors.

B. **Code** shall mean the Internal Revenue Code of 1986, as amended.

C. **Committee** shall mean a committee of two (2) or more Board members appointed by the Board to exercise one or more administrative functions under the Plan.

D. **Common Stock** shall mean the Corporation's common stock.

E. **Corporate Transaction** shall mean either of the following stockholder-approved transactions to which the Corporation is a party:

(i) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction, or

(ii) the sale, transfer or other disposition of all or substantially all of the Corporation's assets in complete liquidation or dissolution of the Corporation.

F. **Corporation** shall mean ERI Corp., a Delaware corporation, and any successor corporation to all or substantially all of the assets or voting stock of ERI Corp. which shall by appropriate action adopt the Plan.

G. **Disability** shall mean the inability of the Optionee or the Participant to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment and shall be determined by the Plan Administrator on the basis of such medical evidence as the Plan Administrator deems warranted under the circumstances.

H. **Employee** shall mean an individual who is in the employ of the Corporation (or any Parent or Subsidiary), subject to the control and direction of the employer entity as to both the work to be performed and the manner and method of performance.

I. **Exercise Date** shall mean the date on which the Corporation shall have received written notice of the option exercise.

J. **Fair Market Value** per share of Common Stock on any relevant date shall be determined in accordance with the following provisions:

(i) If the Common Stock is at the time traded on the Nasdaq National Market, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question, as such price is reported

by the National Association of Securities Dealers on the Nasdaq National Market or any successor system. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(ii) If the Common Stock is at the time listed on any Stock Exchange, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question on the Stock Exchange determined by the Plan Administrator to be the primary market for the Common Stock, as such price is officially quoted in the composite tape of transactions on such exchange. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(iii) If the Common Stock is at the time neither listed on any Stock Exchange nor traded on the Nasdaq National Market, then the Fair Market Value shall be determined by the Plan Administrator after taking into account such factors as the Plan Administrator shall deem appropriate.

K. **Incentive Option** shall mean an option which satisfies the requirements of Code Section 422.

L. **Involuntary Termination** shall mean the termination of the Service of any individual which occurs by reason of:

(i) such individual's involuntary dismissal or discharge by the Corporation for reasons other than Misconduct, or

(ii) such individual's voluntary resignation following (A) a change in his or her position with the Corporation which materially reduces his or her duties and responsibilities or the level of management to which he or she reports, (B) a reduction in his or her level of compensation (including base salary, fringe benefits and target bonuses under any corporate-performance based bonus or incentive programs) by more than fifteen percent (15%) or (C) a relocation of such individual's place of employment by more than fifty (50) miles, provided and only if such change, reduction or relocation is effected without the individual's consent.

M. **Misconduct** shall mean the commission of any act of fraud, embezzlement or dishonesty by the Optionee or Participant, any unauthorized use or disclosure by such person of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary) or any other intentional misconduct by such person adversely affecting the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of any Optionee, Participant or other person in the Service of the Corporation (or any Parent or Subsidiary).

N**. 1934 Act** shall mean the Securities Exchange Act of 1934, as amended.

O. **Non-Statutory Option** shall mean an option not intended to satisfy the requirements of Code Section 422.

P. **Option Grant Program** shall mean the option grant program in effect under the Plan.

Q. **Optionee** shall mean any person to whom an option is granted under the Plan.

R. **Parent** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation, provided each corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

S. **Participant** shall mean any person who is issued shares of Common Stock under the Stock Issuance Program.

T. **Plan** shall mean the Corporation's 2002 Stock Option/Stock Issuance Plan, as set forth in this document.

U. **Plan Administrator** shall mean either the Board or the Committee acting in its capacity as administrator of the Plan.

V. **Service** shall mean the provision of services to the Corporation (or any Parent or Subsidiary) by a person in the capacity of an Employee, a non-employee member of the board of directors or a consultant or independent advisor, except to the extent otherwise specifically provided in the documents evidencing the option grant.

W. **Stock Exchange** shall mean either the American Stock Exchange or the New York Stock Exchange.

X. **Stock Issuance Agreement** shall mean the agreement entered into by the Corporation and the Participant at the time of issuance of shares of Common Stock under the Stock Issuance Program.

Y. **Stock Issuance Program** shall mean the stock issuance program in effect under the Plan.

Z. **Subsidiary** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations beginning with the Corporation, provided each corporation (other than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

AA. **10% Stockholder** shall mean the owner of stock (as determined under Code Section 424(d)) possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Corporation (or any Parent or Subsidiary).

Plan History

Adopted by the Board of Directors at a Regular Meeting held on 1 March 2002.

Ratified by the Stockholders at the 2002 Annual Meeting held on 12 April 2002.

ERI CORP.
STOCK PURCHASE AGREEMENT

AGREEMENT made this ___ day of _____ 200 __, by and between ERI Corp., a Delaware corporation, and _____, Optionee under the Corporation's 2002 Stock Option/Stock Issuance Plan.

All capitalized terms in this Agreement shall have the meaning assigned to them in this Agreement or in the attached Appendix.

A. EXERCISE OF OPTION

1. **Exercise**. Optionee hereby purchases _____ shares of Common Stock (the "Purchased Shares") pursuant to that certain option (the "Option") granted Optionee on _____ (the "Grant Date") to purchase up to _____ shares of Common Stock (the "Option Shares") under the Plan at the exercise price of $_____ per share (the "Exercise Price").

2. **Payment**. Concurrently with the delivery of this Agreement to the Corporation, Optionee shall pay the Exercise Price for the Purchased Shares in accordance with the provisions of the Option Agreement and shall deliver whatever additional documents may be required by the Option Agreement as a condition for exercise, together with a duly-executed blank Assignment Separate from Certificate (in the form attached hereto as Exhibit I) with respect to the Purchased Shares.

3. **Stockholder Rights**. Until such time as the Corporation exercises the Repurchase Right or the First Refusal Right, Optionee (or any successor in interest) shall have all the rights of a stockholder (including voting, dividend and liquidation rights) with respect to the Purchased Shares, subject, however, to the transfer restrictions of Articles B and C.

B. SECURITIES LAW COMPLIANCE

1. **Restricted Securities**. The Purchased Shares have not been registered under the 1933 Act and are being issued to Optionee in reliance upon the exemption from such registration provided by SEC Rule 701 for stock issuances under compensatory benefit plans such as the Plan. Optionee hereby confirms that Optionee has been informed that the Purchased Shares are restricted securities under the 1933 Act and may not be resold or transferred unless the Purchased Shares are first registered under the Federal securities laws or unless an exemption from such registration is available. Accordingly, Optionee hereby acknowledges that Optionee is prepared to hold the Purchased Shares for an indefinite period and that Optionee is aware that SEC Rule 144 issued under the 1933 Act which exempts certain resales of unrestricted securities is not presently available to exempt the resale of the Purchased Shares from the registration requirements of the 1933 Act.

2. **Restrictions on Disposition of Purchased Shares**. Optionee shall make no disposition of the Purchased Shares (other than a Permitted Transfer) unless and until there is compliance with all of the following requirements:

(i) Optionee shall have provided the Corporation with a written summary of the terms and conditions of the proposed disposition.

(ii) Optionee shall have complied with all requirements of this Agreement applicable to the disposition of the Purchased Shares.

(iii) Optionee shall have provided the Corporation with written assurances, in form and substance satisfactory to the Corporation, that (a) the proposed disposition does not require registration of the Purchased Shares under the 1933 Act or (b) all appropriate action necessary for compliance with the registration requirements of the 1933 Act or any exemption from registration available under the 1933 Act (including Rule 144) has been taken.

The Corporation shall not be required (i) to transfer on its books any Purchased Shares which have been sold or transferred in violation of the provisions of this Agreement or (ii) to treat as the owner of the Purchased Shares, or otherwise to accord voting, dividend or liquidation rights to, any transferee to whom the Purchased Shares have been transferred in contravention of this Agreement.

3. **Restrictive Legends**. The stock certificates for the Purchased Shares shall be endorsed with one or more of the following restrictive legends:

"The shares represented by this certificate have not been registered under the Securities Act of 1933. The shares may not be sold or offered for sale in the absence of (a) an effective registration statement for the shares under such Act, (b) a "no action" letter of the Securities and Exchange Commission with respect to such sale or offer or (c) satisfactory assurances to the Corporation that registration under such Act is not required with respect to such sale or offer."

"The shares represented by this certificate are subject to certain repurchase rights and rights of first refusal granted to the Corporation and accordingly may not be sold, assigned, transferred, encumbered, or in any manner disposed of except in conformity with the terms of a written agreement dated _____, 200___ between the Corporation and the registered holder of the shares (or the predecessor in interest to the shares). A copy of such agreement is maintained at the Corporation's principal corporate offices."

C. TRANSFER RESTRICTIONS

1. **Restriction on Transfer**. Except for any Permitted Transfer, Optionee shall not transfer, assign, encumber or otherwise dispose of any of the Purchased Shares which are subject to the Repurchase Right. In addition, Purchased Shares which are released from the Repurchase Right shall not be transferred, assigned, encumbered or otherwise disposed of in contravention of the First Refusal Right or the Market Stand-Off.

2. **Transferee Obligations**. Each person (other than the Corporation) to whom the Purchased Shares are transferred by means of a Permitted Transfer must, as a condition precedent to the validity of such transfer, acknowledge in writing to the Corporation that such person is bound by the provisions of this Agreement and that the transferred shares are subject to (i) the Repurchase Right, (ii) the First Refusal Right and (iii) the Market Stand-Off, to the same extent such shares would be so subject if retained by Optionee.

3. **Market Stand-Off**.

(a) In connection with any underwritten public offering by the Corporation of its equity securities pursuant to an effective registration statement filed under the 1933 Act, including the Corporation's initial public offering, Owner shall not sell, make any short sale of, loan, hypothecate, pledge, grant any option for the purchase of, or otherwise dispose or transfer for value or otherwise agree to engage in any of the foregoing transactions with respect to, any Purchased Shares without the prior written consent of the Corporation or its underwriters. Such restriction (the "Market Stand-Off") shall be in effect for such period of time from and after the effective date of the final prospectus for the offering as may be requested by the Corporation or such underwriters. In no event, however, shall such period exceed one hundred eighty (180) days and the Market Stand-Off shall in all events terminate two (2) years after the effective date of the Corporation's initial public offering.

(b) Owner shall be subject to the Market Stand-Off provided and only if the officers and directors of the Corporation are also subject to similar restrictions.

(c) Any new, substituted or additional securities which are by reason of any Recapitalization or Reorganization distributed with respect to the Purchased Shares shall be immediately subject to the Market Stand-Off to the same extent the Purchased Shares are at such time covered by such provisions.

(d) In order to enforce the Market Stand-Off, the Corporation may impose stop-transfer instructions with respect to the Purchased Shares until the end of the applicable stand-off period.

D. REPURCHASE RIGHT

1. **Grant**. The Corporation is hereby granted the right (the "Repurchase Right"), exercisable at any time during the sixty (60)-day period following the date Optionee ceases for any reason to remain in Service or (if later) during the sixty (60)-day period following the execution date of this Agreement, to repurchase at the Exercise Price any or all of the Purchased Shares in which Optionee is not, at the time of his or her cessation of Service, vested in accordance with the Vesting Schedule applicable to those shares or the special vesting acceleration provisions of Paragraph D.6 of this Agreement (such shares to be hereinafter referred to as the "Unvested Shares").

2. **Exercise of the Repurchase Right**. The Repurchase Right shall be exercisable by written notice delivered to each Owner of the Unvested Shares prior to the expiration of the sixty (60)-day exercise period. The notice shall indicate the number of Unvested Shares to be repurchased and the date on which the repurchase is to be effected, such

date to be not more than thirty (30) days after the date of such notice. The certificates representing the Unvested Shares to be repurchased shall be delivered to the Corporation on or before the close of business on the date specified for the repurchase. Concurrently with the receipt of such stock certificates, the Corporation shall pay to Owner, in cash or cash equivalents (including the cancellation of any purchase-money indebtedness), an amount equal to the Exercise Price previously paid for the Unvested Shares which are to be repurchased from Owner.

3. **Termination of the Repurchase Right**. The Repurchase Right shall terminate with respect to any Unvested Shares for which it is not timely exercised under Paragraph D.2. In addition, the Repurchase Right shall terminate and cease to be exercisable with respect to any and all Purchased Shares in which Optionee vests in accordance with the Vesting Schedule. All Purchased Shares as to which the Repurchase Right lapses shall, however, remain subject to (i) the First Refusal Right and (ii) the Market Stand-Off.

4. **Aggregate Vesting Limitation**. If the Option is exercised in more than one increment so that Optionee is a party to one or more other Stock Purchase Agreements (the "Prior Purchase Agreements") which are executed prior to the date of this Agreement, then the total number of Purchased Shares as to which Optionee shall be deemed to have a fully-vested interest under this Agreement and all Prior Purchase Agreements shall not exceed in the aggregate the number of Purchased Shares in which Optionee would otherwise at the time be vested, in accordance with the Vesting Schedule, had all the Purchased Shares (including those acquired under the Prior Purchase Agreements) been acquired exclusively under this Agreement.

5. **Recapitalization**. Any new, substituted or additional securities or other property (including cash paid other than as a regular cash dividend) which is by reason of any Recapitalization distributed with respect to the Purchased Shares shall be immediately subject to the Repurchase Right and any escrow requirements hereunder, but only to the extent the Purchased Shares are at the time covered by such right or escrow requirements. Appropriate adjustments to reflect such distribution shall be made to the number and/or class of Purchased Shares subject to this Agreement and to the price per share to be paid upon the exercise of the Repurchase Right in order to reflect the effect of any such Recapitalization upon the Corporation's capital structure; provided, however, that the aggregate purchase price shall remain the same.

6. **Corporate Transaction**.

(a) The Repurchase Right shall automatically terminate in its entirety, and all the Purchased Shares shall vest in full, immediately prior to the consummation of any Corporate Transaction, except to the extent the Repurchase Right is to be assigned to the successor entity in such Corporate Transaction.

(b) To the extent the Repurchase Right remains in effect following a Corporate Transaction, such right shall apply to any new securities or other property (including any cash payments) received in exchange for the Purchased Shares in consummation of the Corporate Transaction, but only to the extent the Purchased Shares are at the time covered by such right. Appropriate adjustments shall be made to the price per share payable upon exercise of the Repurchase Right to reflect the effect of the Corporate Transaction upon the Corporation's

capital structure; provided, however, that the aggregate purchase price shall remain the same. The new securities or other property (including any cash payments) issued or distributed with respect to the Purchased Shares in consummation of the Corporate Transaction shall be immediately deposited in escrow with the Corporation (or the successor entity) and shall not be released from escrow until Optionee vests in such securities or other property in accordance with the same Vesting Schedule in effect for the Purchased Shares.

(c) The Repurchase Right shall automatically lapse in its entirety, and all the Purchased Shares shall immediately vest in full, upon an Involuntary Termination of Optionee's Service within twelve (12) months following the effective date of a Corporate Transaction in which the Repurchase Right does not otherwise terminate pursuant to Paragraph D.6(a) above.

E. **RIGHT OF FIRST REFUSAL**

1. **Grant**. The Corporation is hereby granted the right of first refusal (the "First Refusal Right"), exercisable in connection with any proposed transfer of the Purchased Shares in which Optionee has vested in accordance with the provisions of Article D. For purposes of this Article E, the term "transfer" shall include any sale, assignment, pledge, encumbrance or other disposition of the Purchased Shares intended to be made by Owner, but shall not include any Permitted Transfer.

2. **Notice of Intended Disposition**. In the event any Owner of Purchased Shares in which Optionee has vested desires to accept a bona fide third-party offer for the transfer of any or all of such shares (the Purchased Shares subject to such offer to be hereinafter referred to as the "Target Shares"), Owner shall promptly (i) deliver to the Corporation written notice (the "Disposition Notice") of the terms of the offer, including the purchase price and the identity of the third-party offeror, and (ii) provide satisfactory proof that the disposition of the Target Shares to such third-party offeror would not be in contravention of the provisions set forth in Articles B and C.

3. **Exercise of the First Refusal Right**. The Corporation shall, for a period of twenty-five (25) days following receipt of the Disposition Notice, have the right to repurchase any or all of the Target Shares subject to the Disposition Notice upon the same terms as those specified therein or upon such other terms (not materially different from those specified in the Disposition Notice) to which Owner consents. Such right shall be exercisable by delivery of written notice (the "Exercise Notice") to Owner prior to the expiration of the twenty-five (25)-day exercise period. If such right is exercised with respect to all the Target Shares, then the Corporation shall effect the repurchase of such shares, including payment of the purchase price, not more than five (5) business days after delivery of the Exercise Notice; and at such time the certificates representing the Target Shares shall be delivered to the Corporation.

Should the purchase price specified in the Disposition Notice be payable in property other than cash or evidences of indebtedness, the Corporation shall have the right to pay the purchase price in the form of cash equal in amount to the value of such property. If Owner and the Corporation cannot agree on such cash value within ten (10) days after the Corporation's receipt of the Disposition Notice, the valuation shall be made by an appraiser of recognized

standing selected by Owner and the Corporation or, if they cannot agree on an appraiser within twenty (20) days after the Corporation's receipt of the Disposition Notice, each shall select an appraiser of recognized standing and the two (2) appraisers shall designate a third appraiser of recognized standing, whose appraisal shall be determinative of such value. The cost of such appraisal shall be shared equally by Owner and the Corporation. The closing shall then be held on the later of (i) the fifth (5th) business day following delivery of the Exercise Notice or (ii) the fifth (5th) business day after such valuation shall have been made.

4. **Non-Exercise of the First Refusal Right**. In the event the Exercise Notice is not given to Owner prior to the expiration of the twenty-five (25)-day exercise period, Owner shall have a period of thirty (30) days thereafter in which to sell or otherwise dispose of the Target Shares to the third-party offeror identified in the Disposition Notice upon terms (including the purchase price) no more favorable to such third-party offeror than those specified in the Disposition Notice; provided, however, that any such sale or disposition must not be effected in contravention of the provisions of Articles B and C. The third-party offeror shall acquire the Target Shares subject to the First Refusal Right, and the acquired shares shall remain subject to the provisions of Article B and Paragraph C.3. In the event Owner does not effect such sale or disposition of the Target Shares within the specified thirty (30)-day period, the First Refusal Right shall continue to be applicable to any subsequent disposition of the Target Shares by Owner until such right lapses.

5. **Partial Exercise of the First Refusal Right**. In the event the Corporation makes a timely exercise of the First Refusal Right with respect to a portion, but not all, of the Target Shares specified in the Disposition Notice, Owner shall have the option, exercisable by written notice to the Corporation delivered within five (5) business days after Owner's receipt of the Exercise Notice, to effect the sale of the Target Shares pursuant to either of the following alternatives:

(i) sale or other disposition of all the Target Shares to the third-party offeror identified in the Disposition Notice, but in full compliance with the requirements of Paragraph E.4, as if the Corporation did not exercise the First Refusal Right; or

(ii) sale to the Corporation of the portion of the Target Shares which the Corporation has elected to purchase, such sale to be effected in substantial conformity with the provisions of Paragraph E.3. The First Refusal Right shall continue to be applicable to any subsequent disposition of the remaining Target Shares until such right lapses.

Owner's failure to deliver timely notification to the Corporation shall be deemed to be an election by Owner to sell the Target Shares pursuant to alternative (i) above.

6. **Recapitalization/Reorganization**

(a) Any new, substituted or additional securities or other property which is by reason of any Recapitalization distributed with respect to the Purchased Shares shall

be immediately subject to the First Refusal Right, but only to the extent the Purchased Shares are at the time covered by such right.

(b) In the event of a Reorganization, the First Refusal Right shall remain in full force and effect and shall apply to the new capital stock or other property received in exchange for the Purchased Shares in consummation of the Reorganization, but only to the extent the Purchased Shares are at the time covered by such right.

7. **Lapse**. The First Refusal Right shall lapse upon the earliest to occur of (i) the first date on which shares of the Common Stock are held of record by more than five hundred (500) persons, (ii) a determination is made by the Board that a public market exists for the outstanding shares of Common Stock or (iii) a firm commitment underwritten public offering, pursuant to an effective registration statement under the 1933 Act, covering the offer and sale of the Common Stock in the aggregate amount of at least ten million dollars ($10,000,000). However, the Market Stand-Off shall continue to remain in full force and effect following the lapse of the First Refusal Right.

F. SPECIAL TAX ELECTION

The acquisition of the Purchased Shares may result in adverse tax consequences which may be avoided or mitigated by filing an election under Code Section 83(b). Such election must be filed within thirty (30) days after the date of this Agreement. A description of the tax consequences applicable to the acquisition of the Purchased Shares and the form for making the Code Section 83(b) election are set forth in Exhibit II. **OPTIONEE SHOULD CONSULT WITH HIS OR HER TAX ADVISOR TO DETERMINE THE TAX CONSEQUENCES OF ACQUIRING THE PURCHASED SHARES AND THE ADVANTAGES AND DISADVANTAGES OF FILING THE CODE SECTION 83(b) ELECTION. OPTIONEE ACKNOWLEDGES THAT IT IS OPTIONEE'S SOLE RESPONSIBILITY, AND NOT THE CORPORATION'S, TO FILE A TIMELY ELECTION UNDER CODE SECTION 83(b), EVEN IF OPTIONEE REQUESTS THE CORPORATION OR ITS REPRESENTATIVES TO MAKE THIS FILING ON HIS OR HER BEHALF.**

G. GENERAL PROVISIONS

1. **Assignment**. The Corporation may assign the Repurchase Right and/or the First Refusal Right to any person or entity selected by the Board, including (without limitation) one or more stockholders of the Corporation. If the assignee of the Repurchase Right is other than (i) a wholly owned subsidiary of the Corporation or (ii) the parent corporation owning one hundred percent (100%) of the Corporation's outstanding capital stock then such assignee must make a cash payment to the Corporation, upon the assignment of the Repurchase Right, in an amount equal to the excess (if any) of (i) the Fair Market Value of the Purchased Shares at the time subject to the assigned Repurchase Right over (ii) the aggregate repurchase price payable for the Purchased Shares.

2. **No Employment or Service Contract**. Nothing in this Agreement or in the Plan shall confer upon Optionee any right to continue in Service for any period of specific duration or interfere with or otherwise restrict in any way the rights of the Corporation (or any

Parent or Subsidiary employing or retaining Optionee) or of Optionee, which rights are hereby expressly reserved by each, to terminate Optionee's Service at any time for any reason, with or without cause.

3. **Notices**. Any notice required to be given under this Agreement shall be in writing and shall be deemed effective upon personal delivery or upon deposit in the U.S. mail, registered or certified, postage prepaid and properly addressed to the party entitled to such notice at the address indicated below such party's signature line on this Agreement or at such other address as such party may designate by ten (10) days advance written notice under this paragraph to all other parties to this Agreement.

4. **No Waiver**. The failure of the Corporation in any instance to exercise the Repurchase Right or the First Refusal Right shall not constitute a waiver of any other repurchase rights and/or rights of first refusal that may subsequently arise under the provisions of this Agreement or any other agreement between the Corporation and Optionee. No waiver of any breach or condition of this Agreement shall be deemed to be a waiver of any other or subsequent breach or condition, whether of like or different nature.

5. **Cancellation of Shares**. If the Corporation shall make available, at the time and place and in the amount and form provided in this Agreement, the consideration for the Purchased Shares to be repurchased in accordance with the provisions of this Agreement, then from and after such time, the person from whom such shares are to be repurchased shall no longer have any rights as a holder of such shares (other than the right to receive payment of such consideration in accordance with this Agreement). Such shares shall be deemed purchased in accordance with the applicable provisions hereof, and the Corporation shall be deemed the owner and holder of such shares, whether or not the certificates therefor have been delivered as required by this Agreement.

H. MISCELLANEOUS PROVISIONS

1. **Optionee Undertaking**. Optionee hereby agrees to take whatever additional action and execute whatever additional documents the Corporation may deem necessary or advisable in order to carry out or effect one or more of the obligations or restrictions imposed on either Optionee or the Purchased Shares pursuant to the provisions of this Agreement.

2. **Agreement is Entire Contract**. This Agreement constitutes the entire contract between the parties hereto with regard to the subject matter hereof. This Agreement is made pursuant to the provisions of the Plan and shall in all respects be construed in conformity with the terms of the Plan.

3. **Governing Law**. This Agreement shall be governed by, and construed in accordance with, the laws of the State of California without resort to that State's conflict-of-laws rules.

4. **Counterparts**. This Agreement may be executed in counterparts, each of which shall be deemed to be an original, but all of which together shall constitute one and the same instrument.

5. **Successors and Assigns**. The provisions of this Agreement shall inure to the benefit of, and be binding upon, the Corporation and its successors and assigns and upon Optionee, Optionee's permitted assigns and the legal representatives, heirs and legatees of Optionee's estate, whether or not any such person shall have become a party to this Agreement and have agreed in writing to join herein and be bound by the terms hereof.

IN WITNESS WHEREOF, the parties have executed this Agreement on the day and year first indicated above.

ERI CORP.

By: _____
Title: _____
Address: _____
_____

OPTIONEE

By: _____
Address: _____
_____

SPOUSAL ACKNOWLEDGMENT

The undersigned spouse of Optionee has read and hereby approves the foregoing Stock Purchase Agreement. In consideration of the Corporation's granting Optionee the right to acquire the Purchased Shares in accordance with the terms of such Agreement, the undersigned hereby agrees to be irrevocably bound by all the terms of such Agreement, including (without limitation) the right of the Corporation (or its assigns) to purchase any Purchased Shares in which Optionee is not vested at time of his or her cessation of Service.

OPTIONEE SPOUSE

By: _____

Address: _____

_____

EXHIBIT I

ASSIGNMENT SEPARATE FROM CERTIFICATE

FOR VALUE RECEIVED _____ hereby sell(s), assign(s) and transfer(s) unto ERI Corp. (the "Corporation"), _____ (_____) shares of the Common Stock of the Corporation standing in his or her name on the books of the Corporation represented by Certificate No. _____ herewith and do(es) hereby irrevocably constitute and appoint_____ Attorney to transfer the said stock on the books of the Corporation with full power of substitution in the premises.

Dated: _____

Signature: _____

Instruction: Please do not fill in any blanks other than the signature line. Please sign exactly as you would like your name to appear on the issued stock certificate. The purpose of this assignment is to enable the Corporation to exercise the Repurchase Right without requiring additional signatures on the part of Optionee.

EXHIBIT II

FEDERAL INCOME TAX CONSEQUENCES AND SECTION 83(b) TAX ELECTION

II. **Federal Income Tax Consequences and Section 83(b) Election For Exercise of Non-Statutory Option** If the Purchased Shares are acquired pursuant to the exercise of a Non-Statutory Option, as specified in the Grant Notice, then under Code Section 83, the excess of the Fair Market Value of the Purchased Shares on the date any forfeiture restrictions applicable to such shares lapse over the Exercise Price paid for such shares will be reportable as ordinary income on the lapse date. For this purpose, the term "forfeiture restrictions" includes the right of the Corporation to repurchase the Purchased Shares pursuant to the Repurchase Right. However, Optionee may elect under Code Section 83(b) to be taxed at the time the Purchased Shares are acquired, rather than when and as such Purchased Shares cease to be subject to such forfeiture restrictions. Such election must be filed with the Internal Revenue Service within thirty (30) days after the date of the Agreement. Even if the Fair Market Value of the Purchased Shares on the date of the Agreement equals the Exercise Price paid (and thus no tax is payable), the election must be made to avoid adverse tax consequences in the future. The form for making this election is attached as part of this exhibit. **FAILURE TO MAKE THIS FILING WITHIN THE APPLICABLE THIRTY (30)-DAY PERIOD WILL RESULT IN THE RECOGNITION OF ORDINARY INCOME BY OPTIONEE AS THE FORFEITURE RESTRICTIONS LAPSE.**

III. **Federal Income Tax Consequences and Conditional Section 83(b) Election For Exercise of Incentive Option** If the Purchased Shares are acquired pursuant to the exercise of an Incentive Option, as specified in the Grant Notice, then the following tax principles shall be applicable to the Purchased Shares:

(i) For regular tax purposes, no taxable income will be recognized at the time the Option is exercised.

(ii) The excess of (a) the Fair Market Value of the Purchased Shares on the date the Option is exercised or (if later) on the date any forfeiture restrictions applicable to the Purchased Shares lapse over (b) the Exercise Price paid for the Purchased Shares will be includible in Optionee's taxable income for alternative minimum tax purposes.

(iii) If Optionee makes a disqualifying disposition of the Purchased Shares, then Optionee will recognize ordinary income in the year of such disposition equal in amount to the excess of (a) the Fair Market Value of the Purchased Shares on the date the Option is exercised or (if later) on the date any forfeiture restrictions applicable to the Purchased Shares lapse over (b) the Exercise Price paid for the Purchased Shares. Any additional gain recognized upon the disqualifying disposition will be either short-term or long-term capital gain depending upon the period for which the Purchased Shares are held prior to the disposition.

(iv) For purposes of the foregoing, the term "forfeiture restrictions" will include the right of the Corporation to repurchase the Purchased Shares pursuant to the Repurchase Right. The term "disqualifying disposition" means any sale or other disposition [1] of the Purchased Shares within two (2) years after the Grant Date or within one (1) year after the exercise date of the Option.

(v) In the absence of final Treasury Regulations relating to Incentive Options, it is not certain whether Optionee may, in connection with the exercise of the Option for any Purchased Shares at the time subject to forfeiture restrictions, file a protective election under Code Section 83(b) which would limit (a) Optionee's alternative minimum taxable income upon exercise and (b) Optionee's ordinary income upon a disqualifying disposition to the excess of the Fair Market Value of the Purchased Shares on the date the Option is exercised over the Exercise Price paid for the Purchased Shares. Accordingly, such election if properly filed will only be allowed to the extent the final Treasury Regulations permit such a protective election. Page 2 of the attached form for making the election should be filed with any election made in connection with the exercise of an Incentive Option.

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1 Generally a disposition of shares purchased under an Incentive Option includes any transfer of legal title, including a transfer by sale, exchange or gift, but does not include a transfer to the Optionee's spouse, a transfer into joint ownership with right of survivorship if Optionee remains one of the joint owners, a pledge, a transfer by bequest or inheritance or certain tax free exchanges permitted under the Code.

SECTION 83(b) ELECTION

This statement is being made under Section 83(b) of the Internal Revenue Code, pursuant to Treas. Reg. Section 1.83-2.

(1) The taxpayer who performed the services is:

Name:
Address:
Taxpayer Ident. No.:

(2) The property with respect to which the election is being made is _____ shares of the common stock of ERI Corp.

(3) The property was issued on _____, 200_.

(4) The taxable year in which the election is being made is the calendar year 200_.

(5) The property is subject to a repurchase right pursuant to which the issuer has the right to acquire the property at the original purchase price if for any reason taxpayer's service with the issuer terminates. The issuer's repurchase right lapses in a series of annual and monthly installments over a four (4)-year period ending on _____, 200_.

(6) The fair market value at the time of transfer (determined without regard to any restriction other than a restriction which by its terms will never lapse) is $_____ per share.

(7) The amount paid for such property is $_____ per share.

(8) A copy of this statement was furnished to ERI Corp. for whom taxpayer rendered the services underlying the transfer of property.

(9) This statement is executed on _____, 200_.

_____ _____

Spouse (if any) Taxpayer

This election must be filed with the Internal Revenue Service Center with which taxpayer files his or her Federal income tax returns and must be made within thirty (30) days after the execution date of the Stock Purchase Agreement. This filing should be made by registered or certified mail return receipt requested. Optionee must retain two (2) copies of the completed form for filing with his or her Federal and state tax returns for the current tax year and an additional copy for his or her records.

The property described in the above Section 83(b) election is comprised of shares of common stock acquired pursuant to the exercise of an incentive stock option under Section 422 of the Internal Revenue Code (the "Code"). Accordingly, it is the intent of the Taxpayer to utilize this election to achieve the following tax results:

1. The purpose of this election is to have the alternative minimum taxable income attributable to the purchased shares measured by the amount by which the fair market value of such shares at the time of their transfer to the Taxpayer exceeds the purchase price paid for the shares. In the absence of this election, such alternative minimum taxable income would be measured by the spread between the fair market value of the purchased shares and the purchase price which exists on the various lapse dates in effect for the forfeiture restrictions applicable to such shares. The election is to be effective to the full extent permitted under the Code.

2. Section 421(a)(1) of the Code expressly excludes from income any excess of the fair market value of the purchased shares over the amount paid for such shares. Accordingly, this election is also intended to be effective in the event there is a "disqualifying disposition" of the shares, within the meaning of Section 421(b) of the Code, which would otherwise render the provisions of Section 83(a) of the Code applicable at that time. Consequently, the Taxpayer hereby elects to have the amount of disqualifying disposition income measured by the excess of the fair market value of the purchased shares on the date of transfer to the Taxpayer over the amount paid for such shares. Since Section 421(a) presently applies to the shares which are the subject of this Section 83(b) election, no taxable income is actually recognized for regular tax purposes at this time, and no income taxes are payable, by the Taxpayer as a result of this election.

THIS PAGE 2 IS TO BE ATTACHED TO ANY SECTION 83(b) ELECTION FILED IN CONNECTION WITH THE EXERCISE OF AN INCENTIVE STOCK OPTION UNDER THE FEDERAL TAX LAWS.

APPENDIX

The following definitions shall be in effect under the Agreement:

A. **Agreement** shall mean this Stock Purchase Agreement.

B. **Board** shall mean the Corporation's Board of Directors.

C. **Code** shall mean the Internal Revenue Code of 1986, as amended.

D. **Common Stock** shall mean the Corporation's common stock.

E. **Corporate Transaction** shall mean either of the following stockholder approved transactions:

(i) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction, or

(ii) the sale, transfer or other disposition of all or substantially all of the Corporation's assets in complete liquidation or dissolution of the Corporation.

F. **Corporation** shall mean ERI Corp., a Delaware corporation, and any successor corporation to all or substantially all of the assets or voting stock of ERI Corp. which shall by appropriate action adopt the Plan.

G. **Disposition Notice** shall have the meaning assigned to such term in Paragraph E.2.

H. **Exercise Notice** shall have the meaning assigned to such term in Paragraph E.3.

I. **Exercise Price** shall have the meaning assigned to such term in Paragraph A.l.

J. **Fair Market Value** of a share of Common Stock on any relevant date, prior to the initial public offering of the Common Stock, shall be determined by the Plan Administrator after taking into account such factors as it shall deem appropriate.

K: **First Refusal Right** shall mean the right granted to the Corporation in accordance with Article E.

L. **Grant Date** shall have the meaning assigned to such term in Paragraph A.1.

M. **Grant Notice** shall mean the Notice of Grant of Stock Option pursuant to which Optionee has been informed of the basic terms of the Option.

N. **Incentive Option** shall mean an option which satisfies the requirements of Code Section 422.

O. **Involuntary Termination** shall mean the termination of Optionee's Service which occurs by reason of:

(i) Optionee's involuntary dismissal or discharge by the Corporation for reasons other than Misconduct, or

(ii) Optionee's voluntary resignation following (A) a change in his or her position with the Corporation which materially reduces his or her level of responsibility, (B) a reduction in Optionee's level of compensation (including base salary, fringe benefits and target bonuses under any corporate-performance based bonus or incentive programs) by more than fifteen percent (15%) or (C) a relocation of Optionee's place of employment by more than fifty (50) miles, provided and only if such change, reduction or relocation is effected by the Corporation without Optionee's consent.

P. **Market Stand-Off** shall mean the market stand-off restriction specified in Paragraph C.3.

Q. **Misconduct** shall mean the commission of any act of fraud, embezzlement or dishonesty by Optionee, any unauthorized use or disclosure by Optionee of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any other intentional misconduct by Optionee adversely affecting the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of Optionee or any other individual in the Service of the Corporation (or any Parent or Subsidiary).

R. **1933 Act** shall mean the Securities Act of 1933, as amended.

S. **1934 Act** shall mean the Securities Exchange Act of 1934, as amended.

T. **Non-Statutory Option** shall mean an option not intended to satisfy the requirements of Code Section 422.

U. **Option** shall have the meaning assigned to such term in Paragraph A.1.

V. **Option Agreement** shall mean all agreements and other documents evidencing the Option.

W. **Optionee** shall mean the person to whom the Option is granted under the Plan.

X. **Owner** shall mean Optionee and all subsequent holders of the Purchased Shares who derive their chain of ownership through a Permitted Transfer from Optionee.

Y. **Parent** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation, provided each corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

Z. **Permitted Transfer** shall mean (i) a gratuitous transfer of the Purchased Shares, provided and only if Optionee obtains the Corporation's prior written consent to such transfer, (ii) a transfer of title to the Purchased Shares effected pursuant to Optionee's will or the laws of intestate succession following Optionee's death or (iii) a transfer to the Corporation in pledge as security for any purchase-money indebtedness incurred by Optionee in connection with the acquisition of the Purchased Shares.

AA. **Plan** shall mean the Corporation's 2002 Stock Option/Stock Issuance Plan.

BB. **Plan Administrator** shall mean either the Board or a committee of the Board acting in its capacity as administrator of the Plan.

CC. **Prior Purchase Agreement** shall have the meaning assigned to such term in Paragraph D.4.

DD. **Purchased Shares** shall have the meaning assigned to such term in Paragraph A.1.

EE. **Recapitalization** shall mean any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the Corporation's outstanding Common Stock as a class without the Corporation's receipt of consideration.

FF. **Reorganization** shall mean any of the following transactions:

(i) a merger or consolidation in which the Corporation is not the surviving entity,

(ii) a sale, transfer or other disposition of all or substantially all of the Corporation's assets,

(iii) a reverse merger in which the Corporation is the surviving entity but in which the Corporation's outstanding voting securities are transferred

in whole or in part to a person or persons different from the persons holding those securities immediately prior to the merger, or

(iv) any transaction effected primarily to change the state in which the Corporation is incorporated or to create a holding company structure.

GG. **Repurchase Right** shall mean the right granted to the Corporation in accordance with Article D.

HH. **SEC** shall mean the Securities and Exchange Commission.

II. **Service** shall mean the Optionee's performance of services for the Corporation (or any Parent or Subsidiary) in the capacity of an employee subject to the control and direction of the employer entity as to both the work to be performed and the manner and method of performance, a non-employee member of the board of directors or an independent consultant.

JJ. **Subsidiary** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations beginning with the Corporation, provided each corporation (other than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

KK. **Target Shares** shall have the meaning assigned to such term in Paragraph E.2.

LL. **Vesting Schedule** shall mean the vesting schedule specified in the Grant Notice pursuant to which the Optionee is to vest in the Option Shares in a series of installments over his or her period of Service.

MM. **Unvested Shares** shall have the meaning assigned to such term in Paragraph D.1.

ADDENDUM
TO
STOCK PURCHASE AGREEMENT

The following provisions are hereby incorporated into, and are hereby made a part of, that certain Stock Purchase Agreement (the "Purchase Agreement") by and between ERI Corp. (the "Corporation") and ("Optionee") evidencing the shares of Common Stock purchased on this date by Optionee under the Corporation's 2002 Stock Option/Stock Issuance Plan, and such provisions shall be effective immediately. All capitalized terms in this Addendum, to the extent not otherwise defined herein, shall have the meanings assigned to such terms in the Purchase Agreement.

INVOLUNTARY TERMINATION FOLLOWING
CORPORATE TRANSACTION

I. TO THE EXTENT THE REPURCHASE RIGHT IS ASSIGNED TO THE SUCCESSOR CORPORATION (OR PARENT THEREOF) IN CONNECTION WITH A CORPORATE TRANSACTION, NO ACCELERATED VESTING OF THE PURCHASED SHARES SHALL OCCUR UPON SUCH CORPORATE TRANSACTION, AND THE REPURCHASE RIGHT SHALL CONTINUE TO REMAIN IN FULL FORCE AND EFFECT IN ACCORDANCE WITH THE PROVISIONS OF THE PURCHASE AGREEMENT. OPTIONEE SHALL, OVER HIS OR HER PERIOD OF SERVICE FOLLOWING THE CORPORATE TRANSACTION, CONTINUE TO VEST IN THE PURCHASED SHARES IN ONE OR MORE INSTALLMENTS IN ACCORDANCE WITH THE PROVISIONS OF THE PURCHASE AGREEMENT. HOWEVER, UPON AN INVOLUNTARY TERMINATION OF OPTIONEE'S SERVICE WITHIN SIX (6) MONTHS FOLLOWING THE CORPORATE TRANSACTION, THE REPURCHASE RIGHT SHALL TERMINATE AUTOMATICALLY, AND ALL THE PURCHASED SHARES SHALL IMMEDIATELY VEST IN FULL AT THAT TIME.

J. FOR PURPOSES OF THIS ADDENDUM, THE FOLLOWING DEFINITIONS SHALL BE IN EFFECT:

An **Involuntary Termination** shall mean the termination of Optionee's Service by reason of:

1. Optionee's involuntary dismissal or discharge by the Corporation for reasons other than for Misconduct, or

2. Optionee's voluntary resignation following (A) a change in his or her position with the Corporation (or Parent or Subsidiary employing Optionee) which materially reduces his or her duties and responsibilities or the level of management to which he or she reports, (B) a reduction in Optionee's level of compensation (including base salary, fringe benefits and target

bonuses under any corporate-performance based incentive programs) by more than fifteen percent (15%) or (C) a relocation of Optionee's place of employment by more than fifty (50) miles, provided and only if such change, reduction or relocation is effected by the Corporation without Optionee's consent.

Misconduct shall mean the termination of Optionee's Service by reason of Optionee's commission of any act of fraud, embezzlement or dishonesty, any unauthorized use or disclosure by Optionee of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any other intentional misconduct by Optionee adversely affecting the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of Optionee or any other individual in the Service of the Corporation (or any Parent or Subsidiary).

IN WITNESS WHEREOF, ERI Corp. has caused this Addendum to be executed by its duly-authorized officer as of the Effective Date specified below:

ERI CORP.

By: _____

Title: _____

EFFECTIVE DATE: _____

ERI CORP.

2002 STOCK OPTION AGREEMENT

RECITALS

I. The Board has adopted the Plan for the purpose of retaining the services of selected Employees, non-employee members of the Board or the board of directors of any Parent or Subsidiary and consultants and other independent advisors in the service of the Corporation (or any Parent or Subsidiary).

A. Optionee is to render valuable services to the Corporation (or a Parent or Subsidiary), and this Agreement is executed pursuant to, and is intended to carry out the purposes of, the Plan in connection with the Corporation's grant of an option to Optionee.

B. All capitalized terms in this Agreement shall have the meaning assigned to them in the attached Appendix.

NOW, THEREFORE, it is hereby agreed as follows:

1. **Grant of Option**. The Corporation hereby grants to Optionee, as of the Grant Date, an option to purchase up to the number of Option Shares specified in the Grant Notice. The Option Shares shall be purchasable from time to time during the option term specified in Paragraph 2 at the Exercise Price set forth in the Grant Notice.

2. **Option Term**. This option shall have a term of ten (10) years measured from the Grant Date and shall accordingly expire at the close of business on the Expiration Date, unless sooner terminated in accordance with Paragraph 5 or 6.

3. **Limited Transferability**. During Optionee's lifetime, this option shall be exercisable only by Optionee and shall not be assignable or transferable other than by will or by the laws of descent and distribution following Optionee's death.

4. **Dates of Exercise**. This option shall become exercisable for the Option Shares in one or more installments as specified in the Grant Notice. As the option becomes exercisable for such installments, those installments shall accumulate, and the option shall remain exercisable for the accumulated installments until the Expiration Date or sooner termination of the option term under Paragraph 5 or 6.

5. **Cessation of Service**. The option term specified in Paragraph 2 shall terminate (and this option shall cease to be outstanding) prior to the Expiration Date should any of the following provisions become applicable:

(a) Should Optionee cease to remain in Service for any reason (other than death, Disability or Misconduct) while this option is outstanding, then Optionee shall have a period of one (1) month (commencing with the date of such cessation of Service) during which to exercise this option, but in no event shall this option be exercisable at any time after the Expiration Date.

(b) Should Optionee die while this option is outstanding, then the personal representative of Optionee's estate or the person or persons to whom the option is transferred pursuant to Optionee's will or in accordance with the laws of inheritance shall have the right to exercise this option. Such right shall lapse, and this option shall cease to be outstanding, upon the earlier of (i) the expiration of the twelve (12)-month period measured from the date of Optionee's death or (ii) the Expiration Date.

(c) Should Optionee cease Service by reason of Disability while this option is outstanding, then Optionee shall have a period of twelve (12) months (commencing with the date of such cessation of Service) during which to exercise this option. In no event shall this option be exercisable at any time after the Expiration Date.

Note: Exercise of this option on a date later than three (3) months following cessation of Service due to Disability will result in loss of favorable Incentive Option treatment, unless such Disability constitutes Permanent Disability. In the event that Incentive Option treatment is not available, this option will be taxed as a Non-Statutory Option upon exercise.

(d) During the limited period of post-Service exercisability, this option may not be exercised in the aggregate for more than the number of Option Shares in which Optionee is, at the time of Optionee's cessation of Service, vested pursuant to the Vesting Schedule specified in the Grant Notice or the special vesting acceleration provisions of Paragraph 6. Upon the expiration of such limited exercise period or (if earlier) upon the Expiration Date, this option shall terminate and cease to be outstanding for any vested Option Shares for which the option has not been exercised. To the extent Optionee is not vested in the Option Shares at the time of Optionee's cessation of Service, this option shall immediately terminate and cease to be outstanding in respect of those shares.

(e) Should Optionee's Service be terminated for Misconduct, then this option shall terminate immediately and cease to remain outstanding.

(f) In the event of a Corporate Transaction, the provisions of Paragraph 6 shall govern the period for which this option is to remain exercisable following Optionee's cessation of Service and shall supersede any provisions to the contrary in this paragraph.

6. **Accelerated Vesting**.

(a) In the event of any Corporate Transaction, the Option Shares at the time subject to this option but not otherwise vested shall automatically vest in full so that this option shall, immediately prior to the effective date of the Corporate Transaction, become fully exercisable for all of those Option Shares and may be exercised for any or all of those Option

Shares as folly-vested shares of Common Stock. However, the Option Shares shall **not** vest on such an accelerated basis if and to the extent: (i) this option is assumed by the successor corporation (or parent thereof) in the Corporate Transaction and the Corporation's repurchase rights in respect of the unvested Option Shares are assigned to such successor corporation (or parent thereof) or (ii) this option is to be replaced with a cash incentive program of the successor corporation which preserves the spread existing on the unvested Option Shares at the time of the Corporate Transaction (the excess of the Fair Market Value of those Option Shares over the Exercise Price payable for such shares) and provides for subsequent payout in accordance with the same Vesting Schedule applicable to those unvested Option Shares as set forth in the Grant Notice.

(b) Immediately following the Corporate Transaction, this option shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation (or parent thereof) in connection with the Corporate Transaction.

(c) If this option is assumed in connection with a Corporate Transaction, then this option shall be appropriately adjusted, immediately after such Corporate Transaction, to apply to the number and class of securities which would have been issuable to Optionee in consummation of such Corporate Transaction had the option been exercised immediately prior to such Corporate Transaction, and appropriate adjustments shall also be made to the Exercise Price, provided the aggregate Exercise Price shall remain the same.

(d) Should there occur an Involuntary Termination of Optionee's Service within twelve (12) months following a Corporate Transaction in which the Option Shares do not otherwise vest on an accelerated basis pursuant to Paragraph 6(a), then all the Option Shares subject to this option at the time of such Involuntary Termination but not otherwise vested shall automatically vest and the Corporation's repurchase rights in respect of those shares shall terminate so that this option shall immediately become exercisable for all the Option Shares as fully-vested shares. The option shall remain exercisable for any or all of those vested Option Shares until the earlier of (i) the Expiration Date or (ii) the expiration of the one (l)-year period measured from the date of the Involuntary Termination.

(e) This Agreement shall not in any way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

7. **Adjustment in Option Shares**. Should any change be made to the Common Stock by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration, appropriate adjustments shall be made to (i) the total number and/or class of securities subject to this option and (ii) the Exercise Price in order to reflect such change and thereby preclude a dilution or enlargement of benefits hereunder.

8. **Stockholder Rights**. The holder of this option shall not have any stockholder rights in respect of the Option Shares until such person shall have exercised the option, paid the Exercise Price and become the recordholder of the purchased shares.

9. **Manner of Exercising Option.**

(a) In order to exercise this option in respect of all or any part of the Option Shares for which this option is at the time exercisable, Optionee (or any other person or persons exercising the option) must take the following actions:

(i) Execute and deliver to the Corporation a Purchase Agreement for the Option Shares for which the option is exercised.

(ii) Pay the aggregate Exercise Price for the purchased shares in one or more of the following forms:

(A) cash or check made payable to the Corporation; or

Should the Common Stock be registered under Section 12 of the 1934 Act at the time the option is exercised, then the Exercise Price may also be paid as follows:

(B) in shares of Common Stock held by Optionee (or any other person or persons exercising the option) for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at Fair Market Value on the Exercise Date; or

(C) to the extent the option is exercised for vested Option Shares, through a special sale and remittance procedure pursuant to which Optionee (or any other person or persons exercising the option) shall concurrently provide irrevocable instructions (a) to a Corporation-designated brokerage firm to effect the immediate sale of the purchased shares and remit to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate Exercise Price payable for the purchased shares plus all applicable Federal, state and local income and employment taxes required to be withheld by the Corporation by reason of such exercise and (b) to the Corporation to deliver the certificates for the purchased shares directly to such brokerage firm in order to complete the sale.

Except to the extent the sale and remittance procedure is utilized in connection with the option exercise, payment of the Exercise Price must accompany the Purchase Agreement delivered to the Corporation in connection with the option exercise.

(iii) Furnish to the Corporation appropriate documentation that the person or persons exercising the option (if other than Optionee) have the right to exercise this option.

(iv) Execute and deliver to the Corporation such written representations as may be requested by the Corporation in order for it to comply with the applicable requirements of Federal and state securities laws.

(v) Make appropriate arrangements with the Corporation (or Parent or Subsidiary employing or retaining Optionee) for the satisfaction of all Federal, state and local income and employment tax withholding requirements applicable to the option exercise.

(b) As soon as practical after the Exercise Date, the Corporation shall issue to or on behalf of Optionee (or any other person or persons exercising this option) a certificate for the purchased Option Shares, with the appropriate legends affixed thereto.

(c) In no event may this option be exercised for any fractional shares.

10. REPURCHASE RIGHTS. ALL OPTION SHARES ACQUIRED UPON THE EXERCISE OF THIS OPTION SHALL BE SUBJECT TO CERTAIN RIGHTS OF THE CORPORATION AND ITS ASSIGNS TO REPURCHASE THOSE SHARES IN ACCORDANCE WITH THE TERMS SPECIFIED IN THE PURCHASE AGREEMENT.

11. **Compliance with Laws and Regulations**.

(a) The exercise of this option and the issuance of the Option Shares upon such exercise shall be subject to compliance by the Corporation and Optionee with all applicable requirements of law relating thereto and with all applicable regulations of any stock exchange (or the Nasdaq National Market, if applicable) on which the Common Stock may be listed for trading at the time of such exercise and issuance.

(b) The inability of the Corporation to obtain approval from any regulatory body having authority deemed by the Corporation to be necessary to the lawful issuance and sale of any Common Stock pursuant to this option shall relieve the Corporation of any liability in respect of the non-issuance or sale of the Common Stock as to which such approval shall not have been obtained. The Corporation, however, shall use its best efforts to obtain all such approvals.

12. **Successors and Assigns**. Except to the extent otherwise provided in Paragraphs 3 and 6, the provisions of this Agreement shall inure to the benefit of, and be binding upon, the Corporation and its successors and assigns and Optionee, Optionee's assigns and the legal representatives, heirs and legatees of Optionee's estate.

13. **Notices**. Any notice required to be given or delivered to the Corporation under the terms of this Agreement shall be in writing and addressed to the Corporation at its principal corporate offices. Any notice required to be given or delivered to Optionee shall be in writing and addressed to Optionee at the address indicated below Optionee's signature line on the Grant Notice. All notices shall be deemed effective upon personal delivery or upon deposit in the U.S. mail, postage prepaid and properly addressed to the party to be notified.

14. **Construction**. This Agreement and the option evidenced hereby are made and granted pursuant to the Plan and are in all respects limited by and subject to the terms of the Plan. All decisions of the Plan Administrator in respect of any question or issue arising under the

Plan or this Agreement shall be conclusive and binding on all persons having an interest in this option.

15. **Governing Law**. The interpretation, performance and enforcement of this Agreement shall be governed by the laws of the State of California without resort to that State's conflict-of-laws rules.

16. **Stockholder Approval**. If the Option Shares covered by this Agreement exceed, as of the Grant Date, the number of shares of Common Stock which may be issued under the Plan as last approved by the stockholders, then this option shall be void in respect of such excess shares, unless stockholder approval of an amendment sufficiently increasing the number of shares of Common Stock issuable under the Plan is obtained in accordance with the provisions of the Plan.

17. **Additional Terms Applicable to an Incentive Option**. In the event this option is designated an Incentive Option in the Grant Notice, the following terms and conditions shall also apply to the grant:

(a) This option shall cease to qualify for Favorable tax treatment as an Incentive Option if (and to the extent) this option is exercised for one or more Option Shares: (i) more than three (3) months after the date Optionee ceases to be an Employee for any reason other than death or Permanent Disability or (ii) more than twelve (12) months after the date Optionee ceases to be an Employee by reason of Permanent Disability.

(b) This option shall not become exercisable in the calendar year in which granted if (and to the extent) the aggregate Fair Market Value (determined at the Grant Date) of the Common Stock for which this option would otherwise first become exercisable in such calendar year would, when added to the aggregate value (determined as of the respective date or dates of grant) of the Common Stock and any other securities for which one or more other Incentive Options granted to Optionee prior to the Grant Date (whether under the Plan or any other option plan of the Corporation or any Parent or Subsidiary) first become exercisable during the same calendar year, exceed One Hundred Thousand Dollars ($100,000) in the aggregate. To the extent the exercisability of this option is deferred by reason of the foregoing limitation, the deferred portion shall become exercisable in the first calendar year or years thereafter in which the One Hundred Thousand Dollar ($100,000) limitation of this Paragraph 18(b) would not be contravened, but such deferral shall in all events end immediately prior to the effective date of a Corporate Transaction in which this option is not to be assumed or an Involuntary Termination following a Corporate Transaction in which this option is assumed, whereupon the option shall become immediately exercisable as a Non-Statutory Option for the deferred portion of the Option Shares.

(c) Should Optionee hold, in addition to this option, one or more other options to purchase Common Stock which become exercisable for the first time in the same calendar year as this option, then the foregoing limitations on the exercisability of such options as Incentive Options shall be applied on the basis of the order in which such options are granted.

ERI CORP.

By: _____

Title: _____

Address: 1908 Doolittle Drive
San Leandro, CA 94577

The Optionee represents that the Optionee is familiar with the terms and provisions of this Option Agreement and hereby accepts the Option subject to all of the terms and provisions thereof. The Optionee hereby agrees to accept as binding, conclusive and final all decisions or interpretations of the Board upon any questions arising under this Option Agreement. The undersigned acknowledges receipt of a copy of the Plan.

OPTIONEE

Date: _____ _____

Optionee Address:

_____

_____

APPENDIX

The following definitions shall be in effect under the Agreement:

A. **Agreement** shall mean this Stock Option Agreement.

B. **Board** shall mean the Corporation's Board of Directors.

C. **Code** shall mean the Internal Revenue Code of 1986, as amended.

D. **Common Stock** shall mean the Corporation's common stock.

E. **Corporate Transaction** shall mean either of the following stockholder approved transactions to which the Corporation is a party:

(i) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction, or

(ii) the sale, transfer or other disposition of all or substantially all of the Corporation's assets in complete liquidation or dissolution of the Corporation.

F. **Corporation** shall mean ERI Corp., a Delaware corporation, and any successor corporation to all or substantially all of the assets or voting stock of ERI Corp. which shall by appropriate action adopt the Plan.

G. **Disability** shall mean the inability of Optionee to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment and shall be determined by the Plan Administrator on the basis of such medical evidence as the Plan Administrator deems warranted under the circumstances. Disability shall be deemed to constitute **Permanent Disability** in the event that such Disability is expected to result in death or has lasted or can be expected to last for a continuous period of twelve (12) months or more.

H. **Employee** shall mean an individual who is in the employ of the Corporation (or any Parent or Subsidiary), subject to the control and direction of the employer entity as to both the work to be performed and the manner and method of performance.

I. **Exercise Date** shall mean the date on which the option shall have been exercised in accordance with Paragraph 9 of the Agreement.

J. **Exercise Price** shall mean the exercise price payable per Option Share as specified in the Grant Notice.

K. **Expiration Date** shall mean the date on which the option expires as specified in the Grant Notice.

L. **Fair Market Value** per share of Common Stock on any relevant date shall be determined in accordance with the following provisions:

(i) If the Common Stock is at the time traded on the Nasdaq National Market, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question, as the price is reported by the National Association of Securities Dealers on the Nasdaq National Market. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(ii) If the Common Stock is at the time listed on any Stock Exchange, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question on the Stock Exchange determined by the Plan Administrator to be the primary market for the Common Stock, as such price is officially quoted in the composite tape of transactions on such exchange. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(iii) If the Common Stock is at the time neither listed on any Stock Exchange nor traded on the Nasdaq National Market, then the Fair Market Value shall be determined by the Plan Administrator after taking into account such factors as the Plan Administrator shall deem appropriate.

M. **Grant Date** shall mean the date of grant of the option as specified in the Grant Notice.

N. **Grant Notice** shall mean the Notice of Grant of Stock Option accompanying the Agreement, pursuant to which Optionee has been informed of the basic terms of the option evidenced hereby.

O. **Incentive Option** shall mean an option which satisfies the requirements of Code Section 422.

P. **Involuntary Termination** shall mean the termination of Optionee's Service which occurs by reason of:

(i) Optionee's dismissal or discharge by the Corporation for reasons other than Misconduct, or

(ii) Optionee's voluntary resignation following (A) a change in Optionee's position with the Corporation (or Parent or Subsidiary employing Optionee) which materially reduces Optionee's level of responsibility, (B) a reduction in Optionee's level of compensation (including base salary, fringe benefits and target bonuses under any corporate-performance based bonus or incentive programs) by more than fifteen percent (15%) in the aggregate or (C) a relocation of Optionee's place of employment by more than fifty (50) miles from

Optionee's place of employment immediately prior to the Corporate Transaction, provided and only if such change, reduction or relocation is effected by the Corporation without Optionee's consent.

Q. **Misconduct** shall mean the commission of any act of fraud, embezzlement or dishonesty by Optionee, any unauthorized use or disclosure by Optionee of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any other intentional misconduct by Optionee adversely affecting the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of Optionee or any other individual in the Service of the Corporation (or any Parent or Subsidiary).

R. **1934 Act** shall mean the Securities Exchange Act of 1934, as amended.

S. **Non-Statutory Option** shall mean an option not intended to satisfy the requirements of Code Section 422.

T. **Option Shares** shall mean the number of shares of Common Stock subject to the option.

U. **Optionee** shall mean the person to whom the option is granted as specified in the Grant Notice.

V. **Parent** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation, provided each corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

W. **Plan** shall mean the Corporation's 2002 Stock Option/Stock Issuance Plan.

X. **Plan Administrator** shall mean either the Board or a committee of the Board acting in its capacity as administrator of the Plan.

Y. **Purchase Agreement** shall mean the stock purchase agreement in substantial the form of Exhibit B to the Grant Notice.

Z. **Service** shall mean the Optionee's performance of services for the Corporation (or any Parent or Subsidiary) in the capacity of an Employee, a non-employee member of the board of directors or an independent consultant.

AA. **Stock Exchange** shall mean the American Stock Exchange or the New York Stock Exchange.

BB. **Subsidiary** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations beginning with the Corporation, provided each corporation (other

than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

CC. **Vesting Schedule** shall mean the vesting schedule specified in the Grant Notice pursuant to which the Optionee is to vest in the Option Shares in a series of installments over his or her period of Service.

Exhibit 10.4

ENERGY RECOVERY, INC.
2004 STOCK OPTION/STOCK ISSUANCE PLAN

ARTICLE ONE
GENERAL PROVISIONS

I. PURPOSE OF THE PLAN

This 2004 Stock Option/Stock Issuance Plan is intended to promote the interests of Energy Recovery Inc., a Delaware corporation, by providing eligible persons in the Corporation's employ or service with the opportunity to acquire a proprietary interest, or otherwise increase their proprietary interest, in the Corporation as an incentive for them to continue in such employ or service.

Capitalized terms herein shall have the meanings assigned to such terms in the attached Appendix.

II. STRUCTURE OF THE PLAN

A. The Plan shall be divided into two (2) separate equity programs:

(i) the Option Grant Program under which eligible persons may, at the discretion of the Plan Administrator, be granted options to purchase shares of Common Stock, and

(ii) the Stock Issuance Program under which eligible persons may, at the discretion of the Plan Administrator, be issued shares of Common Stock directly, either through the immediate purchase of such shares or as a bonus for services rendered the Corporation (or any Parent or Subsidiary).

B. The provisions of Articles One and Four shall apply to both equity programs under the Plan and shall accordingly govern the interests of all persons under the Plan.

III. ADMINISTRATION OF THE PLAN

A. The Plan shall be administered by the Board. However, any or all administrative functions otherwise exercisable by the Board may be delegated to the Committee. Members of the Committee shall serve for such period of time as the Board may determine and shall be subject to removal by the Board at any time. The Board may also at any time terminate the functions of the Committee and reassume all powers and authority previously delegated to the Committee.

B. The Plan Administrator shall have full power and authority (subject to the provisions of the Plan) to establish such rules and regulations as it may deem appropriate for proper administration of the Plan and to make such determinations under, and issue such interpretations of, the Plan and any outstanding options or stock issuances thereunder as it may deem necessary or advisable. Decisions of the Plan Administrator shall be final and binding on all parties who have an interest in the Plan or any option or stock issuance thereunder.

IV. ELIGIBILITY

A. The persons eligible to participate in the Plan are as follows:

(i) Employees,

(ii) non-employee members of the Board or the non-employee members of the board of directors of any Parent or Subsidiary, and

(iii) consultants and other independent advisors who provide services to the Corporation (or any Parent or Subsidiary).

B. The Plan Administrator shall have full authority to determine, (i) in respect of the grants under the Option Grant Program, which eligible persons are to receive the option grants, the time or times when those grants are to be made, the number of shares to be covered by each such grant, the status of the granted option as either an Incentive Option or a Non-Statutory Option, the time or times when each option is to become exercisable, the vesting schedule (if any) applicable to the option shares and the maximum term for which the option is to remain outstanding, and (ii) in respect of stock issuances under the Stock Issuance Program, which eligible persons are to receive stock issuances, the time or times when those issuances are to be made, the number of shares to be issued to each Participant, the vesting schedule (if any) applicable to the issued shares and the consideration to be paid by the Participant for such shares.

C. The Plan Administrator shall have the absolute discretion either to grant options in accordance with the Option Grant Program or to effect stock issuances in accordance with the Stock Issuance Program.

V. STOCK SUBJECT TO THE PLAN

A. The stock issuable under the Plan shall be shares of authorized but unissued or reacquired Common Stock. The maximum number of shares of Common Stock which may be issued over the term of the Plan shall not exceed eight hundred fifty thousand (850,000) shares.

B. Shares of Common Stock subject to outstanding options shall be available for subsequent issuance under the Plan to the extent (i) the options expire or terminate for any reason prior to exercise in full or (ii) the options are cancelled in accordance with the cancellation-regrant provisions of Article Two. Unvested shares issued under the Plan and subsequently repurchased by the Corporation, at the option exercise or direct issue price paid per share, pursuant to the Corporation's repurchase rights under the Plan shall be added back to the number of shares of Common Stock reserved for issuance under the Plan and shall accordingly be available for reissuance through one or more subsequent option grants or direct stock issuances under the Plan.

C. Should any change be made to the Common Stock by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration, appropriate adjustments shall be made to (i) the maximum number and/or class of

securities issuable under the Plan and (ii) the number and/or class of securities and the exercise price per share in effect under each outstanding option in order to prevent the dilution or enlargement of benefits thereunder. The adjustments determined by the Plan Administrator shall be final, binding and conclusive. In no event shall any such adjustments be made in connection with the conversion of one or more outstanding shares of the Corporation's preferred stock into shares of Common Stock.

ARTICLE TWO
OPTION GRANT PROGRAM

I. OPTION TERMS

Each option shall be evidenced by one or more documents in the form approved by the Plan Administrator; provided, however, that each such document shall comply with the terms specified below. Each document evidencing an Incentive Option shall, in addition, be subject to the provisions of the Plan applicable to such options.

A. **Exercise Price**.

1. The exercise price per share shall be fixed by the Plan Administrator in accordance with the following provisions:

(i) The exercise price per share shall not be less than eighty-five percent (85%) of the Fair Market Value per share of Common Stock on the option grant date.

(ii) If the person to whom the option is granted is a 10% Stockholder, then the exercise price per share shall not be less than one hundred ten percent (110%) of the Fair Market Value per share of Common Stock on the option grant date.

2. The exercise price shall become immediately due upon exercise of the option and shall, subject to the provisions of Section I of Article Four and the documents evidencing the option, be payable in cash or check made payable to the Corporation. Should the Common Stock be registered under Section 12 of the 1934 Act at the time the option is exercised, then the exercise price may also be paid as follows:

(i) in shares of Common Stock held for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at Fair Market Value on the Exercise Date, or

(ii) to the extent the option is exercised for vested shares, through a special sale and remittance procedure pursuant to which the Optionee shall concurrently provide irrevocable instructions (A) to a Corporation-designated brokerage firm to effect the immediate sale of the purchased shares and remit to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate exercise price payable for the purchased shares plus all applicable Federal, state and local income and employment taxes required to be withheld by the Corporation by reason of such exercise and (B) to the Corporation to deliver the certificates for the purchased shares directly to such brokerage firm in order to complete the sale.

Except to the extent such sale and remittance procedure is utilized, payment of the exercise price for the purchased shares must be made on the Exercise Date.

B. **Exercise and Term of Options**. Each option shall be exercisable at such time or times, during such period and for such number of shares as shall be determined by the Plan Administrator and set forth in the documents evidencing the option grant. However, no option shall have a term in excess of ten (10) years measured from the option grant date.

C. **Effect of Termination of Service**.

1. The following provisions shall govern the exercise of any options held by the Optionee at the time of cessation of Service or death:

(i) Should the Optionee cease to remain in Service for any reason other than death, Disability or Misconduct, then the Optionee shall have a period of one (1) month following the date of such cessation of Service during which to exercise each outstanding option held by such Optionee.

(ii) Should Optionee's Service terminate by reason of Disability, then the Optionee shall have a period of twelve (12) months following the date of such cessation of Service during which to exercise each outstanding option held by such Optionee.

(iii) If the Optionee dies while holding an outstanding option, then the personal representative of his or her estate or the person or persons to whom the option is transferred pursuant to the Optionee's will or the laws of inheritance shall have a twelve (12)-month period following the date of the Optionee's death to exercise such option.

(iv) Under no circumstances, however, shall any such option be exercisable after the specified expiration of the option term.

(v) During, the applicable post-Service exercise period, the option may not be exercised in the aggregate for more than the number of vested shares for which the option is exercisable on the date of the Optionee's cessation of Service. Upon the expiration of the applicable exercise period or (if earlier) upon the expiration of the option term, the option shall terminate and cease to be outstanding for any vested shares for which the option has not been exercised. However, the option shall, immediately upon the Optionee's cessation of Service, terminate and cease to be outstanding in respect of any and all option shares for which the option is not otherwise at the time exercisable or in which the Optionee is not otherwise at that time vested.

(vi) Should Optionee's Service be terminated for Misconduct, then all outstanding options held by the Optionee shall terminate immediately and cease to remain outstanding.

2. The Plan Administrator shall have the discretion, exercisable either at the time an option is granted or at any time while the option remains outstanding, to:

(i) extend the period of time for which the option is to remain exercisable following Optionee's cessation of Service or death from the limited period otherwise in effect for that option to such greater period of time as the Plan Administrator shall deem appropriate, but in no event beyond the expiration of the option term, and/or

(ii) permit the option to be exercised, during the applicable post-Service exercise period, not only in respect of the number of vested shares of Common Stock for which such option is exercisable at the time of the Optionee's cessation of Service but also in respect of one or more additional installments in which the Optionee would have vested under the option had the Optionee continued in Service.

D. **Stockholder Rights**. The holder of an option shall have no stockholder rights in respect of the shares subject to the option until such person shall have exercised the option, paid the exercise price and become the recordholder of the purchased shares.

E. **Unvested Shares**. The Plan Administrator shall have the discretion to grant options which are exercisable for unvested shares of Common Stock. Should the Optionee cease Service while holding such unvested shares, the Corporation shall have the right to repurchase, at the exercise price paid per share, any or all of those unvested shares. The terms upon which such repurchase right shall be exercisable (including the period and procedure for exercise and the appropriate vesting schedule for the purchased shares) shall be established by the Plan Administrator and set forth in the document evidencing such repurchase right. The Plan Administrator may not impose a vesting schedule upon the option grant or any shares of Common Stock subject to that option which is more restrictive than twenty percent (20%) per year vesting, with the initial vesting to occur not later than one (1) year after the option grant date. However, such limitation shall not be applicable to any option grants made to individuals who are officers of the Corporation, non-employee Board members or independent consultants.

F. **First Refusal Rights**. Until such time as the Common Stock is first registered under Section 12 of the 1934 Act, the Corporation shall have the right of first refusal in respect of any proposed disposition by the Optionee (or any successor in interest) of any shares of Common Stock issued under the Plan. Such right of first refusal shall be exercisable in accordance with the terms established by the Plan Administrator and set forth in the document evidencing such right.

G. **Limited Transferability of Options**. During the lifetime of the Optionee, the option shall be exercisable only by the Optionee and shall not be assignable or transferable other than by will or by the laws of descent and distribution following the Optionee's death.

H. **Withholding**. The Corporation's obligation to deliver shares of Common Stock upon the exercise of any options granted under the Plan shall be subject to the satisfaction of all applicable Federal, state and local income and employment tax withholding requirements.

II. INCENTIVE OPTIONS

The terms specified below shall be applicable to all Incentive Options. Except as modified by the provisions of this Section II, all the provisions of the Plan shall be applicable to Incentive Options. Options which are specifically designated as Non-Statutory Options shall not be subject to the terms of this Section II.

A. **Eligibility.** Incentive Options may only be granted to Employees.

B. **Exercise Price.** The exercise price per share shall not be less than one hundred percent (100%) of the Fair Market Value per share of Common Stock on the option grant date.

C. **Dollar Limitation.** The aggregate Fair Market Value of the shares of Common Stock (determined as of the respective date or dates of grant) for which one or more options granted to any Employee under the Plan (or any other option plan of the Corporation or any Parent or Subsidiary) may for the first time become exercisable as Incentive Options during any one (1) calendar year shall not exceed the sum of One Hundred Thousand Dollars ($100,000). To the extent the Employee holds two (2) or more such options which become exercisable for the first time in the same calendar year, the foregoing limitation on the exercisability of such options as Incentive Options shall be applied on the basis of the order in which such options are granted.

D. **10% Stockholder.** If any Employee to whom an Incentive Option is granted is a 10% Stockholder, then the option term shall not exceed five (5) years measured from the option grant date.

III. CORPORATE TRANSACTION

A. The shares subject to each option outstanding under the Plan at the time of a Corporate Transaction shall automatically vest in full so that each such option shall, immediately prior to the effective date of the Corporate Transaction, become fully exercisable for all of the shares of Common Stock at the time subject to that option and may be exercised for any or all of those shares as fully-vested shares of Common Stock. However, the shares subject to an outstanding option shall not vest on such an accelerated basis if and to the extent: (i) such option is assumed by the successor corporation (or parent thereof) in the Corporate Transaction and the Corporation's repurchase rights in respect of the unvested option shares are concurrently assigned to such successor corporation (or parent thereof) or (ii) such option is to be replaced with a cash incentive program of the successor corporation which preserves the spread existing on the unvested option shares at the time of the Corporate Transaction and provides for subsequent payout in accordance with the same vesting schedule applicable to those unvested option shares or (iii) the acceleration of such option is subject to other limitations imposed by the Plan Administrator at the time of the option grant.

B. All outstanding repurchase rights shall also terminate automatically, and the shares of Common Stock subject to those terminated rights shall immediately vest in full, in the event of any Corporate Transaction, except to the extent: (i) those repurchase rights are assigned to the successor corporation (or parent thereof) in connection with such Corporate

Transaction or (ii) such accelerated vesting is precluded by other limitations imposed by the Plan Administrator at the time the repurchase right is issued.

C. Immediately following the consummation of the Corporate Transaction, all outstanding options shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation (or parent thereof).

D. Each option which is assumed in connection with a Corporate Transaction shall be appropriately adjusted, immediately after such Corporate Transaction, to apply to the number and class of securities which would have been issuable to the Optionee in consummation of such Corporate Transaction, had the option been exercised immediately prior to such Corporate Transaction. Appropriate adjustments shall also be made to (i) the number and class of securities available for issuance under the Plan following the consummation of such Corporate Transaction and (ii) the exercise price payable per share under each outstanding option, provided the aggregate exercise price payable for such securities shall remain the same.

E. The Plan Administrator shall have the discretion, exercisable either at the time the option is granted or at any time while the option remains outstanding, to provide for the automatic acceleration (in whole or in part) of one or more outstanding options (and the immediate termination of the Corporation's repurchase rights in respect of the share subject to those options) upon the occurrence of a Corporate Transaction, whether or not those options are to be assumed in the Corporate Transaction.

F. The Plan Administrator shall also have full power and authority, exercisable either at the time the option is granted or at any time while the option remains outstanding, to structure such option so that the shares subject to that option will automatically vest on an accelerated basis should the Optionee's Service terminate by reason of an Involuntary Termination within a designated period (not to exceed eighteen (18) months) following the effective date of any Corporate Transaction in which the option is assumed and the repurchase rights applicable to those shares do not otherwise terminate. Any option so accelerated shall remain exercisable for the fully-vested option shares until the earlier of (i) the expiration of the option term or (ii) the expiration of the one (l)-year period measured from the effective date of the Involuntary Termination. In addition, the Plan Administrator may provide that one or more of the Corporation's outstanding repurchase rights in respect of shares held by the Optionee at the time of such Involuntary Termination shall immediately terminate on an accelerated basis, and the shares subject to those terminated rights shall accordingly vest at that time.

G. The portion of any Incentive Option accelerated in connection with a Corporate Transaction shall remain exercisable as an Incentive Option only to the extent the applicable One Hundred Thousand Dollar limitation is not exceeded. To the extent such dollar limitation is exceeded, the accelerated portion of such option shall be exercisable as a Non- Statutory Option under the Federal tax laws.

H. The grant of options under the Plan shall in no way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

IV. CANCELLATION AND REGRANT OF OPTIONS

The Plan Administrator shall have the authority to effect, at any time and from time to time, with the consent of the affected option holders, the cancellation of any or all outstanding options under the Plan and to grant in substitution therefor new options covering the same or different number of shares of Common Stock but with an exercise price per share based on the Fair Market Value per share of Common Stock on the new option grant date.

ARTICLE THREE
STOCK ISSUANCE PROGRAM

I. STOCK ISSUANCE TERMS

Shares of Common Stock may be issued under the Stock Issuance Program through direct and immediate issuances without any intervening option grants. Each such stock issuance shall be evidenced by a Stock Issuance Agreement which complies with the terms specified below.

A. **Purchase Price.**

1. The purchase price per share shall be fixed by the Plan Administrator but shall not be less than eighty-five percent (85%) of the Fair Market Value per share of Common Stock on the issue date. However, the purchase price per share of Common Stock issued to a 10% Stockholder shall not be less than one hundred and ten percent (110%) of such Fair Market Value.

2. Subject to the provisions of Section I of Article Four, shares of Common Stock may be issued under the Stock Issuance Program for any of the following items of consideration which the Plan Administrator may deem appropriate in each individual instance:

(i) cash or check made payable to the Corporation, or

(ii) past services rendered to the Corporation (or any Parent or Subsidiary).

B. **Vesting Provisions.**

1. Shares of Common Stock issued under the Stock Issuance Program may, in the discretion of the Plan Administrator, be fully and immediately vested upon issuance or may vest in one or more installments over the Participant's period of Service or upon attainment of specified performance objectives. However, the Plan Administrator may not impose a vesting schedule upon any stock issuance effected under the Stock Issuance Program which is more restrictive than twenty percent (20%) per year vesting, with initial vesting to occur not later than one (1) year after the issuance date. Such limitation shall not apply to any Common Stock issuances made to the officers of the Corporation, non-employee Board members or independent consultants.

2. Any new, substituted or additional securities or other property (including money paid other than as a regular cash dividend) which the Participant may have the right to receive in respect of the Participant's unvested shares of Common Stock by reason of any stock dividend, stock split, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration shall be issued subject to (i) the same vesting requirements applicable to the Participant's unvested shares of Common Stock and (ii) such escrow arrangements as the Plan Administrator shall deem appropriate.

3. The Participant shall have full stockholder rights in respect of any shares of Common Stock issued to the Participant under the Stock Issuance Program, whether or not the Participant's interest in those shares is vested. Accordingly, the Participant shall have the right to vote such shares and to receive any regular cash dividends paid on such shares.

4. Should the Participant cease to remain in Service while holding one or more unvested shares of Common Stock issued under the Stock Issuance Program or should the performance objectives not be attained in respect of one or more such unvested shares of Common Stock, then those shares shall be immediately surrendered to the Corporation for cancellation, and the Participant shall have no further stockholder rights in respect of those shares. To the extent the surrendered shares were previously issued to the Participant for consideration paid in cash or cash equivalent (including the Participant's purchase-money indebtedness), the Corporation shall repay to the Participant the cash consideration paid for the surrendered shares and shall cancel the unpaid principal balance of any outstanding purchase- money note of the Participant attributable to such surrendered shares.

5. The Plan Administrator may in its discretion waive the surrender and cancellation of one or more unvested shares of Common Stock (or other assets attributable thereto) which would otherwise occur upon the non-completion of the vesting schedule applicable to such shares. Such waiver shall result in the immediate vesting of the Participant's interest in the shares of Common Stock as to which the waiver applies. Such waiver may be effected at any time, whether before or after the Participant's cessation of Service or the attainment or non-attainment of the applicable performance objectives.

C. **First Refusal Rights.** Until such time as the Common Stock is first registered under Section 12 of the 1934 Act, the Corporation shall have the right of first refusal in respect of any proposed disposition by the Participant (or any successor in interest) of any shares of Common Stock issued under the Stock Issuance Program. Such right of first refusal shall be exercisable in accordance with the terms established by the Plan Administrator and set forth in the document evidencing such right.

II. CORPORATE TRANSACTION

A. Upon the occurrence of a Corporate Transaction, all outstanding repurchase rights under the Stock Issuance Program shall terminate automatically, and the shares of Common Stock subject to those terminated rights shall immediately vest in full, except to the extent: (i) those repurchase rights are assigned to the successor corporation (or parent thereof) in connection with such Corporate Transaction or (ii) such accelerated vesting is precluded by other limitations imposed by the Plan Administrator at the time the repurchase right is issued.

B. The Plan Administrator shall have the discretionary authority, exercisable either at the time the unvested shares are issued or any time while the Corporation's repurchase rights in respect of those shares remain outstanding, to provide that those rights shall automatically terminate on an accelerated basis, and the shares of Common Stock subject to those terminated rights shall immediately vest, in the event the Participant's Service should subsequently terminate by reason of an Involuntary Termination within a designated period (not

to exceed eighteen (18) months) following the effective date of any Corporate Transaction in which those repurchase rights are assigned to the successor corporation (or parent thereof).

III. SHARE ESCROW/LEGENDS

Unvested shares may, in the Plan Administrator's discretion, be held in escrow by the Corporation until the Participant's interest in such shares vests or may be issued directly to the Participant with restrictive legends on the certificates evidencing those unvested shares.

ARTICLE FOUR
MISCELLANEOUS

I. FINANCING

The Plan Administrator may permit any Optionee or Participant to pay the option exercise price or the purchase price for shares issued to such person under the Plan by delivering a full-recourse, interest-bearing promissory note payable in one or more installments and secured by the purchased shares. However, any promissory note delivered by a consultant must be secured by collateral in addition to the purchased shares of Common Stock. In no event shall the maximum credit available to the Optionee or Participant exceed the sum of (i) the aggregate option exercise price or purchase price payable for the purchased shares plus (ii) any Federal, state and local income and employment tax liability incurred by the Optionee or the Participant in connection with the option exercise or share purchase.

II. EFFECTIVE DATE AND TERM OF PLAN

A. The Plan shall become effective when adopted by the Board, but no option granted under the Plan may be exercised, and no shares shall be issued under the Plan, until the Plan is approved by the Corporation's stockholders. If such stockholder approval is not obtained within twelve (12) months after the date of the Board's adoption of the Plan, then all options previously granted under the Plan shall terminate and cease to be outstanding, and no further options shall be granted and no shares shall be issued under the Plan. Subject to such limitation, the Plan Administrator may grant options and issue shares under the Plan at any time after the effective date of the Plan and before the date fixed herein for termination of the Plan.

B. The Plan shall terminate upon the earliest of (i) the expiration of the ten (10)-year period measured from the date the Plan is adopted by the Board, (ii) the date on which all shares available for issuance under the Plan shall have been issued as vested shares or (iii) the termination of all outstanding options in connection with a Corporate Transaction. All options and unvested stock issuances outstanding at that time under the Plan shall continue to have full force and effect in accordance with the provisions of the documents evidencing such options or issuances.

III. AMENDMENT OF THE PLAN

A. The Board shall have complete and exclusive power and authority to amend or modify the Plan in any or all respects. However, no such amendment or modification shall adversely affect the rights and obligations in respect of options or unvested stock issuances at the time outstanding under the Plan unless the Optionee or the Participant consents to such amendment or modification. In addition, certain amendments may require stockholder approval pursuant to applicable laws and regulations.

B. Options may be granted under the Option Grant Program and shares may be issued under the Stock Issuance Program which are in each instance in excess of the number of shares of Common Stock then available for issuance under the Plan, provided any excess shares actually issued under those programs shall be held in escrow until there is obtained stockholder approval of an amendment sufficiently increasing the number of shares of Common

Stock available for issuance under the Plan. If such stockholder approval is not obtained within twelve (12) months after the date the first such excess issuances are made, then (i) any unexercised options granted on the basis of such excess shares shall terminate and cease to be outstanding and (ii) the Corporation shall promptly refund to the Optionees and the Participants the exercise or purchase price paid for any excess shares issued under the Plan and held in escrow, together with interest (at the applicable Short Term Federal Rate) for the period the shares were held in escrow, and such shares shall thereupon be automatically cancelled and cease to be outstanding.

IV. USE OF PROCEEDS

Any cash proceeds received by the Corporation from the sale of shares of Common Stock under the Plan shall be used for general corporate purposes.

V. WITHHOLDING

The Corporation's obligation to deliver shares of Common Stock upon the exercise of any options or upon the issuance or vesting of any shares issued under the Plan shall be subject to the satisfaction of all applicable Federal, state and local income and employment tax withholding requirements.

VI. REGULATORY APPROVALS

The implementation of the Plan, the granting of any options under the Plan and the issuance of any shares of Common Stock (i) upon the exercise of any option or (ii) under the Stock Issuance Program shall be subject to the Corporation's procurement of all approvals and permits required by regulatory authorities having jurisdiction over the Plan, the options granted under it and the shares of Common Stock issued pursuant to it.

VII. NO EMPLOYMENT OR SERVICE RIGHTS

Nothing in the Plan shall confer upon the Optionee or the Participant any right to continue in Service for any period of specific duration or interfere with or otherwise restrict in any way the rights of the Corporation (or any Parent or Subsidiary employing or retaining such person) or of the Optionee or the Participant, which rights are hereby expressly reserved by each, to terminate such person's Service at any time for any reason, with or without cause.

VIII. FINANCIAL REPORTS

The Corporation shall deliver a balance sheet and an income statement at least annually to each individual holding an outstanding option under the Plan, unless such individual is a key Employee whose duties in connection with the Corporation (or any Parent or Subsidiary) assure such individual access to equivalent information.

APPENDIX

The following definitions shall be in effect under the Plan:

A. **Board** shall mean the Corporation's Board of Directors.

B. **Code** shall mean the Internal Revenue Code of 1986, as amended.

C. **Committee** shall mean a committee of two (2) or more Board members appointed by the Board to exercise one or more administrative functions under the Plan.

D. **Common Stock** shall mean the Corporation's common stock.

E. **Corporate Transaction** shall mean either of the following stockholder-approved transactions to which the Corporation is a party:

(i) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction, or

(ii) the sale, transfer or other disposition of all or substantially all of the Corporation's assets in complete liquidation or dissolution of the Corporation.

F. **Corporation** shall mean Energy Recovery Inc., a Delaware corporation, and any successor corporation to all or substantially all of the assets or voting stock of Energy Recovery Inc. which shall by appropriate action adopt the Plan.

G. **Disability** shall mean the inability of the Optionee or the Participant to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment and shall be determined by the Plan Administrator on the basis of such medical evidence as the Plan Administrator deems warranted under the circumstances.

H. **Employee** shall mean an individual who is in the employ of the Corporation (or any Parent or Subsidiary), subject to the control and direction of the employer entity as to both the work to be performed and the manner and method of performance.

I. **Exercise Date** shall mean the date on which the Corporation shall have received written notice of the option exercise.

J. **Fair Market Value** per share of Common Stock on any relevant date shall be determined in accordance with the following provisions:

(i) If the Common Stock is at the time traded on the Nasdaq National Market, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question, as such price is reported

by the National Association of Securities Dealers on the Nasdaq National Market or any successor system. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(ii) If the Common Stock is at the time listed on any Stock Exchange, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question on the Stock Exchange determined by the Plan Administrator to be the primary market for the Common Stock, as such price is officially quoted in the composite tape of transactions on such exchange. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(iii) If the Common Stock is at the time neither listed on any Stock Exchange nor traded on the Nasdaq National Market, then the Fair Market Value shall be determined by the Plan Administrator after taking into account such factors as the Plan Administrator shall deem appropriate.

K. **Incentive Option** shall mean an option which satisfies the requirements of Code Section 422.

L. **Involuntary Termination** shall mean the termination of the Service of any individual which occurs by reason of:

(i) such individual's involuntary dismissal or discharge by the Corporation for reasons other than Misconduct, or

(ii) such individual's voluntary resignation following (A) a change in his or her position with the Corporation which materially reduces his or her duties and responsibilities or the level of management to which he or she reports, (B) a reduction in his or her level of compensation (including base salary, fringe benefits and target bonuses under any corporate-performance based bonus or incentive programs) by more than fifteen percent (15%) or (C) a relocation of such individual's place of employment by more than fifty (50) miles, provided and only if such change, reduction or relocation is effected without the individual's consent.

M. **Misconduct** shall mean the commission of any act of fraud, embezzlement or dishonesty by the Optionee or Participant, any unauthorized use or disclosure by such person of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any other intentional misconduct by such person adversely affecting the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of any Optionee, Participant or other person in the Service of the Corporation (or any Parent or Subsidiary).

N. **1934 Act** shall mean the Securities Exchange Act of 1934, as amended.

O. **Non-Statutory Option** shall mean an option not intended to satisfy the requirements of Code Section 422.

P. **Option Grant Program** shall mean the option grant program in effect under the Plan.

Q. **Optionee** shall mean any person to whom an option is granted under the Plan.

R. **Parent** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation, provided each corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

S. **Participant** shall mean any person who is issued shares of Common Stock under the Stock Issuance Program.

T. **Plan** shall mean the Corporation's 2004 Stock Option/Stock Issuance Plan, as set forth in this document.

U. **Plan Administrator** shall mean either the Board or the Committee acting in its capacity as administrator of the Plan.

V. **Service** shall mean the provision of services to the Corporation (or any Parent or Subsidiary) by a person in the capacity of an Employee, a non-employee member of the board of directors or a consultant or independent advisor, except to the extent otherwise specifically provided in the documents evidencing the option grant.

W. **Stock Exchange** shall mean either the American Stock Exchange or the New York Stock Exchange.

X. **Stock Issuance Agreement** shall mean the agreement entered into by the Corporation and the Participant at the time of issuance of shares of Common Stock under the Stock Issuance Program.

Y. **Stock Issuance Program** shall mean the stock issuance program in effect under the Plan.

Z. **Subsidiary** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations beginning with the Corporation, provided each corporation (other than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

AA. **10% Stockholder** shall mean the owner of stock (as determined under Code Section 424(d)) possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Corporation (or any Parent or Subsidiary).

Plan History

Adopted by the Board of Directors at a Regular Meeting held on ___ _____2004.

Ratified by the Stockholders at the 2004 Annual Meeting held on ___ _____ 2004.

ENERGY RECOVERY, INC.
STOCK PURCHASE AGREEMENT

AGREEMENT made this ___day of _____ 2004, by and between Energy Recovery, Inc., a Delaware corporation, and _____, Optionee under the Corporation's 2004 Stock Option/Stock Issuance Plan.

All capitalized terms in this Agreement shall have the meaning assigned to them in this Agreement or in the attached Appendix.

A. EXERCISE OF OPTION

1. **Exercise**. Optionee hereby purchases _____ shares of Common Stock (the "Purchased Shares") pursuant to that certain option (the "Option") granted Optionee on _____ (the "Grant Date") to purchase up to _____ shares of Common Stock (the "Option Shares") under the Plan at the exercise price of $_____ per share (the "Exercise Price").

2. **Payment**. Concurrently with the delivery of this Agreement to the Corporation, Optionee shall pay the Exercise Price for the Purchased Shares in accordance with the provisions of the Option Agreement and shall deliver whatever additional documents may be required by the Option Agreement as a condition for exercise, together with a duly-executed blank Assignment Separate from Certificate (in the form attached hereto as Exhibit I) with respect to the Purchased Shares.

3. **Stockholder Rights**. Until such time as the Corporation exercises the Repurchase Right or the First Refusal Right, Optionee (or any successor in interest) shall have all the rights of a stockholder (including voting, dividend and liquidation rights) with respect to the Purchased Shares, subject, however, to the transfer restrictions of Articles B and C.

B. SECURITIES LAW COMPLIANCE

1. **Restricted Securities**. The Purchased Shares have not been registered under the 1933 Act and are being issued to Optionee in reliance upon the exemption from such registration provided by SEC Rule 701 for stock issuances under compensatory benefit plans such as the Plan. Optionee hereby confirms that Optionee has been informed that the Purchased Shares are restricted securities under the 1933 Act and may not be resold or transferred unless the Purchased Shares are first registered under the Federal securities laws or unless an exemption from such registration is available. Accordingly, Optionee hereby acknowledges that Optionee is prepared to hold the Purchased Shares for an indefinite period and that Optionee is aware that SEC Rule 144 issued under the 1933 Act which exempts certain resales of unrestricted securities is not presently available to exempt the resale of the Purchased Shares from the registration requirements of the 1933 Act.

2. **Restrictions on Disposition of Purchased Shares**. Optionee shall make no disposition of the Purchased Shares (other than a Permitted Transfer) unless and until there is compliance with all of the following requirements:

(i) Optionee shall have provided the Corporation with a written summary of the terms and conditions of the proposed disposition.

(ii) Optionee shall have complied with all requirements of this Agreement applicable to the disposition of the Purchased Shares.

(iii) Optionee shall have provided the Corporation with written assurances, in form and substance satisfactory to the Corporation, that (a) the proposed disposition does not require registration of the Purchased Shares under the 1933 Act or (b) all appropriate action necessary for compliance with the registration requirements of the 1933 Act or any exemption from registration available under the 1933 Act (including Rule 144) has been taken.

The Corporation shall not be required (i) to transfer on its books any Purchased Shares which have been sold or transferred in violation of the provisions of this Agreement or (ii) to treat as the owner of the Purchased Shares, or otherwise to accord voting, dividend or liquidation rights to, any transferee to whom the Purchased Shares have been transferred in contravention of this Agreement.

3. **Restrictive Legends**. The stock certificates for the Purchased Shares shall be endorsed with one or more of the following restrictive legends:

"The shares represented by this certificate have not been registered under the Securities Act of 1933. The shares may not be sold or offered for sale in the absence of (a) an effective registration statement for the shares under such Act, (b) a "no action" letter of the Securities and Exchange Commission with respect to such sale or offer or (c) satisfactory assurances to the Corporation that registration under such Act is not required with respect to such sale or offer."

"The shares represented by this certificate are subject to certain repurchase rights and rights of first refusal granted to the Corporation and accordingly may not be sold, assigned, transferred, encumbered, or in any manner disposed of except in conformity with the terms of a written agreement dated _____, 2004 between the Corporation and the registered holder of the shares (or the predecessor in interest to the shares). A copy of such agreement is maintained at the Corporation's principal corporate offices."

C. TRANSFER RESTRICTIONS

1. **Restriction on Transfer**. Except for any Permitted Transfer, Optionee shall not transfer, assign, encumber or otherwise dispose of any of the Purchased Shares which are subject to the Repurchase Right. In addition, Purchased Shares which are released from the Repurchase Right shall not be transferred, assigned, encumbered or otherwise disposed of in contravention of the First Refusal Right or the Market Stand-Off.

2. **Transferee Obligations**. Each person (other than the Corporation) to whom the Purchased Shares are transferred by means of a Permitted Transfer must, as a condition precedent to the validity of such transfer, acknowledge in writing to the Corporation that such person is bound by the provisions of this Agreement and that the transferred shares are subject to (i) the Repurchase Right, (ii) the First Refusal Right and (iii) the Market Stand-Off, to the same extent such shares would be so subject if retained by Optionee.

3. **Market Stand-Off**.

(a) In connection with any underwritten public offering by the Corporation of its equity securities pursuant to an effective registration statement filed under the 1933 Act, including the Corporation's initial public offering, Owner shall not sell, make any short sale of, loan, hypothecate, pledge, grant any option for the purchase of, or otherwise dispose or transfer for value or otherwise agree to engage in any of the foregoing transactions with respect to, any Purchased Shares without the prior written consent of the Corporation or its underwriters. Such restriction (the "Market Stand-Off") shall be in effect for such period of time from and after the effective date of the final prospectus for the offering as may be requested by the Corporation or such underwriters. In no event, however, shall such period exceed one hundred eighty (180) days and the Market Stand-Off shall in all events terminate two (2) years after the effective date of the Corporation's initial public offering.

(b) Owner shall be subject to the Market Stand-Off provided and only if the officers and directors of the Corporation are also subject to similar restrictions.

(c) Any new, substituted or additional securities which are by reason of any Recapitalization or Reorganization distributed with respect to the Purchased Shares shall be immediately subject to the Market Stand-Off, to the same extent the Purchased Shares are at such time covered by such provisions.

(d) In order to enforce the Market Stand-Off, the Corporation may impose stop-transfer instructions with respect to the Purchased Shares until the end of the applicable stand-off period.

D. REPURCHASE RIGHT

1. **Grant**. The Corporation is hereby granted the right (the "Repurchase Right"), exercisable at any time during the sixty (60)-day period following the date Optionee ceases for any reason to remain in Service or (if later) during the sixty (60)-day period following the execution date of this Agreement, to repurchase at the Exercise Price any or all of the Purchased Shares in which Optionee is not, at the time of his or her cessation of Service, vested in accordance with the Vesting Schedule applicable to those shares or the special vesting acceleration provisions of Paragraph D.6 of this Agreement (such shares to be hereinafter referred to as the "Unvested Shares").

2. **Exercise of the Repurchase Right**. The Repurchase Right shall be exercisable by written notice delivered to each Owner of the Unvested Shares prior to the expiration of the sixty (60)-day exercise period. The notice shall indicate the number of Unvested Shares to be repurchased and the date on which the repurchase is to be effected, such

date to be not more than thirty (30) days after the date of such notice. The certificates representing the Unvested Shares to be repurchased shall be delivered to the Corporation on or before the close of business on the date specified for the repurchase. Concurrently with the receipt of such stock certificates, the Corporation shall pay to Owner, in cash or cash equivalents (including the cancellation of any purchase-money indebtedness), an amount equal to the Exercise Price previously paid for the Unvested Shares which are to be repurchased from Owner.

3. **Termination of the Repurchase Right**. The Repurchase Right shall terminate with respect to any Unvested Shares for which it is not timely exercised under Paragraph D.2. In addition, the Repurchase Right shall terminate and cease to be exercisable with respect to any and all Purchased Shares in which Optionee vests in accordance with the Vesting Schedule. All Purchased Shares as to which the Repurchase Right lapses shall, however, remain subject to (i) the First Refusal Right and (ii) the Market Stand-Off.

4. **Aggregate Vesting Limitation**. If the Option is exercised in more than one increment so that Optionee is a party to one or more other Stock Purchase Agreements (the "Prior Purchase Agreements") which are executed prior to the date of this Agreement, then the total number of Purchased Shares as to which Optionee shall be deemed to have a fully-vested interest under this Agreement and all Prior Purchase Agreements shall not exceed in the aggregate the number of Purchased Shares in which Optionee would otherwise at the time be vested, in accordance with the Vesting Schedule, had all the Purchased Shares (including those acquired under the Prior Purchase Agreements) been acquired exclusively under this Agreement.

5. **Recapitalization**. Any new, substituted or additional securities or other property (including cash paid other than as a regular cash dividend) which is by reason of any Recapitalization distributed with respect to the Purchased Shares shall be immediately subject to the Repurchase Right and any escrow requirements hereunder, but only to the extent the Purchased Shares are at the time covered by such right or escrow requirements. Appropriate adjustments to reflect such distribution shall be made to the number and/or class of Purchased Shares subject to this Agreement and to the price per share to be paid upon the exercise of the Repurchase Right in order to reflect the effect of any such Recapitalization upon the Corporation's capital structure; provided, however, that the aggregate purchase price shall remain the same.

6. **Corporate Transaction**.

(a) The Repurchase Right shall automatically terminate in its entirety, and all the Purchased Shares shall vest in full, immediately prior to the consummation of any Corporate Transaction, except to the extent the Repurchase Right is to be assigned to the successor entity in such Corporate Transaction.

(b) To the extent the Repurchase Right remains in effect following a Corporate Transaction, such right shall apply to any new securities or other property (including any cash payments) received in exchange for the Purchased Shares in consummation of the Corporate Transaction, but only to the extent the Purchased Shares are at the time covered by such right. Appropriate adjustments shall be made to the price per share payable upon exercise of the Repurchase Right to reflect the effect of the Corporate Transaction upon the Corporation's

capital structure; provided, however, that the aggregate purchase price shall remain the same. The new securities or other property (including any cash payments) issued or distributed with respect to the Purchased Shares in consummation of the Corporate Transaction shall be immediately deposited in escrow with the Corporation (or the successor entity) and shall not be released from escrow until Optionee vests in such securities or other property in accordance with the same Vesting Schedule in effect for the Purchased Shares.

(c) The Repurchase Right shall automatically lapse in its entirety, and all the Purchased Shares shall immediately vest in full, upon an Involuntary Termination of Optionee's Service within twelve (12) months following the effective date of a Corporate Transaction in which the Repurchase Right does not otherwise terminate pursuant to Paragraph D.6(a) above.

E. RIGHT OF FIRST REFUSAL

1. **Grant**. The Corporation is hereby granted the right of first refusal (the "First Refusal Right"), exercisable in connection with any proposed transfer of the Purchased Shares in which Optionee has vested in accordance with the provisions of Article D. For purposes of this Article E, the term "transfer" shall include any sale, assignment, pledge, encumbrance or other disposition of the Purchased Shares intended to be made by Owner, but shall not include any Permitted Transfer.

2. **Notice of Intended Disposition**. In the event any Owner of Purchased Shares in which Optionee has vested desires to accept a bona fide third-party offer for the transfer of any or all of such shares (the Purchased Shares subject to such offer to be hereinafter referred to as the "Target Shares"), Owner shall promptly (i) deliver to the Corporation written notice (the "Disposition Notice") of the terms of the offer, including the purchase price and the identity of the third-party offeror, and (ii) provide satisfactory proof that the disposition of the Target Shares to such third-party offeror would not be in contravention of the provisions set forth in Articles B and C.

3. **Exercise of the First Refusal Right**. The Corporation shall, for a period of twenty-five (25) days following receipt of the Disposition Notice, have the right to repurchase any or all of the Target Shares subject to the Disposition Notice upon the same terms as those specified therein or upon such other terms (not materially different from those specified in the Disposition Notice) to which Owner consents. Such right shall be exercisable by delivery of written notice (the "Exercise Notice") to Owner prior to the expiration of the twenty-five (25)- day exercise period. If such right is exercised with respect to all the Target Shares, then the Corporation shall effect the repurchase of such shares, including payment of the purchase price, not more than five (5) business days after delivery of the Exercise Notice; and at such time the certificates representing the Target Shares shall be delivered to the Corporation.

Should the purchase price specified in the Disposition Notice be payable in property other than cash or evidences of indebtedness, the Corporation shall have the right to pay the purchase price in the form of cash equal in amount to the value of such property. If Owner and the Corporation cannot agree on such cash value within ten (10) days after the Corporation's receipt of the Disposition Notice, the valuation shall be made by an appraiser of recognized

standing selected by Owner and the Corporation or, if they cannot agree on an appraiser within twenty (20) days after the Corporation's receipt of the Disposition Notice, each shall select an appraiser of recognized standing and the two (2) appraisers shall designate a third appraiser of recognized standing, whose appraisal shall be determinative of such value. The cost of such appraisal shall be shared equally by Owner and the Corporation. The closing shall then be held on the later of (i) the fifth (5th) business day following delivery of the Exercise Notice or (ii) the fifth (5th) business day after such valuation shall have been made.

4. **Non-Exercise of the First Refusal Right**. In the event the Exercise Notice is not given to Owner prior to the expiration of the twenty-five (25)-day exercise period, Owner shall have a period of thirty (30) days thereafter in which to sell or otherwise dispose of the Target Shares to the third-party offeror identified in the Disposition Notice upon terms (including the purchase price) no more favorable to such third-party offeror than those specified in the Disposition Notice; provided, however, that any such sale or disposition must not be effected in contravention of the provisions of Articles B and C. The third-party offeror shall acquire the Target Shares subject to the First Refusal Right, and the acquired shares shall remain subject to the provisions of Article B and Paragraph C.3. In the event Owner does not effect such sale or disposition of the Target Shares within the specified thirty (30)-day period, the First Refusal Right shall continue to be applicable to any subsequent disposition of the Target Shares by Owner until such right lapses.

5. **Partial Exercise of the First Refusal Right**. In the event the Corporation makes a timely exercise of the First Refusal Right with respect to a portion, but not all, of the Target Shares specified in the Disposition Notice, Owner shall have the option, exercisable by written notice to the Corporation delivered within five (5) business days after Owner's receipt of the Exercise Notice, to effect the sale of the Target Shares pursuant to either of the following alternatives:

(i) sale or other disposition of all the Target Shares to the third-party offeror identified in the Disposition Notice, but in full compliance with the requirements of Paragraph E.4, as if the Corporation did not exercise the First Refusal Right; or

(ii) sale to the Corporation of the portion of the Target Shares which the Corporation has elected to purchase, such sale to be effected in substantial conformity with the provisions of Paragraph E.3. The First Refusal Right shall continue to be applicable to any subsequent disposition of the remaining Target Shares until such right lapses.

Owner's failure to deliver timely notification to the Corporation shall be deemed to be an election by Owner to sell the Target Shares pursuant to alternative (i) above.

6. **Recapitalization/Reorganization**.

(a) Any new, substituted or additional securities or other property which is by reason of any Recapitalization distributed with respect to the Purchased Shares shall

be immediately subject to the First Refusal Right, but only to the extent the Purchased Shares are at the time covered by such right.

(b) In the event of a Reorganization, the First Refusal Right shall remain in full force and effect and shall apply to the new capital stock or other property received in exchange for the Purchased Shares in consummation of the Reorganization, but only to the extent the Purchased Shares are at the time covered by such right.

7. **Lapse**. The First Refusal Right shall lapse upon the earliest to occur of (i) the first date on which shares of the Common Stock are held of record by more than five hundred (500) persons, (ii) a determination is made by the Board that a public market exists for the outstanding shares of Common Stock or (iii) a firm commitment underwritten public offering, pursuant to an effective registration statement under the 1933 Act, covering the offer and sale of the Common Stock in the aggregate amount of at least ten million dollars ($10,000,000). However, the Market Stand-Off shall continue to remain in full force and effect following the lapse of the First Refusal Right.

F. SPECIAL TAX ELECTION

The acquisition of the Purchased Shares may result in adverse tax consequences which may be avoided or mitigated by filing an election under Code Section 83(b). Such election must be filed within thirty (30) days after the date of this Agreement. A description of the tax consequences applicable to the acquisition of the Purchased Shares and the form for making the Code Section 83(b) election are set forth in Exhibit II. **OPTIONEE SHOULD CONSULT WITH HIS OR HER TAX ADVISOR TO DETERMINE THE TAX CONSEQUENCES OF ACQUIRING THE PURCHASED SHARES AND THE ADVANTAGES AND DISADVANTAGES OF FILING THE CODE SECTION 83(b) ELECTION. OPTIONEE ACKNOWLEDGES THAT IT IS OPTIONEE'S SOLE RESPONSIBILITY, AND NOT THE CORPORATION'S, TO FILE A TIMELY ELECTION UNDER CODE SECTION 83(b), EVEN IF OPTIONEE REQUESTS THE CORPORATION OR ITS REPRESENTATIVES TO MAKE THIS FILING ON HIS OR HER BEHALF.**

G. GENERAL PROVISIONS

1. **Assignment**. The Corporation may assign the Repurchase Right and/or the First Refusal Right to any person or entity selected by the Board, including (without limitation) one or more stockholders of the Corporation. If the assignee of the Repurchase Right is other than (i) a wholly owned subsidiary of the Corporation or (ii) the parent corporation owning one hundred percent (100%) of the Corporation's outstanding capital stock, then such assignee must make a cash payment to the Corporation, upon the assignment of the Repurchase Right, in an amount equal to the excess (if any) of (i) the Fair Market Value of the Purchased Shares at the time subject to the assigned Repurchase Right over (ii) the aggregate repurchase price payable for the Purchased Shares.

2. **No Employment or Service Contract**. Nothing in this Agreement or in the Plan shall confer upon Optionee any right to continue in Service for any period of specific duration or interfere with or otherwise restrict in any way the rights of the Corporation (or any

Parent or Subsidiary employing or retaining Optionee) or of Optionee, which rights are hereby expressly reserved by each, to terminate Optionee's Service at any time for any reason, with or without cause.

3. **Notices**. Any notice required to be given under this Agreement shall be in writing and shall be deemed effective upon personal delivery or upon deposit in the U.S. mail registered or certified, postage prepaid and properly addressed to the party entitled to such notice at the address indicated below such party's signature line on this Agreement or at such other address as such party may designate by ten (10) days advance written notice under this paragraph to all other parties to this Agreement.

4. **No Waiver**. The failure of the Corporation in any instance to exercise the Repurchase Right or the First Refusal Right shall not constitute a waiver of any other repurchase rights and/or rights of first refusal that may subsequently arise under the provisions of this Agreement or any other agreement between the Corporation and Optionee. No waiver of any breach or condition of this Agreement shall be deemed to be a waiver of any other or subsequent breach or condition, whether of like or different nature.

5. **Cancellation of Shares**. If the Corporation shall make available, at the time and place and in the amount and form provided in this Agreement, the consideration for the Purchased Shares to be repurchased in accordance with the provisions of this Agreement, then from and after such time, the person from whom such shares are to be repurchased shall no longer have any rights as a holder of such shares (other than the right to receive payment of such consideration in accordance with this Agreement). Such shares shall be deemed purchased in accordance with the applicable provisions hereof, and the Corporation shall be deemed the owner and holder of such shares, whether or not the certificates therefor have been delivered as required by this Agreement.

H. MISCELLANEOUS PROVISIONS

1. **Optionee Undertaking**. Optionee hereby agrees to take whatever additional action and execute whatever additional documents the Corporation may deem necessary or advisable in order to carry out or effect one or more of the obligations or restrictions imposed on either Optionee or the Purchased Shares pursuant to the provisions of this Agreement.

2. **Agreement is Entire Contract**. This Agreement constitutes the entire contract between the parties hereto with regard to the subject matter hereof. This Agreement is made pursuant to the provisions of the Plan and shall in all respects be construed in conformity with the terms of the Plan.

3. **Governing Law**. This Agreement shall be governed by, and construed in accordance with, the laws of the State of California without resort to that State's conflict-of-laws rules.

4. **Counterparts**. This Agreement may be executed in counterparts, each of which shall be deemed to be an original, but all of which together shall constitute one and the same Instrument.

5. **Successors and Assigns**. The provisions of this Agreement shall inure to the benefit of, and be binding upon, the Corporation and its successors and assigns and upon Optionee, Optionee's permitted assigns and the legal representatives, heirs and legatees of Optionee's estate, whether or not any such person shall have become a party to this Agreement and have agreed in writing to join herein and be bound by the terms hereof.

IN WITNESS WHEREOF, the parties have executed this Agreement on the day and year first indicated above.

ENERGY RECOVERY, INC.

By: _____

Title: _____

Address: _____

_____

OPTIONEE

By: _____

Address: _____

_____

SPOUSAL ACKNOWLEDGMENT

The undersigned spouse of Optionee has read and hereby approves the foregoing Stock Purchase Agreement. In consideration of the Corporation's granting Optionee the right to acquire the Purchased Shares in accordance with the terms of such Agreement, the undersigned hereby agrees to be irrevocably bound by all the terms of such Agreement, including (without limitation) the right of the Corporation (or its assigns) to purchase any Purchased Shares in which Optionee is not vested at time of his or her cessation of Service.

OPTIONEE SPOUSE

By: _____

Address: _____

_____

EXHIBIT I

ASSIGNMENT SEPARATE FROM CERTIFICATE

FOR VALUE RECEIVED ___hereby sell(s), assign(s) and transfer(s) unto Energy Recovery, Inc. (the "Corporation"), ___ (___) shares of the Common Stock of the Corporation standing in his or her name on the books of the Corporation represented by Certificate No. ___herewith and do(es) hereby irrevocably constitute and appoint ___Attorney to transfer the said stock on the books of the Corporation with full power of substitution in the premises.

Dated: _____

Signature: _____

Instruction: Please do not fill in any blanks other than the signature line. Please sign exactly as you would like your name to appear on the issued stock certificate. The purpose of this assignment is to enable the Corporation to exercise the Repurchase Right without requiring additional signatures on the part of Optionee.

EXHIBIT II

FEDERAL INCOME TAX CONSEQUENCES AND SECTION 83(b) TAX ELECTION

II. **Federal Income Tax Consequences and Section 83(b) Election For Exercise of Non-Statutory Option** If the Purchased Shares are acquired pursuant to the exercise of a Non-Statutory Option, as specified in the Grant Notice, then under Code Section 83, the excess of the Fair Market Value of the Purchased Shares on the date any forfeiture restrictions applicable to such shares lapse over the Exercise Price paid for such shares will be reportable as ordinary income on the lapse date. For this purpose, the term "forfeiture restrictions" includes the right of the Corporation to repurchase the Purchased Shares pursuant to the Repurchase Right. However, Optionee may elect under Code Section 83(b) to be taxed at the time the Purchased Shares are acquired, rather than when and as such Purchased Shares cease to be subject to such forfeiture restrictions. Such election must be filed with the Internal Revenue Service within thirty (30) days after the date of the Agreement. Even if the Fair Market Value of the Purchased Shares on the date of the Agreement equals the Exercise Price paid (and thus no tax is payable), the election must be made to avoid adverse tax consequences in the future. The form for making this election is attached as part of this exhibit. **FAILURE TO MAKE THIS FILING WITHIN THE APPLICABLE THIRTY (30)-DAY PERIOD WILL RESULT IN THE RECOGNITION OF ORDINARY INCOME BY OPTIONEE AS THE FORFEITURE RESTRICTIONS LAPSE.**

III. **Federal Income Tax Consequences and Conditional Section 83(h) Election For Exercise of Incentive Option** If the Purchased Shares are acquired pursuant to the exercise of an Incentive Option, as specified in the Grant Notice, then the following tax principles shall be applicable to the Purchased Shares:

(i) For regular tax purposes, no taxable income will be recognized at the time the Option is exercised.

(ii) The excess of (a) the Fair Market Value of the Purchased Shares on the date the Option is exercised or (if later) on the date any forfeiture restrictions applicable to the Purchased Shares lapse over (b) the Exercise Price paid for the Purchased Shares will be includible in Optionee's taxable income for alternative minimum tax purposes.

(iii) If Optionee makes a disqualifying disposition of the Purchased Shares, then Optionee will recognize ordinary income in the year of such disposition equal in amount to the excess of (a) the Fair Market Value of the Purchased Shares on the date the Option is exercised or (if later) on the date any forfeiture restrictions applicable to the Purchased Shares lapse over (b) the Exercise Price paid for the Purchased Shares. Any additional gain recognized upon the disqualifying disposition will be either short-term or long-term capital gain depending upon the period for which the Purchased Shares are held prior to the disposition.

(iv) For purposes of the foregoing, the term "forfeiture restrictions" will include the right of the Corporation to repurchase the Purchased Shares pursuant to the Repurchase Right. The term "disqualifying disposition" means any sale or other disposition[1] of the Purchased Shares within two (2) years after the Grant Date or within one (1) year after the exercise date of the Option.

(v) In the absence of final Treasury Regulations relating to Incentive Options, it is not certain whether Optionee may, in connection with the exercise of the Option for any Purchased Shares at the time subject to forfeiture restrictions, file a protective election under Code Section 83(b) which would limit (a) Optionee's alternative minimum taxable income upon exercise and (b) Optionee's ordinary income upon a disqualifying disposition to the excess of the Fair Market Value of the Purchased Shares on the date the Option is exercised over the Exercise Price paid for the Purchased Shares. Accordingly, such election if properly filed will only be allowed to the extent the final Treasury Regulations permit such a protective election. Page 2 of the attached form for making the election should be filed with any election made in connection with the exercise of an Incentive Option.

1 Generally, a disposition of shares purchased under an Incentive Option includes any transfer of legal title, including a transfer by sale, exchange or gift, but does not include a transfer to the Optionee's spouse, a transfer into joint ownership with right of survivorship if Optionee remains one of the joint owners, a pledge, a transfer by bequest or inheritance or certain tax free exchanges permitted under the Code.

SECTION 83(b) ELECTION

This statement is being made under Section 83(b) of the Internal Revenue Code, pursuant to Treas. Reg. Section 1.83-2.

(1) The taxpayer who performed the services is:

Name:
Address:
Taxpayer Ident. No.:

(2) The property with respect to which the election is being made is _____ shares of the common stock of Energy Recovery, Inc.

(3) The property was issued on _____, 2004.

(4) The taxable year in which the election is being made is the calendar year 2004.

(5) The property is subject to a repurchase right pursuant to which the issuer has the right to acquire the property at the original purchase price if for any reason taxpayer's service with the issuer terminates. The issuer's repurchase right lapses in a series of annual and monthly installments over a four (4)-year period ending on _____, 200___.

(6) The fair market value at the time of transfer (determined without regard to any restriction other than a restriction which by its terms will never lapse) is $_____ per share.

(7) The amount paid for such property is $_____ per share.

(8) A copy of this statement was furnished to Energy Recovery, Inc. for whom taxpayer rendered the services underlying the transfer of property.

(9) This statement is executed on _____ , 2004.

_____ _____

Spouse (if any) Taxpayer

This election must be filed with the Internal Revenue Service Center with which taxpayer files his or her Federal income tax returns and must be made within thirty (30) days after the execution date of the Stock Purchase Agreement. This filing should be made by registered or certified mail, return receipt requested. Optionee must retain two (2) copies of the completed form for filing with his or her Federal and state tax returns for the current tax year and an additional copy for his or her records.

The property described in the above Section 83(b) election is comprised of shares of common stock acquired pursuant to the exercise of an incentive stock option under Section 422 of the Internal Revenue Code (the "Code"). Accordingly, it is the intent of the Taxpayer to utilize this election to achieve the following tax results:

1. The purpose of this election is to have the alternative minimum taxable income attributable to the purchased shares measured by the amount by which the fair market value of such shares at the time of their transfer to the Taxpayer exceeds the purchase price paid for the shares. In the absence of this election, such alternative minimum taxable income would be measured by the spread between the fair market value of the purchased shares and the purchase price which exists on the various lapse dates in effect for the forfeiture restrictions applicable to such shares. The election is to be effective to the full extent permitted under the Code.

2. Section 421(a)(l) of the Code expressly excludes from income any excess of the fair market value of the purchased shares over the amount paid for such shares. Accordingly, this election is also intended to be effective in the event there is a "disqualifying disposition" of the shares, within the meaning of Section 421(b) of the Code, which would otherwise render the provisions of Section 83(a) of the Code applicable at that time. Consequently, the Taxpayer hereby elects to have the amount of disqualifying disposition income measured by the excess of the fair market value of the purchased shares on the date of transfer to the Taxpayer over the amount paid for such shares. Since Section 421 (a) presently applies to the shares which are the subject of this Section 83(b) election, no taxable income is actually recognized for regular tax purposes at this time, and no income taxes are payable, by the Taxpayer as a result of this election.

THIS PAGE 2 IS TO BE ATTACHED TO ANY SECTION 83(b) ELECTION FILED IN CONNECTION WITH THE EXERCISE OF AN INCENTIVE STOCK OPTION UNDER THE FEDERAL TAX LAWS.

APPENDIX

The following definitions shall be in effect under the Agreement:

A. **Agreement** shall mean this Stock Purchase Agreement.

B. **Board** shall mean the Corporation's Board of Directors.

C. **Code** shall mean the Internal Revenue Code of 1986, as amended.

D. **Common Stock** shall mean the Corporation's common stock.

E. **Corporate Transaction** shall mean either of the following stockholder-approved transactions:

(i) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction, or

(ii) the sale, transfer or other disposition of all or substantially all of the Corporation's assets in complete liquidation or dissolution of the Corporation.

F. **Corporation** shall mean Energy Recovery, Inc., a Delaware corporation, and any successor corporation to all or substantially all of the assets or voting stock of Energy Recovery, Inc. which shall by appropriate action adopt the Plan.

G. **Disposition Notice** shall have the meaning assigned to such term in Paragraph E.2.

H. **Exercise Notice** shall have the meaning assigned to such term in Paragraph E.3.

I. **Exercise Price** shall have the meaning assigned to such term in Paragraph A.1.

J. **Fair Market Value** of a share of Common Stock on any relevant date, prior to the initial public offering of the Common Stock, shall be determined by the Plan Administrator after taking into account such factors as it shall deem appropriate.

K. **First Refusal Right** shall mean the right granted to the Corporation in accordance with Article E.

L. **Grant Date** shall have the meaning assigned to such term in Paragraph A.1.

M. **Grant Notice** shall mean the Notice of Grant of Stock Option pursuant to which Optionee has been informed of the basic terms of the Option.

N. **Incentive Option** shall mean an option which satisfies the requirements of Code Section 422.

O. **Involuntary Termination** shall mean the termination of Optionee's Service which occurs by reason of:

(i) Optionee's involuntary dismissal or discharge by the Corporation for reasons other than Misconduct, or

(ii) Optionee's voluntary resignation following (A) a change in his or her position with the Corporation which materially reduces his or her level of responsibility, (B) a reduction in Optionee's level of compensation (including base salary, fringe benefits and target bonuses under any corporate-performance based bonus or incentive programs) by more than fifteen percent (15%) or (C) a relocation of Optionee's place of employment by more than fifty (50) miles, provided and only if such change, reduction or relocation is effected by the Corporation without Optionee's consent.

P. **Market Stand-Off** shall mean the market stand-off restriction specified in Paragraph C.3.

Q. **Misconduct** shall mean the commission of any act of fraud, embezzlement or dishonesty by Optionee, any unauthorized use or disclosure by Optionee of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any other intentional misconduct by Optionee adversely affecting the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of Optionee or any other individual in the Service of the Corporation (or any Parent or Subsidiary).

R. **1933 Act** shall mean the Securities Act of 1933, as amended.

S. **1934 Act** shall mean the Securities Exchange Act of 1934, as amended.

T. **Non-Statutory Option** shall mean an option not intended to satisfy the requirements of Code Section 422.

U. **Option** shall have the meaning assigned to such term in Paragraph A.1.

V. **Option Agreement** shall mean all agreements and other documents evidencing the Option.

W. **Optionee** shall mean the person to whom the Option is granted under the Plan.

X. **Owner** shall mean Optionee and all subsequent holders of the Purchased Shares who derive their chain of ownership through a Permitted Transfer from Optionee.

Y. **Parent** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation, provided each corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

Z. **Permitted Transfer** shall mean (i) a gratuitous transfer of the Purchased Shares, provided and only if Optionee obtains the Corporation's prior written consent to such transfer, (ii) a transfer of title to the Purchased Shares effected pursuant to Optionee's will or the laws of intestate succession following Optionee's death or (iii) a transfer to the Corporation in pledge as security for any purchase-money indebtedness incurred by Optionee in connection with the acquisition of the Purchased Shares.

AA. **Plan** shall mean the Corporation's 2004 Stock Option/Stock Issuance Plan.

BB. **Plan Administrator** shall mean either the Board or a committee of the Board acting in its capacity as administrator of the Plan.

CC. **Prior Purchase Agreement** shall have the meaning assigned to such term in Paragraph D.4.

DD. **Purchased Shares** shall have the meaning assigned to such term in Paragraph A.1.

EE. **Recapitalization** shall mean any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the Corporation's outstanding Common Stock as a class without the Corporation's receipt of consideration.

FF. **Reorganization** shall mean any of the following transactions:

(i) a merger or consolidation in which the Corporation is not the surviving entity,

(ii) a sale, transfer or other disposition of all or substantially all of the Corporation's assets,

(iii) a reverse merger in which the Corporation is the surviving entity but in which the Corporation's outstanding voting securities are transferred

in whole or in part to a person or persons different from the persons holding those securities immediately prior to the merger, or

(iv) any transaction effected primarily to change the state in which the Corporation is incorporated or to create a holding company structure.

GG. **Repurchase Right** shall mean the right granted to the Corporation in accordance with Article D.

HH. **SEC** shall mean the Securities and Exchange Commission.

II. **Service** shall mean the Optionee's performance of services for the Corporation (or any Parent or Subsidiary) in the capacity of an employee, subject to the control and direction of the employer entity as to both the work to be performed and the manner and method of performance, a non-employee member of the board of directors or an independent consultant.

JJ. **Subsidiary** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations beginning with the Corporation, provided each corporation (other than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

KK. **Target Shares** shall have the meaning assigned to such term in Paragraph E.2.

LL. **Vesting Schedule** shall mean the vesting schedule specified in the Grant Notice pursuant to which the Optionee is to vest in the Option Shares in a series of installments over his or her period of Service.

MM. **Unvested Shares** shall have the meaning assigned to such term in Paragraph D.1.

ADDENDUM
TO
STOCK PURCHASE AGREEMENT

The following provisions are hereby incorporated into, and are hereby made a part of, that certain Stock Purchase Agreement (the "Purchase Agreement") by and between Energy Recovery, Inc. (the "Corporation") and ("Optionee") evidencing the shares of Common Stock purchased on this date by Optionee under the Corporation's 2004 Stock Option/Stock Issuance Plan, and such provisions shall be effective immediately. All capitalized terms in this Addendum, to the extent not otherwise defined herein, shall have the meanings assigned to such terms in the Purchase Agreement.

INVOLUNTARY TERMINATION FOLLOWING
CORPORATE TRANSACTION

I. TO THE EXTENT THE REPURCHASE RIGHT IS ASSIGNED TO THE SUCCESSOR CORPORATION (OR PARENT THEREOF) IN CONNECTION WITH A CORPORATE TRANSACTION, NO ACCELERATED VESTING OF THE PURCHASED SHARES SHALL OCCUR UPON SUCH CORPORATE TRANSACTION, AND THE REPURCHASE RIGHT SHALL CONTINUE TO REMAIN IN FULL FORCE AND EFFECT IN ACCORDANCE WITH THE PROVISIONS OF THE PURCHASE AGREEMENT. OPTIONEE SHALL, OVER HIS OR HER PERIOD OF SERVICE FOLLOWING THE CORPORATE TRANSACTION, CONTINUE TO VEST IN THE PURCHASED SHARES IN ONE OR MORE INSTALLMENTS IN ACCORDANCE WITH THE PROVISIONS OF THE PURCHASE AGREEMENT. HOWEVER, UPON AN INVOLUNTARY TERMINATION OF OPTIONEE'S SERVICE WITHIN SIX (6) MONTHS FOLLOWING THE CORPORATE TRANSACTION, THE REPURCHASE RIGHT SHALL TERMINATE AUTOMATICALLY, AND ALL THE PURCHASED SHARES SHALL IMMEDIATELY VEST IN FULL AT THAT TIME.

J. FOR PURPOSES OF THIS ADDENDUM, THE FOLLOWING DEFINITIONS SHALL BE IN EFFECT:

An **Involuntary Termination** shall mean the termination of Optionee's Service by reason of:

1. Optionee's involuntary dismissal or discharge by the Corporation for reasons other than for Misconduct, or

2. Optionee's voluntary resignation following (A) a change in his or her position with the Corporation (or Parent or Subsidiary employing Optionee) which materially reduces his or her duties and responsibilities or the level of management to which he or she reports, (B) a reduction in Optionee's level of compensation (including base salary, fringe benefits and target

bonuses under any corporate-performance based incentive programs) by more than fifteen percent (15%) or (C) a relocation of Optionee's place of employment by more than fifty (50) miles, provided and only if such change, reduction or relocation is effected by the Corporation without Optionee's consent.

Misconduct shall mean the termination of Optionee's Service by reason of Optionee's commission of any act of fraud, embezzlement or dishonesty, any unauthorized use or disclosure by Optionee of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any other intentional misconduct by Optionee adversely affecting the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of Optionee or any other individual in the Service of the Corporation (or any Parent or Subsidiary).

IN WITNESS WHEREOF, Energy Recovery, Inc. has caused this Addendum to be executed by its duly-authorized officer as of the Effective Date specified below.

ENERGY RECOVERY, INC.

By: _____

Title: _____

EFFECTIVE DATE: _____, ___

ENERGY RECOVERY, INC.

2004 STOCK OPTION AGREEMENT

RECITALS

I. The Board has adopted the Plan for the purpose of retaining the services of selected Employees, non-employee members of the Board or the board of directors of any Parent or Subsidiary and consultants and other independent advisors in the service of the Corporation (or any Parent or Subsidiary).

A. Optionee is to render valuable services to the Corporation (or a Parent or Subsidiary), and this Agreement is executed pursuant to, and is intended to carry out the purposes of, the Plan in connection with the Corporation's grant of an option to Optionee.

B. All capitalized terms in this Agreement shall have the meaning assigned to them in the attached Appendix.

NOW, THEREFORE, it is hereby agreed as follows:

1. Grant of Option. The Corporation hereby grants to Optionee, as of the Grant Date, an option to purchase up to the number of Option Shares specified in the Grant Notice. The Option Shares shall be purchasable from time to time during the option term specified in Paragraph 2 at the Exercise Price set forth in the Grant Notice.

2. Option Term. This option shall have a term of ten (10) years measured from the Grant Date and shall accordingly expire at the close of business on the Expiration Date, unless sooner terminated in accordance with Paragraph 5 or 6.

3. Limited Transferability. During Optionee's lifetime, this option shall be exercisable only by Optionee and shall not be assignable or transferable other than by will or by the laws of descent and distribution following Optionee's death.

4. Dates of Exercise. This option shall become exercisable for the Option Shares in one or more installments as specified in the Grant Notice. As the option becomes exercisable for such installments, those installments shall accumulate, and the option shall remain exercisable for the accumulated installments until the Expiration Date or sooner termination of the option term under Paragraph 5 or 6.

5. Cessation of Service. The option term specified in Paragraph 2 shall terminate (and this option shall cease to be outstanding) prior to the Expiration Date should any of the following provisions become applicable:

(a) Should Optionee cease to remain in Service for any reason (other than death, Disability or Misconduct) while this option is outstanding, then Optionee shall have a period of one (1) month (commencing with the date of such cessation of Service) during which to exercise this option, but in no event shall this option be exercisable at any time after the Expiration Date.

(b) Should Optionee die while this option is outstanding, then the personal representative of Optionee's estate or the person or persons to whom the option is transferred pursuant to Optionee's will or in accordance with the laws of inheritance shall have the right to exercise this option. Such right shall lapse, and this option shall cease to be outstanding, upon the earlier of (i) the expiration of the twelve (12)-month period measured from the date of Optionee's death or (ii) the Expiration Date.

(c) Should Optionee cease Service by reason of Disability while this option is outstanding, then Optionee shall have a period of twelve (12) months (commencing with the date of such cessation of Service) during which to exercise this option. In no event shall this option be exercisable at any time after the Expiration Date.

Note: Exercise of this option on a date later than three (3) months following cessation of Service due to Disability will result in loss of favorable Incentive Option treatment, unless such Disability constitutes Permanent Disability. In the event that Incentive Option treatment is not available, this option will be taxed as a Non-Statutory Option upon exercise.

(d) During the limited period of post-Service exercisability, this option may not be exercised in the aggregate for more than the number of Option Shares in which Optionee is, at the time of Optionee's cessation of Service, vested pursuant to the Vesting Schedule specified in the Grant Notice or the special vesting acceleration provisions of Paragraph 6. Upon the expiration of such limited exercise period or (if earlier) upon the Expiration Date, this option shall terminate and cease to be outstanding for any vested Option Shares for which the option has not been exercised. To the extent Optionee is not vested in the Option Shares at the time of Optionee's cessation of Service, this option shall immediately terminate and cease to be outstanding in respect of those shares.

(e) Should Optionee's Service be terminated for Misconduct, then this option shall terminate immediately and cease to remain outstanding.

(f) In the event of a Corporate Transaction, the provisions of Paragraph 6 shall govern the period for which this option is to remain exercisable following Optionee's cessation of Service and shall supersede any provisions to the contrary in this paragraph.

6. **Accelerated Vesting**.

(a) In the event of any Corporate Transaction, the Option Shares at the time subject to this option but not otherwise vested shall automatically vest in full so that this option shall, immediately prior to the effective date of the Corporate Transaction, become fully exercisable for all of those Option Shares and may be exercised for any or all of those Option

Shares as fully-vested shares of Common Stock. However, the Option Shares shall not vest on such an accelerated basis if and to the extent: (i) this option is assumed by the successor corporation (or parent thereof) in the Corporate Transaction and the Corporation's repurchase rights in respect of the unvested Option Shares are assigned to such successor corporation (or parent thereof) or (ii) this option is to be replaced with a cash incentive program of the successor corporation which preserves the spread existing on the unvested Option Shares at the time of the Corporate Transaction (the excess of the Fair Market Value of those Option Shares over the Exercise Price payable for such shares) and provides for subsequent payout in accordance with the same Vesting Schedule applicable to those unvested Option Shares as set forth in the Grant Notice.

(b) Immediately following the Corporate Transaction, this option shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation (or parent thereof) in connection with the Corporate Transaction.

(c) If this option is assumed in connection with a Corporate Transaction, then this option shall be appropriately adjusted, immediately after such Corporate Transaction, to apply to the number and class of securities which would have been issuable to Optionee in consummation of such Corporate Transaction had the option been exercised immediately prior to such Corporate Transaction, and appropriate adjustments shall also be made to the Exercise Price, provided the aggregate Exercise Price shall remain the same.

(d) Should there occur an Involuntary Termination of Optionee's Service within twelve (12) months following a Corporate Transaction in which the Option Shares do not otherwise vest on an accelerated basis pursuant to Paragraph 6(a), then all the Option Shares subject to this option at the time of such Involuntary Termination but not otherwise vested shall automatically vest and the Corporation's repurchase rights in respect of those shares shall terminate so that this option shall immediately become exercisable for all the Option Shares as fully-vested shares. The option shall remain exercisable for any or all of those vested Option Shares until the earlier of (i) the Expiration Date or (ii) the expiration of the one (l)-year period measured from the date of the Involuntary Termination.

(e) This Agreement shall not in any way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

7. Adjustment in Option Shares. Should any change be made to the Common Stock by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration, appropriate adjustments shall be made to (i) the total number and/or class of securities subject to this option and (ii) the Exercise Price in order to reflect such change and thereby preclude a dilution or enlargement of benefits hereundcr.

8. Stockholder Rights. The holder of this option shall not have any stockholder rights in respect of the Option Shares until such person shall have exercised the option, paid the Exercise Price and become the record holder of the purchased shares.

9. **Manner of Exercising Option**.

(a) In order to exercise this option in respect of all or any part of the Option Shares for which this option is at the time exercisable, Optionee (or any other person or persons exercising the option) must take the following actions:

(i) Execute and deliver to the Corporation a Purchase Agreement for the Option Shares for which the option is exercised.

(ii) Pay the aggregate Exercise Price for the purchased shares in one or more of the following forms:

(A) cash or check made payable to the Corporation; or

Should the Common Stock be registered under Section 12 of the 1934 Act at the time the option is exercised, then the Exercise Price may also be paid as follows:

(B) in shares of Common Stock held by Optionee (or any other person or persons exercising the option) for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at Fair Market Value on the Exercise Date; or

(C) to the extent the option is exercised for vested Option Shares, through a special sale and remittance procedure pursuant to which Optionee (or any other person or persons exercising the option) shall concurrently provide irrevocable instructions (a) to a Corporation-designated brokerage firm to effect the immediate sale of the purchased shares and remit to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate Exercise Price payable for the purchased shares plus all applicable Federal, state and local income and employment taxes required to be withheld by the Corporation by reason of such exercise and (b) to the Corporation to deliver the certificates for the purchased shares directly to such brokerage firm in order to complete the sale.

Except to the extent the sale and remittance procedure is utilized in connection with the option exercise, payment of the Exercise Price must accompany the Purchase Agreement delivered to the Corporation in connection with the option exercise.

(iii) Furnish to the Corporation appropriate documentation that the person or persons exercising the option (if other than Optionee) have the right to exercise this option.

(iv) Execute and deliver to the Corporation such written representations as may be requested by the Corporation in order for it to comply with the applicable requirements of Federal and state securities laws.

(v) Make appropriate arrangements with the Corporation (or Parent or Subsidiary employing or retaining Optionee) for the satisfaction of all Federal, state and local income and employment tax withholding requirements applicable to the option exercise.

(b) As soon as practical after the Exercise Date, the Corporation shall issue to or on behalf of Optionee (or any other person or persons exercising this option) a certificate for the purchased Option Shares, with the appropriate legends affixed thereto.

(c) In no event may this option be exercised for any fractional shares.

10. REPURCHASE RIGHTS. ALL OPTION SHARES ACQUIRED UPON THE EXERCISE OF THIS OPTION SHALL BE SUBJECT TO CERTAIN RIGHTS OF THE CORPORATION AND ITS ASSIGNS TO REPURCHASE THOSE SHARES IN ACCORDANCE WITH THE TERMS SPECIFIED IN THE PURCHASE AGREEMENT.

11. **Compliance with Laws and Regulations.**

(a) The exercise of this option and the issuance of the Option Shares upon such exercise shall be subject to compliance by the Corporation and Optionee with all applicable requirements of law relating thereto and with all applicable regulations of any stock exchange (or the Nasdaq National Market, if applicable) on which the Common Stock may be listed for trading at the time of such exercise and issuance.

(b) The inability of the Corporation to obtain approval from any regulatory body having authority deemed by the Corporation to be necessary to the lawful issuance and sale of any Common Stock pursuant to this option shall relieve the Corporation of any liability in respect of the non-issuance or sale of the Common Stock as to which such approval shall not have been obtained. The Corporation, however, shall use its best efforts to obtain all such approvals.

12. **Successors and Assigns.** Except to the extent otherwise provided in Paragraphs 3 and 6, the provisions of this Agreement shall inure to the benefit of, and be binding upon, the Corporation and its successors and assigns and Optionee, Optionee's assigns and the legal representatives, heirs and legatees of Optionee's estate.

13. **Notices.** Any notice required to be given or delivered to the Corporation under the terms of this Agreement shall be in writing and addressed to the Corporation at its principal corporate offices. Any notice required to be given or delivered to Optionee shall be in writing and addressed to Optionee at the address indicated below Optionee's signature line on the Grant Notice. All notices shall be deemed effective upon personal delivery or upon deposit in the U.S. mail, postage prepaid and properly addressed to the party to be notified.

14. **Construction.** This Agreement and the option evidenced hereby are made and granted pursuant to the Plan and are in all respects limited by and subject to the terms of the Plan. All decisions of the Plan Administrator in respect of any question or issue arising under the

Plan or this Agreement shall be conclusive and binding on all persons having an interest in this option.

15. **Governing Law**. The interpretation, performance and enforcement of this Agreement shall be governed by the laws of the State of California without resort to that State's conflict-of-laws rules.

16. **Stockholder Approval**. If the Option Shares covered by this Agreement exceed, as of the Grant Date, the number of shares of Common Stock which may be issued under the Plan as last approved by the stockholders, then this option shall be void in respect of such excess shares, unless stockholder approval of an amendment sufficiently increasing the number of shares of Common Stock issuable under the Plan is obtained in accordance with the provisions of the Plan.

17. **Additional Terms Applicable to an Incentive Option**. In the event this option is designated an Incentive Option in the Grant Notice, the following terms and conditions shall also apply to the grant:

(a) This option shall cease to qualify for favorable tax treatment as an Incentive Option if (and to the extent) this option is exercised for one or more Option Shares: (i) more than three (3) months after the date Optionee ceases to be an Employee for any reason other than death or Permanent Disability or (ii) more than twelve (12) months after the date Optionee ceases to be an Employee by reason of Permanent Disability.

(b) This option shall not become exercisable in the calendar year in which granted if (and to the extent) the aggregate Fair Market Value (determined at the Grant Date) of the Common Stock for which this option would otherwise first become exercisable in such calendar year would, when added to the aggregate value (determined as of the respective date or dates of grant) of the Common Stock and any other securities for which one or more other Incentive Options granted to Optionee prior to the Grant Date (whether under the Plan or any other option plan of the Corporation or any Parent or Subsidiary) first become exercisable during the same calendar year, exceed One Hundred Thousand Dollars ($100,000) in the aggregate. To the extent the exercisability of this option is deferred by reason of the foregoing limitation, the deferred portion shall become exercisable in the first calendar year or years thereafter in which the One Hundred Thousand Dollar ($100,000) limitation of this Paragraph 18(b) would not be contravened, but such deferral shall in all events end immediately prior to the effective date of a Corporate Transaction in which this option is not to be assumed or an Involuntary Termination following a Corporate Transaction in which this option is assumed, whereupon the option shall become immediately exercisable as a Non-Statutory Option for the deferred portion of the Option Shares.

(c) Should Optionee hold, in addition to this option, one or more other options to purchase Common Stock which become exercisable for the first time in the same calendar year as this option, then the foregoing limitations on the exercisability of such options as Incentive Options shall be applied on the basis of the order in which such options are granted.

ENERGY RECOVERY, INC.

By: _____

Title: _____

Address: 1908 Doolittle Drive
San Leandro, CA 94577

The Optionee represents that the Optionee is familiar with the terms and provisions of this Option Agreement and hereby accepts the Option subject to all of the terms and provisions thereof. The Optionee hereby agrees to accept as binding, conclusive and final all decisions or interpretations of the Board upon any questions arising under this Option Agreement. The undersigned acknowledges receipt of a copy of the Plan.

OPTIONEE

Date: _____

Optionee Address:

_____

_____

APPENDIX

The following definitions shall be in effect under the Agreement:

A. **Agreement** shall mean this Stock Option Agreement.

B. **Board** shall mean the Corporation's Board of Directors.

C. **Code** shall mean the Internal Revenue Code of 1986, as amended.

D. **Common Stock** shall mean the Corporation's common stock.

E. **Corporate Transaction** shall mean either of the following stockholder-approved transactions to which the Corporation is a party:

(i) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction, or

(ii) the sale, transfer or other disposition of all or substantially all of the Corporation's assets in complete liquidation or dissolution of the Corporation.

F. **Corporation** shall mean Energy Recovery, Inc., a Delaware corporation, and any successor corporation to all or substantially all of the assets or voting stock of Energy Recovery, Inc. which shall by appropriate action adopt the Plan.

G. **Disability** shall mean the inability of Optionee to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment and shall be determined by the Plan Administrator on the basis of such medical evidence as the Plan Administrator deems warranted under the circumstances. Disability shall be deemed to constitute **Permanent Disability** in the event that such Disability is expected to result in death or has lasted or can be expected to last for a continuous period of twelve (12) months or more.

H. **Employee** shall mean an individual who is in the employ of the Corporation (or any Parent or Subsidiary), subject to the control and direction of the employer entity as to both the work to be performed and the manner and method of performance.

I. **Exercise Date** shall mean the date on which the option shall have been exercised in accordance with Paragraph 9 of the Agreement.

J. **Exercise Price** shall mean the exercise price payable per Option Share as specified in the Grant Notice.

K. **Expiration Date** shall mean the date on which the option expires as specified in the Grant Notice.

L. **Fair Market Value** per share of Common Stock on any relevant date shall be determined in accordance with the following provisions:

(i) If the Common Stock is at the time traded on the Nasdaq National Market, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question, as the price is reported by the National Association of Securities Dealers on the Nasdaq National Market. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(ii) If the Common Stock is at the time listed on any Stock Exchange, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question on the Stock Exchange determined by the Plan Administrator to be the primary market for the Common Stock, as such price is officially quoted in the composite tape of transactions on such exchange. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(iii) If the Common Stock is at the time neither listed on any Stock Exchange nor traded on the Nasdaq National Market, then the Fair Market Value shall be determined by the Plan Administrator after taking into account such factors as the Plan Administrator shall deem appropriate.

M. **Grant Date** shall mean the date of grant of the option as specified in the Grant Notice.

N. **Grant Notice** shall mean the Notice of Grant of Stock Option accompanying the Agreement, pursuant to which Optionee has been informed of the basic terms of the option evidenced hereby.

O. **Incentive Option** shall mean an option which satisfies the requirements of Code Section 422.

P. **Involuntary Termination** shall mean the termination of Optionee's Service which occurs by reason of:

(i) Optionee's dismissal or discharge by the Corporation for reasons other than Misconduct, or

(ii) Optionee's voluntary resignation following (A) a change in Optionee's position with the Corporation (or Parent or Subsidiary employing Optionee) which materially reduces Optionee's level of responsibility, (B) a reduction in Optionee's level of compensation (including base salary, fringe benefits and target bonuses under any corporate-performance based bonus or incentive programs) by more than fifteen percent (15%) in the aggregate or (C) a relocation of Optionee's place of employment by more than fifty (50) miles from

Optionee's place of employment immediately prior to the Corporate Transaction, provided and only if such change, reduction or relocation is effected by the Corporation without Optionee's consent.

Q. **Misconduct** shall mean the commission of any act of fraud, embezzlement or dishonesty by Optionee, any unauthorized use or disclosure by Optionee of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any other intentional misconduct by Optionee adversely affecting the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of Optionee or any other individual in the Service of the Corporation (or any Parent or Subsidiary).

R. **1934 Act** shall mean the Securities Exchange Act of 1934, as amended.

S. **Non-Statutory Option** shall mean an option not intended to satisfy the requirements of Code Section 422.

T. **Option Shares** shall mean the number of shares of Common Stock subject to the option.

U. **Optionee** shall mean the person to whom the option is granted as specified in the Grant Notice.

V. **Parent** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation, provided each corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

W. **Plan** shall mean the Corporation's 2004 Stock Option/Stock Issuance Plan.

X. **Plan Administrator** shall mean either the Board or a committee of the Board acting in its capacity as administrator of the Plan.

Y. **Purchase Agreement** shall mean the stock purchase agreement in substantially the form of Exhibit B to the Grant Notice.

Z. **Service** shall mean the Optionee's performance of services for the Corporation (or any Parent or Subsidiary) in the capacity of an Employee, a non-employee member of the board of directors or an independent consultant.

AA. **Stock Exchange** shall mean the American Stock Exchange or the New York Stock Exchange.

BB. **Subsidiary** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations beginning with the Corporation, provided each corporation (other

than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

CC. **Vesting Schedule** shall mean the vesting schedule specified in the Grant Notice pursuant to which the Optionee is to vest in the Option Shares in a series of installments over his or her period of Service.

Exhibit 10.5

ENERGY RECOVERY, INC.
2006 STOCK OPTION/STOCK ISSUANCE PLAN

ARTICLE ONE
GENERAL PROVISIONS

I. PURPOSE OF THE PLAN

This 2006 Stock Option/Stock Issuance Plan is intended to promote the interests of Energy Recovery Inc., a Delaware corporation, by providing eligible persons in the Corporation's employ or service with the opportunity to acquire a proprietary interest, or otherwise increase their proprietary interest, in the Corporation as an incentive for them to continue in such employ or service.

Capitalized terms herein shall have the meanings assigned to such terms in the attached Appendix.

II. STRUCTURE OF THE PLAN

A. The Plan shall be divided into two (2) separate equity programs:

(i) the Option Grant Program under which eligible persons may, at the discretion of the Plan Administrator, be granted options to purchase shares of Common Stock, and

(ii) the Stock Issuance Program under which eligible persons may, at the discretion of the Plan Administrator, be issued shares of Common Stock directly, either through the immediate purchase of such shares or as a bonus for services rendered the Corporation (or any Parent or Subsidiary).

B. The provisions of Articles One and Four shall apply to both equity programs under the Plan and shall accordingly govern the interests of all persons under the Plan.

III. ADMINISTRATION OF THE PLAN

A. The Plan shall be administered by the Board. However, any or all administrative functions otherwise exercisable by the Board may be delegated to the Committee. Members of the Committee shall serve for such period of time as the Board may determine and shall be subject to removal by the Board at any time. The Board may also at any time terminate the functions of the Committee and reassume all powers and authority previously delegated to the Committee.

B. The Plan Administrator shall have full power and authority (subject to the provisions of the Plan) to establish such rules and regulations as it may deem appropriate for proper administration of the Plan and to make such determinations under, and issue such interpretations of, the Plan and any outstanding options or stock issuances thereunder as it may deem necessary or advisable. Decisions of the Plan Administrator shall be final and binding on all parties who have an interest in the Plan or any option or stock issuance thereunder.

IV. ELIGIBILITY

A. The persons eligible to participate in the Plan are as follows:

(i) Employees,

(ii) non-employee members of the Board or the non-employee members of the board of directors of any Parent or Subsidiary, and

(iii) consultants and other independent advisors who provide services to the Corporation (or any Parent or Subsidiary).

B. The Plan Administrator shall have full authority to determine, (i) in respect of the grants under the Option Grant Program, which eligible persons are to receive the option grants, the time or times when those grants are to be made, the number of shares to be covered by each such grant, the status of the granted option as either an Incentive Option or a Non-Statutory Option, the time or times when each option is to become exercisable, the vesting schedule (if any) applicable to the option shares and the maximum term for which the option is to remain outstanding, and (ii) in respect of stock issuances under the Stock Issuance Program, which eligible persons are to receive stock issuances, the time or times when those issuances are to be made, the number of shares to be issued to each Participant, the vesting schedule (if any) applicable to the issued shares and the consideration to be paid by the Participant for such shares.

C. The Plan Administrator shall have the absolute discretion either to grant options in accordance with the Option Grant Program or to effect stock issuances in accordance with the Stock Issuance Program.

V. STOCK SUBJECT TO THE PLAN

A. The stock issuable under the Plan shall be shares of authorized but unissued or reacquired Common Stock. The maximum number of shares of Common Stock which may be issued over the term of the Plan shall not exceed eight hundred fifty thousand (850,000) shares.

B. Shares of Common Stock subject to outstanding options shall be available for subsequent issuance under the Plan to the extent (i) the options expire or terminate for any reason prior to exercise in full or (ii) the options are cancelled in accordance with the cancellation-regrant provisions of Article Two. Unvested shares issued under the Plan and subsequently repurchased by the Corporation, at the option exercise or direct issue price paid per share, pursuant to the Corporation's repurchase rights under the Plan shall be added back to the number of shares of Common Stock reserved for issuance under the Plan and shall accordingly be available for reissuance through one or more subsequent option grants or direct stock issuances under the Plan.

C. Should any change be made to the Common Stock by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration, appropriate adjustments shall be made to (i) the maximum number and/or class of

securities issuable under the Plan and (ii) the number and/or class of securities and the exercise price per share in effect under each outstanding option in order to prevent the dilution or enlargement of benefits thereunder. The adjustments determined by the Plan Administrator shall be final, binding and conclusive. In no event shall any such adjustments be made in connection with the conversion of one or more outstanding shares of the Corporation's preferred stock into shares of Common Stock.

ARTICLE TWO
OPTION GRANT PROGRAM

I. OPTION TERMS

Each option shall be evidenced by one or more documents in the form approved by the Plan Administrator; provided, however, that each such document shall comply with the terms specified below. Each document evidencing an Incentive Option shall, in addition, be subject to the provisions of the Plan applicable to such options.

A. **Exercise Price.**

1. The exercise price per share shall be fixed by the Plan Administrator in accordance with the following provisions:

(i) The exercise price per share shall not be less than eighty-five percent (85%) of the Fair Market Value per share of Common Stock on the option grant date.

(ii) If the person to whom the option is granted is a 10% Stockholder, then the exercise price per share shall not be less than one hundred ten percent (110%) of the Fair Market Value per share of Common Stock on the option grant date.

2. The exercise price shall become immediately due upon exercise of the option and shall, subject to the provisions of Section I of Article Four and the documents evidencing the option, be payable in cash or check made payable to the Corporation. Should the Common Stock be registered under Section 12 of the 1934 Act at the time the option is exercised, then the exercise price may also be paid as follows:

(i) in shares of Common Stock held for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at Fair Market Value on the Exercise Date, or

(ii) to the extent the option is exercised for vested shares, through a special sale and remittance procedure pursuant to which the Optionee shall concurrently provide irrevocable instructions (A) to a Corporation-designated brokerage firm to effect the immediate sale of the purchased shares and remit to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate exercise price payable for the purchased shares plus all applicable Federal, state and local income and employment taxes required to be withheld by the Corporation by reason of such exercise and (B) to the Corporation to deliver the certificates for the purchased shares directly to such brokerage firm in order to complete the sale.

Except to the extent such sale and remittance procedure is utilized, payment of the exercise price for the purchased shares must be made on the Exercise Date.

B. **Exercise and Term of Options**. Each option shall be exercisable at such time or times, during such period and for such number of shares as shall be determined by the Plan Administrator and set forth in the documents evidencing the option grant. However, no option shall have a term in excess of ten (10) years measured from the option grant date.

C. **Effect of Termination of Service**.

1. The following provisions shall govern the exercise of any options held by the Optionee at the time of cessation of Service or death:

(i) Should the Optionee cease to remain in Service for any reason other than death, Disability or Misconduct, then the Optionee shall have a period of one (1) month following the date of such cessation of Service during which to exercise each outstanding option held by such Optionee.

(ii) Should Optionee's Service terminate by reason of Disability, then the Optionee shall have a period of twelve (12) months following the date of such cessation of Service during which to exercise each outstanding option held by such Optionee.

(iii) If the Optionee dies while holding an outstanding option, then the personal representative of his or her estate or the person or persons to whom the option is transferred pursuant to the Optionee's will or the laws of inheritance shall have a twelve (12)-month period following the date of the Optionee's death to exercise such option.

(iv) Under no circumstances, however, shall any such option be exercisable after the specified expiration of the option term.

(v) During the applicable post-Service exercise period, the option may not be exercised in the aggregate for more than the number of vested shares for which the option is exercisable on the date of the Optionee's cessation of Service. Upon the expiration of the applicable exercise period or (if earlier) upon the expiration of the option term, the option shall terminate and cease to be outstanding for any vested shares for which the option has not been exercised. However, the option shall, immediately upon the Optionee's cessation of Service, terminate and cease to be outstanding in respect of any and all option shares for which the option is not otherwise at the time exercisable or in which the Optionee is not otherwise at that time vested.

(vi) Should Optionee's Service be terminated for Misconduct then all outstanding options held by the Optionee shall terminate immediately and cease to remain outstanding.

2. The Plan Administrator shall have the discretion, exercisable either at the time an option is granted or at any time while the option remains outstanding, to:

(i) extend the period of time for which the option is to remain exercisable following Optionee's cessation of Service or death from the limited period otherwise in effect for that option to such greater period of time as the Plan Administrator shall deem appropriate, but in no event beyond the expiration of the option term, and/or

(ii) permit the option to be exercised, during the applicable post-Service exercise period, not only in respect of the number of vested shares of Common Stock for which such option is exercisable at the time of the Optionee's cessation of Service but also in respect of one or more additional installments in which the Optionee would have vested under the option had the Optionee continued in Service.

D. **Stockholder Rights**. The holder of an option shall have no stockholder rights in respect of the shares subject to the option until such person shall have exercised the option, paid the exercise price and become the recordholder of the purchased shares.

E. **Unvested Shares**. The Plan Administrator shall have the discretion to grant options which are exercisable for unvested shares of Common Stock. Should the Optionee cease Service while holding such unvested shares, the Corporation shall have the right to repurchase, at the exercise price paid per share, any or all of those unvested shares. The terms upon which such repurchase right shall be exercisable (including the period and procedure for exercise and the appropriate vesting schedule for the purchased shares) shall be established by the Plan Administrator and set forth in the document evidencing such repurchase right. The Plan Administrator may not impose a vesting schedule upon the option grant or any shares of Common Stock subject to that option which is more restrictive than twenty percent (20%) per year vesting, with the initial vesting to occur not later than one (1) year after the option grant date. However, such limitation shall not be applicable to any option grants made to individuals who are officers of the Corporation, non-employee Board members or independent consultants.

F. **First Refusal Rights**. Until such time as the Common Stock is first registered under Section 12 of the 1934 Act, the Corporation shall have the right of first refusal in respect of any proposed disposition by the Optionee (or any successor in interest) of any shares of Common Stock issued under the Plan. Such right of first refusal shall be exercisable in accordance with the terms established by the Plan Administrator and set forth in the document evidencing such right.

G. **Limited Transferability of Options**. During the lifetime of the Optionee, the option shall be exercisable only by the Optionee and shall not be assignable or transferable other than by will or by the laws of descent and distribution following the Optionee's death.

H. **Withholding**. The Corporation's obligation to deliver shares of Common Stock upon the exercise of any options granted under the Plan shall be subject to the satisfaction of all applicable Federal, state and local income and employment tax withholding requirements.

II. INCENTIVE OPTIONS

The terms specified below shall be applicable to all Incentive Options. Except as modified by the provisions of this Section II, all the provisions of the Plan shall be applicable to Incentive Options. Options which are specifically designated as Non-Statutory Options shall not be subject to the terms of this Section II.

A. **Eligibility**. Incentive Options may only be granted to Employees.

B. **Exercise Price**. The exercise price per share shall not be less than one hundred percent (100%) of the Fair Market Value per share of Common Stock on the option grant date.

C. **Dollar Limitation**. The aggregate Fair Market Value of the shares of Common Stock (determined as of the respective date or dates of grant) for which one or more options granted to any Employee under the Plan (or any other option plan of the Corporation or any Parent or Subsidiary) may for the first time become exercisable as Incentive Options during any one (1) calendar year shall not exceed the sum of One Hundred Thousand Dollars ($100,000). To the extent the Employee holds two (2) or more such options which become exercisable for the first time in the same calendar year, the foregoing limitation on the exercisability of such options as Incentive Options shall be applied on the basis of the order in which such options are granted.

D. **10% Stockholder**. If any Employee to whom an Incentive Option is granted is a 10% Stockholder, then the option term shall not exceed five (5) years measured from the option grant date.

III. CORPORATE TRANSACTION

A. The shares subject to each option outstanding under the Plan at the time of a Corporate Transaction shall automatically vest in full so that each such option shall, immediately prior to the effective date of the Corporate Transaction, become fully exercisable for all of the shares of Common Stock at the time subject to that option and may be exercised for any or all of those shares as fully-vested shares of Common Stock. However, the shares subject to an outstanding option shall **not** vest on such an accelerated basis if and to the extent: (i) such option is assumed by the successor corporation (or parent thereof) in the Corporate Transaction and the Corporation's repurchase rights in respect of the unvested option shares are concurrently assigned to such successor corporation (or parent thereof) or (ii) such option is to be replaced with a cash incentive program of the successor corporation which preserves the spread existing on the unvested option shares at the time of the Corporate Transaction and provides for subsequent payout in accordance with the same vesting schedule applicable to those unvested option shares or (iii) the acceleration of such option is subject to other limitations imposed by the Plan Administrator at the time of the option grant.

B. All outstanding repurchase rights shall also terminate automatically, and the shares of Common Stock subject to those terminated rights shall immediately vest in full, in the event of any Corporate Transaction, except to the extent: (i) those repurchase rights are assigned to the successor corporation (or parent thereof) in connection with such Corporate

Transaction or (ii) such accelerated vesting is precluded by other limitations imposed by the Plan Administrator at the time the repurchase right is issued.

C. Immediately following the consummation of the Corporate Transaction, all outstanding options shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation (or parent thereof).

D. Each option which is assumed in connection with a Corporate Transaction shall be appropriately adjusted, immediately after such Corporate Transaction, to apply to the number and class of securities which would have been issuable to the Optionee in consummation of such Corporate Transaction, had the option been exercised immediately prior to such Corporate Transaction. Appropriate adjustments shall also be made to (i) the number and class of securities available for issuance under the Plan following the consummation of such Corporate Transaction and (ii) the exercise price payable per share under each outstanding option, provided the aggregate exercise price payable for such securities shall remain the same.

E. The Plan Administrator shall have the discretion exercisable either at the time the option is granted or at any time while the option remains outstanding, to provide for the automatic acceleration (in whole or in part) of one or more outstanding options (and the immediate termination of the Corporation's repurchase rights in respect of the share subject to those options) upon the occurrence of a Corporate Transaction, whether or not those options are to be assumed in the Corporate Transaction.

F. The Plan Administrator shall also have full power and authority, exercisable either at the time the option is granted or at any time while the option remains outstanding, to structure such option so that the shares subject to that option will automatically vest on an accelerated basis should the Optionee's Service terminate by reason of an Involuntary Termination within a designated period (not to exceed eighteen (18) months) following the effective date of any Corporate Transaction in which the option is assumed and the repurchase rights applicable to those shares do not otherwise terminate. Any option so accelerated shall remain exercisable for the fully-vested option shares until the earlier of (i) the expiration of the option term or (ii) the expiration of the one (l)-year period measured from the effective date of the Involuntary Termination. In addition, the Plan Administrator may provide that one or more of the Corporation's outstanding repurchase rights in respect of shares held by the Optionee at the time of such Involuntary Termination shall immediately terminate on an accelerated basis, and the shares subject to those terminated rights shall accordingly vest at that time.

G. The portion of any Incentive Option accelerated in connection with a Corporate Transaction shall remain exercisable as an Incentive Option only to the extent the applicable One Hundred Thousand Dollar limitation is not exceeded. To the extent such dollar limitation is exceeded, the accelerated portion of such option shall be exercisable as a Non- Statutory Option under the Federal tax laws.

H. The grant of options under the Plan shall in no way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

IV. CANCELLATION AND REGRANT OF OPTIONS

The Plan Administrator shall have the authority to effect, at any time and from time to time, with the consent of the affected option holders, the cancellation of any or all outstanding options under the Plan and to grant in substitution therefor new options covering the same or different number of shares of Common Stock but with an exercise price per share based on the Fair Market Value per share of Common Stock on the new option grant date.

ARTICLE THREE
STOCK ISSUANCE PROGRAM

I. STOCK ISSUANCE TERMS

Shares of Common Stock may be issued under the Stock Issuance Program through direct and immediate issuances without any intervening option grants. Each such stock issuance shall be evidenced by a Stock Issuance Agreement which complies with the terms specified below.

A. **Purchase Price**.

1. The purchase price per share shall be fixed by the Plan Administrator but shall not be less than eighty-five percent (85%) of the Fair Market Value per share of Common Stock on the issue date. However, the purchase price per share of Common Stock issued to a 10% Stockholder shall not be less than one hundred and ten percent (110%) of such Fair Market Value.

2. Subject to the provisions of Section I of Article Four, shares of Common Stock may be issued under the Stock Issuance Program for any of the following items of consideration which the Plan Administrator may deem appropriate in each individual instance:

(i) cash or check made payable to the Corporation, or

(ii) past services rendered to the Corporation (or any Parent or Subsidiary).

B. **Vesting Provisions**.

1. Shares of Common Stock issued under the Stock Issuance Program may, in the discretion of the Plan Administrator, be fully and immediately vested upon issuance or may vest in one or more installments over the Participant's period of Service or upon attainment of specified performance objectives. However, the Plan Administrator may not impose a vesting schedule upon any stock issuance effected under the Stock Issuance Program which is more restrictive than twenty percent (20%) per year vesting, with initial vesting to occur not later than one (1) year after the issuance date. Such limitation shall not apply to any Common Stock issuances made to the officers of the Corporation, non-employee Board members or independent consultants.

2. Any new, substituted or additional securities or other property (including money paid other than as a regular cash dividend) which the Participant may have the right to receive in respect of the Participant's unvested shares of Common Stock by reason of any stock dividend, stock split, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration shall be issued subject to (i) the same vesting requirements applicable to the Participant's unvested shares of Common Stock and (ii) such escrow arrangements as the Plan Administrator shall deem appropriate.

3. The Participant shall have full stockholder rights in respect of any shares of Common Stock issued to the Participant under the Stock Issuance Program, whether or not the Participant's interest in those shares is vested. Accordingly, the Participant shall have the right to vote such shares and to receive any regular cash dividends paid on such shares.

4. Should the Participant cease to remain in Service while holding one or more unvested shares of Common Stock issued under the Stock Issuance Program or should the performance objectives not be attained in respect of one or more such unvested shares of Common Stock, then those shares shall be immediately surrendered to the Corporation for cancellation, and the Participant shall have no further stockholder rights in respect of those shares. To the extent the surrendered shares were previously issued to the Participant for consideration paid in cash or cash equivalent (including the Participant's purchase-money indebtedness), the Corporation shall repay to the Participant the cash consideration paid for the surrendered shares and shall cancel the unpaid principal balance of any outstanding purchase-money note of the Participant attributable to such surrendered shares.

5. The Plan Administrator may in its discretion waive the surrender and cancellation of one or more unvested shares of Common Stock (or other assets attributable thereto) which would otherwise occur upon the non-completion of the vesting schedule applicable to such shares. Such waiver shall result in the immediate vesting of the Participant's interest in the shares of Common Stock as to which the waiver applies. Such waiver may be effected at any time, whether before or after the Participant's cessation of Service or the attainment or non-attainment of the applicable performance objectives.

C. **First Refusal Rights**. Until such time as the Common Stock is first registered under Section 12 of the 1934 Act, the Corporation shall have the right of first refusal in respect of any proposed disposition by the Participant (or any successor in interest) of any shares of Common Stock issued under the Stock Issuance Program. Such right of first refusal shall be exercisable in accordance with the terms established by the Plan Administrator and set forth in the document evidencing such right.

II. CORPORATE TRANSACTION

A. Upon the occurrence of a Corporate Transaction, all outstanding repurchase rights under the Stock Issuance Program shall terminate automatically, and the shares of Common Stock subject to those terminated rights shall immediately vest in full, except to the extent: (i) those repurchase rights are assigned to the successor corporation (or parent thereof) in connection with such Corporate Transaction or (ii) such accelerated vesting is precluded by other limitations imposed by the Plan Administrator at the time the repurchase right is issued.

B. The Plan Administrator shall have the discretionary authority, exercisable either at the time the unvested shares are issued or any time while the Corporation's repurchase rights in respect of those shares remain outstanding, to provide that those rights shall automatically terminate on an accelerated basis, and the shares of Common Stock subject to those terminated rights shall immediately vest, in the event the Participant's Service should subsequently terminate by reason of an Involuntary Termination within a designated period (not

to exceed eighteen (18) months) following the effective date of any Corporate Transaction in which those repurchase rights are assigned to the successor corporation (or parent thereof).

III. SHARE ESCROW/LEGENDS

Unvested shares may, in the Plan Administrator's discretion, be held in escrow by the Corporation until the Participant's interest in such shares vests or may be issued directly to the Participant with restrictive legends on the certificates evidencing those unvested shares.

ARTICLE FOUR
MISCELLANEOUS

I. FINANCING

The Plan Administrator may permit any Optionee or Participant to pay the option exercise price or the purchase price for shares issued to such person under the Plan by delivering a full-recourse, interest-bearing promissory note payable in one or more installments and secured by the purchased shares. However, any promissory note delivered by a consultant must be secured by collateral in addition to the purchased shares of Common Stock. In no event shall the maximum credit available to the Optionee or Participant exceed the sum of (i) the aggregate option exercise price or purchase price payable for the purchased shares plus (ii) any Federal, state and local income and employment tax liability incurred by the Optionee or the Participant in connection with the option exercise or share purchase.

II. EFFECTIVE DATE AND TERM OF PLAN

A. The Plan shall become effective when adopted by the Board, but no option granted under the Plan may be exercised, and no shares shall be issued under the Plan, until the Plan is approved by the Corporation's stockholders. If such stockholder approval is not obtained within twelve (12) months after the date of the Board's adoption of the Plan, then all options previously granted under the Plan shall terminate and cease to be outstanding, and no further options shall be granted and no shares shall be issued under the Plan. Subject to such limitation, the Plan Administrator may grant options and issue shares under the Plan at any time after the effective date of the Plan and before the date fixed herein for termination of the Plan.

B. The Plan shall terminate upon the earliest of (i) the expiration of the ten (10)-year period measured from the date the Plan is adopted by the Board, (ii) the date on which all shares available for issuance under the Plan shall have been issued as vested shares or (iii) the termination of all outstanding options in connection with a Corporate Transaction. All options and unvested stock issuances outstanding at that time under the Plan shall continue to have full force and effect in accordance with the provisions of the documents evidencing such options or issuances.

III. AMENDMENT OF THE PLAN

A. The Board shall have complete and exclusive power and authority to amend or modify the Plan in any or all respects. However, no such amendment or modification shall adversely affect the rights and obligations in respect of options or unvested stock issuances at the time outstanding under the Plan unless the Optionee or the Participant consents to such amendment or modification. In addition, certain amendments may require stockholder approval pursuant to applicable laws and regulations.

B. Options may be granted under the Option Grant Program and shares may be issued under the Stock Issuance Program which are in each instance in excess of the number of shares of Common Stock then available for issuance under the Plan, provided any excess shares actually issued under those programs shall be held in escrow until there is obtained stockholder approval of an amendment sufficiently increasing the number of shares of Common

Stock available for issuance under the Plan. If such stockholder approval is not obtained within twelve (12) months after the date the first such excess issuances are made, then (i) any unexercised options granted on the basis of such excess shares shall terminate and cease to be outstanding and (ii) the Corporation shall promptly refund to the Optionees and the Participants the exercise or purchase price paid for any excess shares issued under the Plan and held in escrow, together with interest (at the applicable Short Term Federal Rate) for the period the shares were held in escrow, and such shares shall thereupon be automatically cancelled and cease to be outstanding.

IV. USE OF PROCEEDS

Any cash proceeds received by the Corporation from the sale of shares of Common Stock under the Plan shall be used for general corporate purposes.

V. WITHHOLDING

The Corporation's obligation to deliver shares of Common Stock upon the exercise of any options or upon the issuance or vesting of any shares issued under the Plan shall be subject to the satisfaction of all applicable Federal, state and local income and employment tax withholding requirements.

VI. REGULATORY APPROVALS

The implementation of the Plan, the granting of any options under the Plan and the issuance of any shares of Common Stock (i) upon the exercise of any option or (ii) under the Stock Issuance Program shall be subject to the Corporation's procurement of all approvals and permits required by regulatory authorities having jurisdiction over the Plan, the options granted under it and the shares of Common Stock issued pursuant to it.

VII. NO EMPLOYMENT OR SERVICE RIGHTS

Nothing in the Plan shall confer upon the Optionee or the Participant any right to continue in Service for any period of specific duration or interfere with or otherwise restrict in any way the rights of the Corporation (or any Parent or Subsidiary employing or retaining such person) or of the Optionee or the Participant, which rights are hereby expressly reserved by each, to terminate such person's Service at any time for any reason, with or without cause.

VIII. FINANCIAL REPORTS

The Corporation shall deliver a balance sheet and an income statement at least annually to each individual holding an outstanding option under the Plan, unless such individual is a key Employee whose duties in connection with the Corporation (or any Parent or Subsidiary) assure such individual access to equivalent information.

APPENDIX

The following definitions shall be in effect under the Plan:

A. **Board** shall mean the Corporation's Board of Directors.

B. **Code** shall mean the Internal Revenue Code of 1986, as amended.

C. **Committee** shall mean a committee of two (2) or more Board members appointed by the Board to exercise one or more administrative functions under the Plan.

D. **Common Stock** shall mean the Corporation's common stock.

E. **Corporate Transaction** shall mean either of the following stockholder-approved transactions to which the Corporation is a party:

(i) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction, or

(ii) the sale, transfer or other disposition of all or substantially all of the Corporation's assets in complete liquidation or dissolution of the Corporation.

F. **Corporation** shall mean Energy Recovery Inc., a Delaware corporation, and any successor corporation to all or substantially all of the assets or voting stock of Energy Recovery Inc. which shall by appropriate action adopt the Plan.

G. **Disability** shall mean the inability of the Optionee or the Participant to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment and shall be determined by the Plan Administrator on the basis of such medical evidence as the Plan Administrator deems warranted under the circumstances.

H. **Employee** shall mean an individual who is in the employ of the Corporation (or any Parent or Subsidiary), subject to the control and direction of the employer entity as to both the work to be performed and the manner and method of performance.

I. **Exercise Date** shall mean the date on which the Corporation shall have received written notice of the option exercise.

J. **Fair Market Value** per share of Common Stock on any relevant date shall be determined in accordance with the following provisions:

(i) If the Common Stock is at the time traded on the Nasdaq National Market, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question, as such price is reported

by the National Association of Securities Dealers on the Nasdaq National Market or any successor system. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(ii) If the Common Stock is at the time listed on any Stock Exchange, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question on the Stock Exchange determined by the Plan Administrator to be the primary market for the Common Stock, as such price is officially quoted in the composite tape of transactions on such exchange. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(iii) If the Common Stock is at the time neither listed on any Stock Exchange nor traded on the Nasdaq National Market, then the Fair Market Value shall be determined by the Plan Administrator after taking into account such factors as the Plan Administrator shall deem appropriate.

K. **Incentive Option** shall mean an option which satisfies the requirements of Code Section 422.

L. **Involuntary Termination** shall mean the termination of the Service of any individual which occurs by reason of:

(i) such individual's involuntary dismissal or discharge by the Corporation for reasons other than Misconduct, or

(ii) such individual's voluntary resignation following (A) a change in his or her position with the Corporation which materially reduces his or her duties and responsibilities or the level of management to which he or she reports, (B) a reduction in his or her level of compensation (including base salary, fringe benefits and target bonuses under any corporate-performance based bonus or incentive programs) by more than fifteen percent (15%) or (C) a relocation of such individual's place of employment by more than fifty (50) miles, provided and only if such change, reduction or relocation is effected without the individual's consent.

M. **Misconduct** shall mean the commission of any act of fraud, embezzlement or dishonesty by the Optionee or Participant, any unauthorized use or disclosure by such person of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any other intentional misconduct by such person adversely affecting the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of any Optionee, Participant or other person in the Service of the Corporation (or any Parent or Subsidiary).

N. **1934 Act** shall mean the Securities Exchange Act of 1934, as amended.

O. **Non-Statutory Option** shall mean an option not intended to satisfy the requirements of Code Section 422.

P. **Option Grant Program** shall mean the option grant program in effect under the Plan.

Q. **Optionee** shall mean any person to whom an option is granted under the Plan.

R. **Parent** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation, provided each corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

S. **Participant** shall mean any person who is issued shares of Common Stock under the Stock Issuance Program.

T. **Plan** shall mean the Corporation's 2006 Stock Option/Stock Issuance Plan, as set forth in this document.

U. **Plan Administrator** shall mean either the Board or the Committee acting in its capacity as administrator of the Plan.

V. **Service** shall mean the provision of services to the Corporation (or any Parent or Subsidiary) by a person in the capacity of an Employee, a non-employee member of the board of directors or a consultant or independent advisor, except to the extent otherwise specifically provided in the documents evidencing the option grant.

W. **Stock Exchange** shall mean either the American Stock Exchange or the New York Stock Exchange.

X. **Stock Issuance Agreement** shall mean the agreement entered into by the Corporation and the Participant at the time of issuance of shares of Common Stock under the Stock Issuance Program.

Y. **Stock Issuance Program** shall mean the stock issuance program in effect under the Plan.

Z. **Subsidiary** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations beginning with the Corporation, provided each corporation (other than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

AA. **10% Stockholder** shall mean the owner of stock (as determined under Code Section 424(d)) possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Corporation (or any Parent or Subsidiary).

Plan History

Adopted by the Board of Directors at a Regular Meeting held on May 19, 2006.

Ratified by the Stockholders at the 2006 Board of Directors Meeting held on May 19, 2006.

ENERGY RECOVERY, INC.
STOCK PURCHASE AGREEMENT

AGREEMENT made this 1st day of February 2005, by and between Energy Recovery, Inc., a Delaware corporation ("Corporation"), and _____, ("Optionee") under the Corporation's 2006 Stock Option/Stock Issuance Plan.

All capitalized terms in this Agreement shall have the meaning assigned to them in this Agreement or in the attached Appendix.

A. EXERCISE OF OPTION

1. **Exercise**. Optionee hereby purchases _____ shares of Common Stock (the "Purchased Shares") pursuant to that certain option (the "Option") granted Optionee on _____ (the "Grant Date") to purchase up to _____ shares of Common Stock (the "Option Shares") under the Plan at the exercise price of $_____ per share (the "Exercise Price").

2. **Payment**. Concurrently with the delivery of this Agreement to the Corporation, Optionee shall pay the Exercise Price for the Purchased Shares in accordance with the provisions of the Option Agreement and shall deliver whatever additional documents may be required by the Option Agreement as a condition for exercise, together with a duly-executed blank Assignment Separate from Certificate (in the form attached hereto as Exhibit I) with respect to the Purchased Shares.

3. **Stockholder Rights**. Until such time as the Corporation exercises the Repurchase Right or the First Refusal Right. Optionee (or any successor in interest) shall have all the rights of a stockholder (including voting, dividend and liquidation rights) with respect to the Purchased Shares, subject, however, to the transfer restrictions of Articles B and C.

B. SECURITIES LAW COMPLIANCE

1. **Restricted Securities**. The Purchased Shares have not been registered under the 1933 Act and are being issued to Optionee in reliance upon the exemption from such registration provided by SEC Rule 701 for stock issuances under compensatory benefit plans such as the Plan. Optionee hereby confirms that Optionee has been informed that the Purchased Shares are restricted securities under the 1933 Act and may not be resold or transferred unless the Purchased Shares are first registered under the Federal securities laws or unless an exemption from such registration is available. Accordingly, Optionee hereby acknowledges that Optionee is prepared to hold the Purchased Shares for an indefinite period and that Optionee is aware that SEC Rule 144 issued under the 1933 Act which exempts certain resales of unrestricted securities is not presently available to exempt the resale of the Purchased Shares from the registration requirements of the 1933 Act.

2. **Restrictions on Disposition of Purchased Shares**. Optionee shall make no disposition of the Purchased Shares (other than a Permitted Transfer) unless and until there is compliance with all of the following requirements:

(i) Optionee shall have provided the Corporation with a written summary of the terms and conditions of the proposed disposition.

(ii) Optionee shall have complied with all requirements of this Agreement applicable to the disposition of the Purchased Shares.

(iii) Optionee shall have provided the Corporation with written assurances, in form and substance satisfactory to the Corporation, that (a) the proposed disposition does not require registration of the Purchased Shares under the 1933 Act or (b) all appropriate action necessary for compliance with the registration requirements of the 1933 Act or any exemption from registration available under the 1933 Act (including Rule 144) has been taken.

The Corporation shall not be required (i) to transfer on its books any Purchased Shares which have been sold or transferred in violation of the provisions of this Agreement or (ii) to treat as the owner of the Purchased Shares, or otherwise to accord voting, dividend or liquidation rights to, any transferee to whom the Purchased Shares have been transferred in contravention of this Agreement.

3. **Restrictive Legends**. The stock certificates for the Purchased Shares shall be endorsed with one or more of the following restrictive legends:

"THE SHARES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933. THE SHARES MAY NOT BE SOLD OR OFFERED FOR SALE IN THE ABSENCE OF (A) AN EFFECTIVE REGISTRATION STATEMENT FOR THE SHARES UNDER SUCH ACT, (B) A "NO ACTION" LETTER OF THE SECURITIES AND EXCHANGE COMMISSION IN RESPECT OF SUCH SALE OR OFFER, OR (C) SATISFACTORY ASSURANCES TO THE CORPORATION THAT REGISTRATION UNDER THE ACT IS NOT REQUIRED IN RESPECT OF SUCH SALE OR OFFER."

"THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO CERTAIN REPURCHASE RIGHTS AND RIGHTS OF FIRST REFUSAL GRANTED TO THE CORPORATION AND ACORDINGLY MAY NOT BE SOLD, ASSIGNED, TRANSFERRED, ENCUMBERED, OR IN ANY MANNER DISPOSED OF EXCEPT IN CONFORMITY WITH THE TERMS OF A WRITTEN AGREEMENT DATED _____, 200__ BETWEEN THE CORPORATION AND THE REGISTERED HOLDER OF THE SHARES (OR THE PREDECESSOR IN INTEREST TO THE SHARES). A COPY OF SUCH AGREEMENT IS MAINTAINED AT THE CORPORATION'S PRINCIPAL

CORPORATE OFFICES."

C. TRANSFER RESTRICTIONS

1. **Restriction on Transfer**. Except for any Permitted Transfer, Optionee shall not transfer, assign, encumber or otherwise dispose of any of the Purchased Shares which are subject to the Repurchase Right. In addition, Purchased Shares which are released from the Repurchase Right shall not be transferred, assigned, encumbered or otherwise disposed of in contravention of the First Refusal Right or the Market Stand-Off.

2. **Transferee Obligations**. Each person (other than the Corporation) to whom the Purchased Shares are transferred by means of a Permitted Transfer must as a condition precedent to the validity of such transfer, acknowledge in writing to the Corporation that such person is bound by the provisions of this Agreement and that the transferred shares are subject to (i) the Repurchase Right, (ii) the First Refusal Right and (iii) the Market Stand-Off, to the same extent such shares would be so subject if retained by Optionee.

3. **Market Stand-Off**.

(a) In connection with any underwritten public offering by the Corporation of its equity securities pursuant to an effective registration statement filed under the 1933 Act, including the Corporation's initial public offering. Owner shall not sell, make any short sale of, loan, hypothecate, pledge, grant any option for the purchase of, or otherwise dispose or transfer for value or otherwise agree to engage in any of the foregoing transactions with respect to, any Purchased Shares without the prior written consent of the Corporation or its underwriters. Such restriction (the "Market Stand-Off") shall be in effect for such period of time from and after the effective date of the final prospectus for the offering as may be requested by the Corporation or such underwriters. In no event, however, shall such period exceed one hundred eighty (180) days and the Market Stand-Off shall in all events terminate two (2) years after the effective date of the Corporation's initial public offering.

(b) Owner shall be subject to the Market Stand-Off provided and only if the officers and directors of the Corporation are also subject to similar restrictions.

(c) Any new, substituted or additional securities which are by reason of any Recapitalization or Reorganization distributed with respect to the Purchased Shares shall be immediately subject to the Market Stand-Off, to the same extent the Purchased Shares are at such time covered by such provisions.

(d) In order to enforce the Market Stand-Off, the Corporation may impose stop-transfer instructions with respect to the Purchased Shares until the end of the applicable stand-off period.

D. REPURCHASE RIGHT

1. **Grant**. The Corporation is hereby granted the right (the "Repurchase Right"), exercisable at any time during the sixty (60)-day period following the date Optionee ceases for any reason to remain in Service or (if later) during the sixty (60)-day period following

the execution date of this Agreement, to repurchase at the Exercise Price any or all of the Purchased Shares in which Optionee is not, at the time of his or her cessation of Service, vested in accordance with the Vesting Schedule applicable to those shares or the special vesting acceleration provisions of Paragraph D.6 of this Agreement (such shares to be hereinafter referred to as the "Unvested Shares").

2. **Exercise of the Repurchase Right**. The Repurchase Right shall be exercisable by written notice delivered to each Owner of the Unvested Shares prior to the expiration of the sixty (60)-day exercise period. The notice shall indicate the number of Unvested Shares to be repurchased and the date on which the repurchase is to be effected, such date to be not more than thirty (30) days after the date of such notice. The certificates representing the Unvested Shares to be repurchased shall be delivered to the Corporation on or before the close of business on the date specified for the repurchase. Concurrently with the receipt of such stock certificates, the Corporation shall pay to Owner, in cash or cash equivalents (including the cancellation of any purchase-money indebtedness), an amount equal to the Exercise Price previously paid for the Unvested Shares which are to be repurchased from Owner.

3. **Termination of the Repurchase Right**. The Repurchase Right shall terminate with respect to any Unvested Shares for which it is not timely exercised under Paragraph D.2. In addition, the Repurchase Right shall terminate and cease to be exercisable with respect to any and all Purchased Shares in which Optionee vests in accordance with the Vesting Schedule. All Purchased Shares as to which the Repurchase Right lapses shall, however, remain subject to (i) the First Refusal Right and (ii) the Market Stand-Off.

4. **Aggregate Vesting Limitation**. If the Option is exercised in more than one increment so that Optionee is a party to one or more other Stock Purchase Agreements (the "Prior Purchase Agreements") which are executed prior to the date of this Agreement, then the total number of Purchased Shares as to which Optionee shall be deemed to have a fully-vested interest under this Agreement and all Prior Purchase Agreements shall not exceed in the aggregate the number of Purchased Shares in which Optionee would otherwise at the time be vested, in accordance with the Vesting Schedule, had all the Purchased Shares (including those acquired under the Prior Purchase Agreements) been acquired exclusively under this Agreement.

5. **Recapitalization**. Any new, substituted or additional securities or other property (including cash paid other than as a regular cash dividend) which is by reason of any Recapitalization distributed with respect to the Purchased Shares shall be immediately subject to the Repurchase Right and any escrow requirements hereunder, but only to the extent the Purchased Shares are at the time covered by such right or escrow requirements. Appropriate adjustments to reflect such distribution shall be made to the number and/or class of Purchased Shares subject to this Agreement and to the price per share to be paid upon the exercise of the Repurchase Right in order to reflect the effect of any such Recapitalization upon the Corporation's capital structure; provided, however, that the aggregate purchase price shall remain the same.

6. **Corporate Transaction**.

(a) The Repurchase Right shall automatically terminate in its entirety, and all the Purchased Shares shall vest in full, immediately prior to the consummation of any Corporate Transaction, except to the extent the Repurchase Right is to be assigned to the successor entity in such Corporate Transaction.

(b) To the extent the Repurchase Right remains in effect following a Corporate Transaction, such right shall apply to any new securities or other property (including any cash payments) received in exchange for the Purchased Shares in consummation of the Corporate Transaction, but only to the extent the Purchased Shares are at the time covered by such right. Appropriate adjustments shall be made to the price per share payable upon exercise of the Repurchase Right to reflect the effect of the Corporate Transaction upon the Corporation's capital structure; provided, however, that the aggregate purchase price shall remain the same. The new securities or other property (including any cash payments) issued or distributed with respect to the Purchased Shares in consummation of the Corporate Transaction shall be immediately deposited in escrow with the Corporation (or the successor entity) and shall not be released from escrow until Optionee vests in such securities or other property in accordance with the same Vesting Schedule in effect for the Purchased Shares.

(c) The Repurchase Right shall automatically lapse in its entirety, and all the Purchased Shares shall immediately vest in full, upon an Involuntary Termination of Optionee's Service within twelve (12) months following the effective date of a Corporate Transaction in which the Repurchase Right does not otherwise terminate pursuant to Paragraph D.6(a) above.

E. RIGHT OR FIRST REFUSAL

1. **Grant.** The Corporation is hereby granted the right of first refusal (the "First Refusal Right"), exercisable in connection with any proposed transfer of the Purchased Shares in which Optionee has vested in accordance with the provisions of Article D. For purposes of this Article E, the term "transfer" shall include any sale, assignment, pledge, encumbrance or other disposition of the Purchased Shares intended to be made by Owner, but shall not include any Permitted Transfer.

2. **Notice of Intended Disposition**. In the event any Owner of Purchased Shares in which Optionee has vested desires to accept a bona fide third-party offer for the transfer of any or all of such shares (the Purchased Shares subject to such offer to be hereinafter referred to as the "Target Shares"), Owner shall promptly (i) deliver to the Corporation written notice (the "Disposition Notice") of the terms of the offer, including the purchase price and the identity of the third-party offeror, and (ii) provide satisfactory proof that the disposition of the Target Shares to such third-party offeror would not be in contravention of the provisions set forth in Articles B and C.

3. **Exercise of the First Refusal Right**. The Corporation shall, for a period of twenty-five (25) days following receipt of the Disposition Notice, have the right to repurchase any or all of the Target Shares subject to the Disposition Notice upon the same terms as those specified therein or upon such other terms (not materially different from those specified in the Disposition Notice) to which Owner consents. Such right shall be exercisable by delivery of

written notice (the "Exercise Notice") to Owner prior to the expiration of the twenty-five (25)-day exercise period. If such right is exercised with respect to all the Target Shares, then the Corporation shall effect the repurchase of such shares, including payment of the purchase price, not more than five (5) business days after delivery of the Exercise Notice; and at such time the certificates representing the Target Shares shall be delivered to the Corporation.

Should the purchase price specified in the Disposition Notice be payable in property other than cash or evidences of indebtedness, the Corporation shall have the right to pay the purchase price in the form of cash equal in amount to the value of such property. If Owner and the Corporation cannot agree on such cash value within ten (10) days after the Corporation's receipt of the Disposition Notice, the valuation shall be made by an appraiser of recognized standing selected by Owner and the Corporation or, if they cannot agree on an appraiser within twenty (20) days after the Corporation's receipt of the Disposition Notice, each shall select an appraiser of recognized standing and the two (2) appraisers shall designate a third appraiser of recognized standing, whose appraisal shall be determinative of such value. The cost of such appraisal shall be shared equally by Owner and the Corporation. The closing shall then be held on the later of (i) the fifth (5th) business day following delivery of the Exercise Notice or (ii) the fifth (5th) business day after such valuation shall have been made.

4. **Non-Exercise of the First Refusal Right**. In the event the Exercise Notice is not given to Owner prior to the expiration of the twenty-five (25)-day exercise period, Owner shall have a period of thirty (30) days thereafter in which to sell or otherwise dispose of the Target Shares to the third-party offeror identified in the Disposition Notice upon terms (including the purchase price) no more favorable to such third-party offeror than those specified in the Disposition Notice; provided, however, that any such sale or disposition must not be effected in contravention of the provisions of Articles B and C. The third-party offeror shall acquire the Target Shares subject to the First Refusal Right, and the acquired shares shall remain subject to the provisions of Article B and Paragraph C.3. In the event Owner does not effect such sale or disposition of the Target Shares within the specified thirty (30)-day period, the First Refusal Right shall continue to be applicable to any subsequent disposition of the Target Shares by Owner until such right lapses.

5. **Partial Exercise of the First Refusal Right**. In the event the Corporation makes a timely exercise of the First Refusal Right with respect to a portion, but not all, of the Target Shares specified in the Disposition Notice, Owner shall have the option, exercisable by written notice to the Corporation delivered within five (5) business days after Owner's receipt of the Exercise Notice, to effect the sale of the Target Shares pursuant to either of the following alternatives:

(i) sale or other disposition of all the Target Shares to the third-party offeror identified in the Disposition Notice, but in full compliance with the requirements of Paragraph E.4, as if the Corporation did not exercise the First Refusal Right; or

(ii) sale to the Corporation of the portion of the Target Shares which the Corporation has elected to purchase, such sale to be effected in substantial conformity with the provisions of Paragraph E.3. The First Refusal

Right shall continue to be applicable to any subsequent disposition of the remaining Target Shares until such right lapses.

Owner's failure to deliver timely notification to the Corporation shall be deemed to be an election by Owner to sell the Target Shares pursuant to alternative (i) above.

6. **Recapitalization/Reorganization**.

(a) Any new, substituted or additional securities or other property which is by reason of any Recapitalization distributed with respect to the Purchased Shares shall be immediately subject to the First Refusal Right, but only to the extent the Purchased Shares are at the time covered by such right.

(b) In the event of a Reorganization, the First Refusal Right shall remain in full force and effect and shall apply to the new capital stock or other property received in exchange for the Purchased Shares in consummation of the Reorganization, but only to the extent the Purchased Shares are at the time covered by such right.

7. **Lapse**. The First Refusal Right shall lapse upon the earliest to occur of (i) the first date on which shares of the Common Stock are held of record by more than five hundred (500) persons, (ii) a determination is made by the Board that a public market exists for the outstanding shares of Common Stock or (iii) a firm commitment underwritten public offering, pursuant to an effective registration statement under the 1933 Act, covering the offer and sale of the Common Stock in the aggregate amount of at least ten million dollars ($10,000,000). However, the Market Stand-Off shall continue to remain in full force and effect following the lapse of the First Refusal Right.

F. SPECIAL TAX ELECTION

The acquisition of the Purchased Shares may result in adverse tax consequences which may be avoided or mitigated by filing an election under Code Section 83(b). Such election must be filed within thirty (30) days after the date of this Agreement. A description of the tax consequences applicable to the acquisition of the Purchased Shares and the form for making the Code Section 83(b) election are set forth in Exhibit II. **OPTIONEE SHOULD CONSULT WITH HIS OR HER TAX ADVISOR TO DETERMINE THE TAX CONSEQUENCES OF ACQUIRING THE PURCHASED SHARES AND THE ADVANTAGES AND DISADVANTAGES OF FILING THE CODE SECTION 83(b) ELECTION. OPTIONEE ACKNOWLEDGES THAT IT IS OPTIONEE'S SOLE RESPONSIBILITY, AND NOT THE CORPORATION'S TO FILE A TIMELY ELECTION UNDER CODE SECTION 83(b). EVEN IF OPTIONEE REQUESTS THE CORPORATION OR ITS REPRESENTATIVES TO MAKE THIS FILING ON HIS OR HER BEHALF.**

G. GENERAL PROVISIONS

1. **Assignment**. The Corporation may assign the Repurchase Right and/or the First Refusal Right to any person or entity selected by the Board, including (without limitation) one or more stockholders of the Corporation. If the assignee of the Repurchase Right is other than (i) a wholly owned subsidiary of the Corporation or (ii) the parent corporation

owning one hundred percent (100%) of the Corporation's outstanding capital stock, then such assignee must make a cash payment to the Corporation, upon the assignment of the Repurchase Right, in an amount equal to the excess (if any) of (i) the Fair Market Value of the Purchased Shares at the time subject to the assigned Repurchase Right over (ii) the aggregate repurchase price payable for the Purchased Shares.

2. **No Employment or Service Contract**. Nothing in this Agreement or in the Plan shall confer upon Optionee any right to continue in Service for any period of specific duration or interfere with or otherwise restrict in any way the rights of the Corporation (or any Parent or Subsidiary employing or retaining Optionee) or of Optionee, which rights are hereby expressly reserved by each, to terminate Optionee's Service at any time for any reason, with or without cause.

3. **Notices**. Any notice required to be given under this Agreement shall be in writing and shall be deemed effective upon personal delivery or upon deposit in the U.S. mail, registered or certified, postage prepaid and properly addressed to the party entitled to such notice at the address indicated below such party's signature line on this Agreement or at such other address as such party may designate by ten (10) days advance written notice under this paragraph to all other parties to this Agreement.

4. **No Waiver**. The failure of the Corporation in any instance to exercise the Repurchase Right or the First Refusal Right shall not constitute a waiver of any other repurchase rights and/or rights of first refusal that may subsequently arise under the provisions of this Agreement or any other agreement between the Corporation and Optionee. No waiver of any breach or condition of this Agreement shall be deemed to be a waiver of any other or subsequent breach or condition, whether of like or different nature.

5. **Cancellation of Shares**. If the Corporation shall make available, at the time and place and in the amount and form provided in this Agreement, the consideration for the Purchased Shares to be repurchased in accordance with the provisions of this Agreement, then from and after such time, the person from whom such shares are to be repurchased shall no longer have any rights as a holder of such shares (other than the right to receive payment of such consideration in accordance with this Agreement). Such shares shall be deemed purchased in accordance with the applicable provisions hereof, and the Corporation shall be deemed the owner and holder of such shares, whether or not the certificates therefor have been delivered as required by this Agreement.

H. MISCELLANEOUS PROVISIONS

1. **Optionee Undertaking**. Optionee hereby agrees to take whatever additional action and execute whatever additional documents the Corporation may deem necessary or advisable in order to carry out or effect one or more of the obligations or restrictions imposed on either Optionee or the Purchased Shares pursuant to the provisions of this Agreement.

2. **Agreement is Entire Contract**. This Agreement constitutes the entire contract between the parties hereto with regard to the subject matter hereof. This Agreement is

made pursuant to the provisions of the Plan and shall in all respects be construed in conformity with the terms of the Plan.

3. **Governing Law**. This Agreement shall be governed by, and construed in accordance with, the laws of the State of California without resort to that State's conflict-of-laws rules.

4. **Counterparts**. This Agreement may be executed in counterparts, each of which shall be deemed to be an original, but all of which together shall constitute one and the same instrument.

5. **Successors and Assigns**. The provisions of this Agreement shall inure to the benefit of, and be binding upon, the Corporation and its successors and assigns and upon Optionee, Optionee's permitted assigns and the legal representatives, heirs and legatees of Optionee's estate, whether or not any such person shall have become a party to this Agreement and have agreed in writing to join herein and be bound by the terms hereof.

IN WITNESS WHEREOF, the parties have executed this Agreement on the day and year first indicated above.

ENERGY RECOVERY, INC.

By: _____

Title: _____

Address: _____

_____

OPTIONEE

By: _____

Address: _____

_____

SPOUSAL ACKNOWLEDGMENT

The undersigned spouse of Optionee has read and hereby approves the foregoing Stock Purchase Agreement. In consideration of the Corporation's granting Optionee the right to acquire the Purchased Shares in accordance with the terms of such Agreement, the undersigned hereby agrees to be irrevocably bound by all the terms of such Agreement, including (without limitation) the right of the Corporation (or its assigns) to purchase any Purchased Shares in which Optionee is not vested at time of his or her cessation of Service.

OPTIONEE SPOUSE

By: _____

Address: _____

_____

EXHIBIT I

ASSIGNMENT SEPARATE FROM CERTIFICATE

FOR VALUE RECEIVED _____ hereby sell(s), assign(s) and transfer(s) unto Energy Recovery, Inc. (the "Corporation"), _____ (_____) shares of the Common Stock of the Corporation standing in his or her name on the books of the Corporation represented by Certificate No. _____ herewith and do(es) hereby irrevocably constitute and appoint_____ Attorney to transfer the said stock on the books of the Corporation with full power of substitution in the premises.

Dated: _____

Signature: _____

Instruction: Please do not fill in any blanks other than the signature line. Please sign exactly as you would like your name to appear on the issued stock certificate. The purpose of this assignment is to enable the Corporation to exercise the Repurchase Right without requiring additional signatures on the part of Optionee.

EXHIBIT II

FEDERAL INCOME TAX CONSEQUENCES AND SECTION 83(b) TAX ELECTION

II. **Federal Income Tax Consequences and Section 83(b) Election For Exercise of Non-Statutory Option** If the Purchased Shares are acquired pursuant to the exercise of a Non-Statutory Option, as specified in the Grant Notice, then under Code Section 83, the excess of the Fair Market Value of the Purchased Shares on the date any forfeiture restrictions applicable to such shares lapse over the Exercise Price paid for such shares will be reportable as ordinary income on the lapse date. For this purpose, the term "forfeiture restrictions" includes the right of the Corporation to repurchase the Purchased Shares pursuant to the Repurchase Right. However, Optionee may elect under Code Section 83(b) to be taxed at the time the Purchased Shares are acquired, rather than when and as such Purchased Shares cease to be subject to such forfeiture restrictions. Such election must be filed with the Internal Revenue Service within thirty (30) days after the date of the Agreement. Even if the Fair Market Value of the Purchased Shares on the date of the Agreement equals the Exercise Price paid (and thus no tax is payable), the election must be made to avoid adverse tax consequences in the future. The form for making this election is attached as part of this exhibit. **FAILURE TO MAKE THIS FILING WITHIN THE APPLICABLE THIRTY (30)-DAY PERIOD WILL RESULT IN THE RECOGNITION OF ORDINARY INCOME BY OPTIONEE AS THE FORFEITURE RESTRICTIONS LAPSE.**

III. **Federal Income Tax Consequences and Conditional Section 83(b) Election For Exercise of Incentive Option** If the Purchased Shares are acquired pursuant to the exercise of an Incentive Option, as specified in the Grant Notice, then the following tax principles shall be applicable to the Purchased Shares:

(i) For regular tax purposes, no taxable income will be recognized at the time the Option is exercised.

(ii) The excess of (a) the Fair Market Value of the Purchased Shares on the date the Option is exercised or (if later) on the date any forfeiture restrictions applicable to the Purchased Shares lapse over (b) the Exercise Price paid for the Purchased Shares will be includible in Optionee's taxable income for alternative minimum tax purposes.

(iii) If Optionee makes a disqualifying disposition of the Purchased Shares, then Optionee will recognize ordinary income in the year of such disposition equal in amount to the excess of (a) the Fair Market Value of the Purchased Shares on the date the Option is exercised or (if later) on the date any forfeiture restrictions applicable to the Purchased Shares lapse over (b) the Exercise Price paid for the Purchased Shares. Any additional gain recognized upon the disqualifying disposition will be either short-term or long-term capital gain depending upon the period for which the Purchased Shares are held prior to the disposition.

(iv) For purposes of the foregoing, the term "forfeiture restrictions" will include the right of the Corporation to repurchase the Purchased Shares pursuant to the Repurchase Right. The term "disqualifying disposition" means any sale or other disposition [1] of the Purchased Shares within two (2) years after the Grant Date or within one (1) year after the exercise date of the Option.

(v) In the absence of final Treasury Regulations relating to Incentive Options, it is not certain whether Optionee may, in connection with the exercise of the Option for any Purchased Shares at the time subject to forfeiture restrictions, file a protective election under Code Section 83(b) which would limit (a) Optionee's alternative minimum taxable income upon exercise and (b) Optionee's ordinary income upon a disqualifying disposition to the excess of the Fair Market Value of the Purchased Shares on the date the Option is exercised over the Exercise Price paid for the Purchased Shares. Accordingly, such election if properly filed will only be allowed to the extent the final Treasury Regulations permit such a protective election. Page 2 of the attached form for making the election should be filed with any election made in connection with the exercise of an Incentive Option.

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1 Generally, a disposition of stores purchased under an Incentive Option includes any transfer of legal title, including a transfer by sale, exchange or gift, but does not include a transfer to the Optionee's spouse, a transfer into joint ownership with right of survivorship if Optionee remains one of the joint owners a pledge a transfer by bequest or inheritance or certain tax free exchanges permitted under the Code.

SECTION 83(b) ELECTION

This statement is being made under Section 83(b) of the Internal Revenue Code, pursuant to Treas. Reg. Section 1.83-2.

(1) The taxpayer who performed the services is:

Name:
Address:
Taxpayer Ident. No.:

(2) The property with respect to which the election is being made is _____ shares of the common stock of Energy Recovery, Inc.

(3) The property was issued on 1 February, 2005..

(4) The taxable year in which the election is being made is the calendar year 2006.

(5) The property is subject to a repurchase right pursuant to which the issuer has the right to acquire the property at the original purchase price if for any reason taxpayer's service with the issuer terminates. The issuer's repurchase right lapses in a series of annual and monthly installments over a four (4)-year period ending on _____, 200 __.

(6) The fair market value at the time of transfer (determined without regard to any restriction other than a restriction which by its terms will never lapse) is $0.25 per share.

(7) The amount paid for such property is $_____ per share.

(8) A copy of this statement was furnished to Energy Recovery, Inc. for whom taxpayer rendered the services underlying the transfer of property.

(9) This statement is executed on _____, 200__.

Spouse (if any)

Taxpayer

This election must be filed with the Internal Revenue Service Center with which taxpayer files his or her Federal income tax returns and must be made within thirty (30) days after the execution date of the Stock Purchase Agreement. This filing should be made by registered or certified mail return receipt requested. Optionee must retain two (2) copies of the completed form for filing with his or her Federal and state tax returns for the current tax year and an additional copy for his or her records.

The property described in the above Section 83(b) election is comprised of shares of common stock acquired pursuant to the exercise of an incentive stock option under Section 422 of the Internal Revenue Code (the "Code"). Accordingly, it is the intent of the Taxpayer to utilize this election to achieve the following tax results:

1. The purpose of this election is to have the alternative minimum taxable income attributable to the purchased shares measured by the amount by which the fair market value of such shares at the time of their transfer to the Taxpayer exceeds the purchase price paid for the shares. In the absence of this election, such alternative minimum taxable income would be measured by the spread between the fair market value of the purchased shares and the purchase price which exists on the various lapse dates in effect for the forfeiture restrictions applicable to such shares. The election is to be effective to the full extent permitted under the Code.

2. Section 421(a)(1) of the Code expressly excludes from income any excess of the fair market value of the purchased shares over the amount paid for such shares. Accordingly, this election is also intended to be effective in the event there is a "disqualifying disposition" of the shares, within the meaning of Section 421 (b) of the Code, which would otherwise render the provisions of Section 83(a) of the Code applicable at that time. Consequently, the Taxpayer hereby elects to have the amount of disqualifying disposition income measured by the excess of the fair market value of the purchased shares on the date of transfer to the Taxpayer over the amount paid for such shares. Since Section 421(a) presently applies to the shares which are the subject of this Section 83(b) election, no taxable income is actually recognized for regular tax purposes at this time, and no income taxes are payable, by the Taxpayer as a result of this election.

THIS PAGE 2 IS TO BE ATTACHED TO ANY SECTION 83(b) ELECTION FILED IN CONNECTION WITH THE EXERCISE OF AN INCENTIVE STOCK OPTION UNDER THE FEDERAL TAX LAWS.

APPENDIX

The following definitions shall be in effect under the Agreement:

A. **Agreement** shall mean this Stock Purchase Agreement.

B. **Board** shall mean the Corporation's Board of Directors.

C. **Code** shall mean the Internal Revenue Code of 1986, as amended.

D. **Common Stock** shall mean the Corporation's common stock.

E. **Corporate Transaction** shall mean either of the following stockholder-approved transactions:

(i) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction, or

(ii) the sale, transfer or other disposition of all or substantially all of the Corporation's assets in complete liquidation or dissolution of the Corporation.

F. **Corporation** shall mean Energy Recovery, Inc., a Delaware corporation, and any successor corporation to all or substantially all of the assets or voting stock of Energy Recovery, Inc. which shall by appropriate action adopt the Plan.

G. **Disposition Notice** shall have the meaning assigned to such term in Paragraph E.2.

H. **Exercise Notice** shall have the meaning assigned to such term in Paragraph E.3.

I. **Exercise Price** shall have the meaning assigned to such term in Paragraph A.l.

J. **Fair Market Value** of a share of Common Stock on any relevant date, prior to the initial public offering of the Common Stock, shall be determined by the Plan Administrator after taking into account such factors as it shall deem appropriate.

K. **First Refusal Right** shall mean the right granted to the Corporation in accordance with Article E.

L. **Grant Date** shall have the meaning assigned to such term in Paragraph A.1.

M. **Grant Notice** shall mean the Notice of Grant of Stock Option pursuant to which Optionee has been informed of the basic terms of the Option.

N. **Incentive Option** shall mean an option which satisfies the requirements of Code Section 422.

O. **Involuntary Termination** shall mean the termination of Optionee's Service which occurs by reason of:

(i) Optionee's involuntary dismissal or discharge by the Corporation for reasons other than Misconduct, or

(ii) Optionee's voluntary resignation following (A) a change in his or her position with the Corporation which materially reduces his or her level of responsibility, (B) a reduction in Optionee's level of compensation (including base salary, fringe benefits and target bonuses under any corporate-performance based bonus or incentive programs) by more than fifteen percent (15%) or (C) a relocation of Optionee's place of employment by more than fifty (50) miles, provided and only if such change, reduction or relocation is effected by the Corporation without Optionee's consent.

P. **Market Stand-Off** shall mean the market stand-off restriction specified in Paragraph C. 3.

Q. **Misconduct** shall mean the commission of any act of fraud, embezzlement or dishonesty by Optionee, any unauthorized use or disclosure by Optionee of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any other intentional misconduct by Optionee adversely affecting the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of Optionee or any other individual in the Service of the Corporation (or any Parent or Subsidiary).

R. **1933 Act** shall mean the Securities Act of 1933, as amended.

S. **1934 Act** shall mean the Securities Exchange Act of 1934, as amended.

T. **Non-Statutory Option** shall mean an option not intended to satisfy the requirements of Code Section 422.

U. **Option** shall have the meaning assigned to such term in Paragraph A. 1.

V. **Option Agreement** shall mean all agreements and other documents evidencing the Option.

W. **Optionee** shall mean the person to whom the Option is granted under the Plan.

X. **Owner** shall mean Optionee and all subsequent holders of the Purchased Shares who derive their chain of ownership through a Permitted Transfer from Optionee.

Y. **Parent** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation, provided each corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

Z. **Permitted Transfer** shall mean (i) a gratuitous transfer of the Purchased Shares, provided and only if Optionee obtains the Corporation's prior written consent to such transfer, (ii) a transfer of title to the Purchased Shares effected pursuant to Optionee's will or the laws of intestate succession following Optionee's death or (iii) a transfer to the Corporation in pledge as security for any purchase-money indebtedness incurred by Optionee in connection with the acquisition of the Purchased Shares.

AA. **Plan** shall mean the Corporation's 2006 Stock Option/Stock Issuance Plan.

BB. **Plan Administrator** shall mean either the Board or a committee of the Board acting in its capacity as administrator of the Plan.

CC. **Prior Purchase Agreement** shall have the meaning assigned to such term in Paragraph D.4.

DD. **Purchased Shares** shall have the meaning assigned to such term in Paragraph A. 1.

EE. **Recapitalization** shall mean any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the Corporation's outstanding Common Stock as a class without the Corporation's receipt of consideration.

FF. **Reorganization** shall mean any of the following transactions:

(i) a merger or consolidation in which the Corporation is not the surviving entity,

(ii) a sale, transfer or other disposition of all or substantially all of the Corporation's assets,

(iii) a reverse merger in which the Corporation is the surviving entity but in which the Corporation's outstanding voting securities are transferred

in whole or in part to a person or persons different from the persons holding those securities immediately prior to the merger, or

(iv) any transaction effected primarily to change the state in which the Corporation is incorporated or to create a holding company structure.

GG. **Repurchase Right** shall mean the right granted to the Corporation in accordance with Article D.

HH. **SEC** shall mean the Securities and Exchange Commission.

II. **Service** shall mean the Optionee's performance of services for the Corporation (or any Parent or Subsidiary) in the capacity of an employee, subject to the control and direction of the employer entity as to both the work to be performed and the manner and method of performance, a non-employee member of the board of directors or an independent consultant.

JJ. **Subsidiary** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations beginning with the Corporation, provided each corporation (other than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

KK. **Target Shares** shall have the meaning assigned to such term in Paragraph E.2.

LL. **Vesting Schedule** shall mean the vesting schedule specified in the Grant Notice pursuant to which the Optionee is to vest in the Option Shares in a series of installments over his or her period of Service.

MM. **Unvested Shares** shall have the meaning assigned to such term in Paragraph D.1.

ADDENDUM
TO
STOCK PURCHASE AGREEMENT

The following provisions are hereby incorporated into, and are hereby made a part of, that certain Stock Purchase Agreement (the "Purchase Agreement") by and between Energy Recovery, Inc. (the "Corporation") and ("Optionee") evidencing the shares of Common Stock purchased on this date by Optionee under the Corporation's 2006 Stock Option/Stock Issuance Plan, and such provisions shall be effective immediately. All capitalized terms in this Addendum, to the extent not otherwise defined herein, shall have the meanings assigned to such terms in the Purchase Agreement.

INVOLUNTARY TERMINATION FOLLOWING
CORPORATE TRANSACTION

I. TO THE EXTENT THE REPURCHASE RIGHT IS ASSIGNED TO THE SUCCESSOR CORPORATION (OR PARENT THEREOF) IN CONNECTION WITH A CORPORATE TRANSACTION, NO ACCELERATED VESTING OF THE PURCHASED SHARES SHALL OCCUR UPON SUCH CORPORATE TRANSACTION, AND THE REPURCHASE RIGHT SHALL CONTINUE TO REMAIN IN FULL FORCE AND EFFECT IN ACCORDANCE WITH THE PROVISIONS OF THE PURCHASE AGREEMENT. OPTIONEE SHALL, OVER HIS OR HER PERIOD OF SERVICE FOLLOWING THE CORPORATE TRANSACTION, CONTINUE TO VEST IN THE PURCHASED SHARES IN ONE OR MORE INSTALLMENTS IN ACCORDANCE WITH THE PROVISIONS OF THE PURCHASE AGREEMENT. HOWEVER, UPON AN INVOLUNTARY TERMINATION OF OPTIONEE'S SERVICE WITHIN SIX (6) MONTHS FOLLOWING THE CORPORATE TRANSACTION, THE REPURCHASE RIGHT SHALL TERMINATE AUTOMATICALLY, AND ALL THE PURCHASED SHARES SHALL IMMEDIATELY VEST IN FULL AT THAT TIME.

J. FOR PURPOSES OF THIS ADDENDUM, THE FOLLOWING DEFINITIONS SHALL BE IN EFFECT:

An **Involuntary Termination** shall mean the termination of Optionee's Service by reason of:

1. Optionee's involuntary dismissal or discharge by the Corporation for reasons other than for Misconduct, or

2. Optionee's voluntary resignation following (A) a change in his or her position with the Corporation (or Parent or Subsidiary employing Optionee) which materially reduces his or her duties and responsibilities or the level of management to which he or she reports, (B) a reduction in Optionee's level of compensation (including base salary, fringe benefits and target

bonuses under any corporate-performance based incentive programs) by more than fifteen percent (15%) or (C) a relocation of Optionee's place of employment by more than fifty (50) miles, provided and only if such change, reduction or relocation is effected by the Corporation without Optionee's consent.

Misconduct shall mean the termination of Optionee's Service by reason of Optionee's commission of any act of fraud, embezzlement or dishonesty, any unauthorized use or disclosure by Optionee of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any other intentional misconduct by Optionee adversely affecting the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of Optionee or any other individual in the Service of the Corporation (or any Parent or Subsidiary).

IN WITNESS WHEREOF, Energy Recovery, Inc. has caused this Addendum to be executed by its duly-authorized officer as of the Effective Date specified below.

ENERGY RECOVERY, INC.

By: _____

Title: _____

EFFECTIVE DATE: 1 February 2005

ENERGY RECOVERY, INC.

2006 STOCK OPTION AGREEMENT

RECITALS

I. The Board has adopted the Plan for the purpose of retaining the services of selected Employees, non-employee members of the Board or the board of directors of any Parent or Subsidiary and consultants and other independent advisors in the service of the Corporation (or any Parent or Subsidiary).

A. Optionee is to render valuable services to the Corporation (or a Parent or Subsidiary), and this Agreement is executed pursuant to, and is intended to carry out the purposes of, the Plan in connection with the Corporation's grant of an option to Optionee.

B. All capitalized terms in this Agreement shall have the meaning assigned to them in the attached Appendix.

NOW, THEREFORE, it is hereby agreed as follows:

1. **Grant of Option**. The Corporation hereby grants to Optionee, as of the Grant Date, an option to purchase up to the number of Option Shares specified in the Grant Notice. The Option Shares shall be purchasable from time to time during the option term specified in Paragraph 2 at the Exercise Price set forth in the Grant Notice.

2. **Option Term**. This option shall have a term of ten (10) years measured from the Grant Date and shall accordingly expire at the close of business on the Expiration Date, unless sooner terminated in accordance with Paragraph 5 or 6.

3. **Limited Transferability**. During Optionee's lifetime, this option shall be exercisable only by Optionee and shall not be assignable or transferable other than by will or by the laws of descent and distribution following Optionee's death.

4. **Dates of Exercise**. This option shall become exercisable for the Option Shares in one or more installments as specified in the Grant Notice. As the option becomes exercisable for such installments, those installments shall accumulate, and the option shall remain exercisable for the accumulated installments until the Expiration Date or sooner termination of the option term under Paragraph 5 or 6.

5. **Cessation of Service**. The option term specified in Paragraph 2 shall terminate (and this option shall cease to be outstanding) prior to the Expiration Date should any of the following provisions become applicable:

(a) Should Optionee cease to remain in Service for any reason (other than death, Disability or Misconduct) while this option is outstanding, then Optionee shall have a period of one (1) month (commencing with the date of such cessation of Service) during which to exercise this option, but in no event shall this option be exercisable at any time after the Expiration Date.

(b) Should Optionee die while this option is outstanding, then the personal representative of Optionee's estate or the person or persons to whom the option is transferred pursuant to Optionee's will or in accordance with the laws of inheritance shall have the right to exercise this option. Such right shall lapse, and this option shall cease to be outstanding, upon the earlier of (i) the expiration of the twelve (12)-month period measured from the date of Optionee's death or (ii) the Expiration Date.

(c) Should Optionee cease Service by reason of Disability while this option is outstanding, then Optionee shall have a period of twelve (12) months (commencing with the date of such cessation of Service) during which to exercise this option. In no event shall this option be exercisable at any time after the Expiration Date.

Note: Exercise of this option on a date later than three (3) months following cessation of Service due to Disability will result in loss of favorable Incentive Option treatment, unless such Disability constitutes Permanent Disability. In the event that Incentive Option treatment is not available, this option will be taxed as a Non-Statutory Option upon exercise.

(d) During the limited period of post-Service exercisability, this option may not be exercised in the aggregate for more than the number of Option Shares in which Optionee is, at the time of Optionee's cessation of Service, vested pursuant to the Vesting Schedule specified in the Grant Notice or the special vesting acceleration provisions of Paragraph 6. Upon the expiration of such limited exercise period or (if earlier) upon the Expiration Date, this option shall terminate and cease to be outstanding for any vested Option Shares for which the option has not been exercised. To the extent Optionee is not vested in the Option Shares at the time of Optionee's cessation of Service, this option shall immediately terminate and cease to be outstanding in respect of those shares.

(e) Should Optionee's Service be terminated for Misconduct, then this option shall terminate immediately and cease to remain outstanding.

(f) In the event of a Corporate Transaction, the provisions of Paragraph 6 shall govern the period for which this option is to remain exercisable following Optionee's cessation of Service and shall supersede any provisions to the contrary in this paragraph.

6. **Accelerated Vesting**.

(a) In the event of any Corporate Transaction, the Option Shares at the time subject to this option but not otherwise vested shall automatically vest in full so that this option shall, immediately prior to the effective date of the Corporate Transaction, become fully exercisable for all of those Option Shares and may be exercised for any or all of those Option

Shares as fully-vested shares of Common Stock. However, the Option Shares shall **not** vest on such an accelerated basis if and to the extent: (i) this option is assumed by the success or corporation (or parent thereof) in the Corporate Transaction and the Corporation's repurchase rights in respect of the unvested Option Shares are assigned to such successor corporation (or parent thereof) or (ii) this option is to be replaced with a cash incentive program of the successor corporation which preserves the spread existing on the unvested Option Shares at the time of the Corporate Transaction (the excess of the Fair Market Value of those Option Shares over the Exercise Price payable for such shares) and provides for subsequent payout in accordance with the same Vesting Schedule applicable to those unvested Option Shares as set forth in the Grant Notice.

(b) Immediately following the Corporate Transaction, this option shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation (or parent thereof) in connection with the Corporate Transaction.

(c) If this option is assumed in connection with a Corporate Transaction, then this option shall be appropriately adjusted, immediately after such Corporate Transaction, to apply to the number and class of securities which would have been issuable to Optionee in consummation of such Corporate Transaction had the option been exercised immediately prior to such Corporate Transaction, and appropriate adjustments shall also be made to the Exercise Price, provided the aggregate Exercise Price shall remain the same.

(d) Should there occur an Involuntary Termination of Optionee's Service within twelve (12) months following a Corporate Transaction in which the Option Shares do not otherwise vest on an accelerated basis pursuant to Paragraph 6(a), then all the Option Shares subject to this option at the time of such Involuntary Termination but not otherwise vested shall automatically vest and the Corporation's repurchase rights in respect of those shares shall terminate so that this option shall immediately become exercisable for all the Option Shares as fully-vested shares. The option shall remain exercisable for any or all of those vested Option Shares until the earlier of (i) the Expiration Date or (ii) the expiration of the one (l)-year period measured from the date of the Involuntary Termination.

(e) This Agreement shall not in any way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

7. **Adjustment in Option Shares**. Should any change be made to the Common Stock by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration, appropriate adjustments shall be made to (i) the total number and/or class of securities subject to this option and (ii) the Exercise Price in order to reflect such change and thereby preclude a dilution or enlargement of benefits hereunder.

8. **Stockholder Rights**. The holder of this option shall not have any stockholder rights in respect of the Option Shares until such person shall have exercised the option, paid the Exercise Price and become the record holder of the purchased shares.

9. **Manner of Exercising Option**.

(a) In order to exercise this option in respect of all or any part of the Option Shares for which this option is at the time exercisable, Optionee (or any other person or persons exercising the option) must take the following actions:

(i) Execute and deliver to the Corporation a Purchase Agreement for the Option Shares for which the option is exercised.

(ii) Pay the aggregate Exercise Price for the purchased shares in one or more of the following forms:

(A) cash or check made payable to the Corporation; or

Should the Common Stock be registered under Section 12 of the 1934 Act at the time the option is exercised, then the Exercise Price may also be paid as follows:

(B) in shares of Common Stock held by Optionee (or any other person or persons exercising the option) for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at Fair Market Value on the Exercise Date; or

(C) to the extent the option is exercised for vested Option Shares, through a special sale and remittance procedure pursuant to which Optionee (or any other person or persons exercising the option) shall concurrently provide irrevocable instructions (a) to a Corporation-designated brokerage firm to effect the immediate sale of the purchased shares and remit to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate Exercise Price payable for the purchased shares plus all applicable Federal, state and local income and employment taxes required to be withheld by the Corporation by reason of such exercise and (b) to the Corporation to deliver the certificates for the purchased shares directly to such brokerage firm in order to complete the sale.

Except to the extent the sale and remittance procedure is utilized in connection with the option exercise, payment of the Exercise Price must accompany the Purchase Agreement delivered to the Corporation in connection with the option exercise.

(iii) Furnish to the Corporation appropriate documentation that the person or persons exercising the option (if other than Optionee) have the right to exercise this option.

(iv) Execute and deliver to the Corporation such written representations as may be requested by the Corporation in order for it to comply with the applicable requirements of Federal and state securities laws.

(v) Make appropriate arrangements with the Corporation (or Parent or Subsidiary employing or retaining Optionee) for the satisfaction of all Federal, state and local income and employment tax withholding requirements applicable to the option exercise.

(b) As soon as practical after the Exercise Date, the Corporation shall issue to or on behalf of Optionee (or any other person or persons exercising this option) a certificate for the purchased Option Shares, with the appropriate legends affixed thereto.

(c) In no event may this option be exercised for any fractional shares.

10. REPURCHASE RIGHTS. ALL OPTION SHARES ACQUIRED UPON THE EXERCISE OF THIS OPTION SHALL BE SUBJECT TO CERTAIN RIGHTS OF THE CORPORATION AND ITS ASSIGNS TO REPURCHASE THOSE SHARES IN ACCORDANCE WITH THE TERMS SPECIFIED IN THE PURCHASE AGREEMENT.

11. **Compliance with Laws and Regulations**.

(a) The exercise of this option and the issuance of the Option Shares upon such exercise shall be subject to compliance by the Corporation and Optionee with all applicable requirements of law relating thereto and with all applicable regulations of any stock exchange (or the Nasdaq National Market, if applicable) on which the Common Stock may be listed for trading at the time of such exercise and issuance.

(b) The inability of the Corporation to obtain approval from any regulatory body having authority deemed by the Corporation to be necessary to the lawful issuance and sale of any Common Stock pursuant to this option shall relieve the Corporation of any liability in respect of the non-issuance or sale of the Common Stock as to which such approval shall not have been obtained. The Corporation, however, shall use its best efforts to obtain all such approvals.

12. **Successors and Assigns**. Except to the extent otherwise provided in Paragraphs 3 and 6, the provisions of this Agreement shall inure to the benefit of, and be binding upon, the Corporation and its successors and assigns and Optionee, Optionee's assigns and the legal representatives, heirs and legatees of Optionee's estate.

13. **Notices**. Any notice required to be given or delivered to the Corporation under the terms of this Agreement shall be in writing and addressed to the Corporation at its principal corporate offices. Any notice required to be given or delivered to Optionee shall be in writing and addressed to Optionee at the address indicated below Optionee's signature line on the Grant Notice. All notices shall be deemed effective upon personal delivery or upon deposit in the U.S. mail, postage prepaid and properly addressed to the party to be notified.

14. **Construction**. This Agreement and the option evidenced hereby are made and granted pursuant to the Plan and are in all respects limited by and subject to the terms of the Plan. All decisions of the Plan Administrator in respect of any question or issue arising under the

Plan or this Agreement shall be conclusive and binding on all persons having an interest in this option.

15. **Governing Law**. The interpretation, performance and enforcement of this Agreement shall be governed by the laws of the State of California without resort to that State's conflict-of-laws rules.

16. **Stockholder Approval**. If the Option Shares covered by this Agreement exceed, as of the Grant Date, the number of shares of Common Stock which may be issued under the Plan as last approved by the stockholders, then this option shall be void in respect of such excess shares, unless stockholder approval of an amendment sufficiently increasing the number of shares of Common Stock issuable under the Plan is obtained in accordance with the provisions of the Plan.

17. **Additional Terms Applicable to an Incentive Option.** In the event this option is designated an Incentive Option in the Grant Notice, the following terms and conditions shall also apply to the grant:

(a) This option shall cease to qualify for favorable tax treatment as an Incentive Option if (and to the extent) this option is exercised for one or more Option Shares: (i) more than three (3) months after the date Optionee ceases to be an Employee for any reason other than death or Permanent Disability or (ii) more than twelve (12) months after the date Optionee ceases to be an Employee by reason of Permanent Disability.

(b) This option shall not become exercisable in the calendar year in which granted if (and to the extent) the aggregate Fair Market Value (determined at the Grant Date) of the Common Stock for which this option would otherwise first become exercisable in such calendar year would, when added to the aggregate value (determined as of the respective date or dates of grant) of the Common Stock and any other securities for which one or more other Incentive Options granted to Optionee prior to the Grant Date (whether under the Plan or any other option plan of the Corporation or any Parent or Subsidiary) first become exercisable during the same calendar year, exceed One Hundred Thousand Dollars ($100,000) in the aggregate. To the extent the exercisability of this option is deferred by reason of the foregoing limitation, the deferred portion shall become exercisable in the first calendar year or years thereafter in which the One Hundred Thousand Dollar ($100,000) limitation of this Paragraph 18(b) would not be contravened, but such deferral shall in all events end immediately prior to the effective date of a Corporate Transaction in which this option is not to be assumed or an Involuntary Termination following a Corporate Transaction in which this option is assumed, whereupon the option shall become immediately exercisable as a Non-Statutory Option for the deferred portion of the Option Shares.

(c) Should Optionee hold, in addition to this option, one or more other options to purchase Common Stock which become exercisable for the first time in the same calendar year as this option, then the foregoing limitations on the exercisability of such options as Incentive Options shall be applied on the basis of the order in which such options are granted.

ENERGY RECOVERY, INC.

By: _____

Title: _____

Address: 1908 Doolittle Drive
San Leandro, CA 94577

The Optionee represents that the Optionee is familiar with the terms and provisions of this Option Agreement and hereby accepts the Option subject to all of the terms and provisions thereof. The Optionee hereby agrees to accept as binding, conclusive and final all decisions or interpretations of the Board upon any questions arising under this Option Agreement. The undersigned acknowledges receipt of a copy of the Plan.

OPTIONEE

Date: _____

_____

Optionee Address:

_____

_____

APPENDIX

The following definitions shall be in effect under the Agreement:

A. **Agreement** shall mean this Stock Option Agreement.

B. **Board** shall mean the Corporation's Board of Directors.

C. **Code** shall mean the Internal Revenue Code of 1986, as amended.

D. **Common Stock** shall mean the Corporation's common stock.

E. **Corporate Transaction** shall mean either of the following stockholder- approved transactions to which the Corporation is a party:

(i) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction, or

(ii) the sale, transfer or other disposition of all or substantially all of the Corporation's assets in complete liquidation or dissolution of the Corporation.

F. **Corporation** shall mean Energy Recovery, Inc., a Delaware corporation, and any successor corporation to all or substantially all of the assets or voting stock of Energy Recovery, Inc. which shall by appropriate action adopt the Plan.

G. **Disability** shall mean the inability of Optionee to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment and shall be determined by the Plan Administrator on the basis of such medical evidence as the Plan Administrator deems warranted under the circumstances. Disability shall be deemed to constitute **Permanent Disability** in the event that such Disability is expected to result in death or has lasted or can be expected to last for a continuous period of twelve (12) months or more.

H. **Employee** shall mean an individual who is in the employ of the Corporation (or any Parent or Subsidiary), subject to the control and direction of the employer entity as to both the work to be performed and the manner and method of performance.

I. **Exercise Date** shall mean the date on which the option shall have been exercised in accordance with Paragraph 9 of the Agreement.

J. **Exercise Price** shall mean the exercise price payable per Option Share as specified in the Grant Notice.

K. **Expiration Date** shall mean the date on which the option expires as specified in the Grant Notice.

L. **Fair Market Value** per share of Common Stock on any relevant date shall be determined in accordance with the following provisions:

(i) If the Common Stock is at the time traded on the Nasdaq National Market, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question, as the price is reported by the National Association of Securities Dealers on the Nasdaq National Market. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(ii) If the Common Stock is at the time listed on any Stock Exchange, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question on the Stock Exchange determined by the Plan Administrator to be the primary market for the Common Stock, as such price is officially quoted in the composite tape of transactions on such exchange. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(iii) If the Common Stock is at the time neither listed on any Stock Exchange nor traded on the Nasdaq National Market, then the Fair Market Value shall be determined by the Plan Administrator after taking into account such factors as the Plan Administrator shall deem appropriate.

M. **Grant Date** shall mean the date of grant of the option as specified in the Grant Notice.

N. **Grant Notice** shall mean the Notice of Grant of Stock Option accompanying the Agreement, pursuant to which Optionee has been informed of the basic terms of the option evidenced hereby.

O. **Incentive Option** shall mean an option which satisfies the requirements of Code Section 422.

P. **Involuntary Termination** shall mean the termination of Optionee's Service which occurs by reason of:

(i) Optionee's dismissal or discharge by the Corporation for reasons other than Misconduct, or

(ii) Optionee's voluntary resignation following (A) a change in Optionee's position with the Corporation (or Parent or Subsidiary employing Optionee) which materially reduces Optionee's level of responsibility, (B) a reduction in Optionee's level of compensation (including base salary, fringe benefits and target bonuses under any corporate-performance based bonus or incentive programs) by more than fifteen percent (15%) in the aggregate or (C) a relocation of Optionee's place of employment by more than fifty (50) miles from

Optionee's place of employment immediately prior to the Corporate Transaction, provided and only if such change, reduction or relocation is effected by the Corporation without Optionee's consent.

Q. **Misconduct** shall mean the commission of any act of fraud, embezzlement or dishonesty by Optionee, any unauthorized use or disclosure by Optionee of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any other intentional misconduct by Optionee adversely affecting the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of Optionee or any other individual in the Service of the Corporation (or any Parent or Subsidiary).

R. **1934 Act** shall mean the Securities Exchange Act of 1934, as amended.

S. **Non-Statutory Option** shall mean an option not intended to satisfy the requirements of Code Section 422.

T. **Option Shares** shall mean the number of shares of Common Stock subject to the option.

U. **Optionee** shall mean the person to whom the option is granted as specified in the Grant Notice.

V. **Parent** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation, provided each corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

W. **Plan** shall mean the Corporation's 2004 Stock Option/Stock Issuance Plan.

X. **Plan Administrator** shall mean either the Board or a committee of the Board acting in its capacity as administrator of the Plan.

Y. **Purchase Agreement** shall mean the stock purchase agreement in substantially the form of Exhibit B to the Grant Notice.

Z. **Service** shall mean the Optionee's performance of services for the Corporation (or any Parent or Subsidiary) in the capacity of an Employee, a non-employee member of the board of directors or an independent consultant.

AA. **Stock Exchange** shall mean the American Stock Exchange or the New York Stock Exchange.

BB. **Subsidiary** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations beginning with the Corporation, provided each corporation (other

than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

CC. **Vesting Schedule** shall mean the vesting schedule specified in the Grant Notice pursuant to which the Optionee is to vest in the Option Shares in a series of installments over his or her period of Service.

Exhibit 10.5.1

ENERGY RECOVERY, INC.

AMENDMENT TO 2006 STOCK OPTION/STOCK ISSUANCE PLAN

(Amended as of November 8, 2007)
Exhibit A

Article One, Section V(A) of the Energy Recovery, Inc. 2006 Stock Option/Stock Issuance Plan (the "Plan") is hereby amended and restated in its entirety to read:

"The stock issuable under the Plan shall be shares of authorized but unissued or reacquired Common Stock. The maximum number of shares of Common Stock which may be issued over the term of the Plan shall not exceed eight hundred thousand (800,000) shares."

Exhibit 10.5.2

ENERGY RECOVERY, INC.

AMENDMENT TO 2006 STOCK OPTION/STOCK ISSUANCE PLAN

(Amended as of January 8, 2008)
Exhibit A

Article One, Section V(A) of the Energy Recovery, Inc. 2006 Stock Option/Stock Issuance Plan (the "Plan") is hereby amended and restated in its entirety to read:

"The stock issuable under the Plan shall be shares of authorized but unissued or reacquired Common Stock. The maximum number of shares of Common Stock which may be issued over the term of the Plan shall not exceed eight hundred fifty thousand (850,000) shares."

Exhibit 10.7

EXECUTIVE EMPLOYEE AGREEMENT

This EXECUTIVE EMPLOYEE AGREEMENT (the "Agreement") is made and entered into as of March 1, 2006, by and between Energy Recovery Inc., a Delaware corporation, with its principal offices at 1908 Doolittle Drive, San Leandro, CA 94577 (the "Company"), and G. G. Pique, an individual (the "Executive").

RECITALS

A. WHEREAS, the Company is in the business of designing and manufacturing energy recovery devices.

B. WHEREAS, Executive has been serving as President and Chief Executive Officer of the Company, and the Company desires to continue its relationship with Executive as its President and Chief Executive Officer, and Executive desires to provide his services to the Company on all of the terms and conditions herein set forth.

C. WHEREAS, The Company desires to provide Executive with a compensation plan in recognition of Executive's valuable skills and services.

NOW, THEREFORE, in consideration of the mutual covenants and conditions herein contained, the parties hereto agree as follows:

ARTICLE I. EMPLOYMENT

1.1 Employment. The Company hereby employs Executive as its President and Chief Executive Officer, and Executive hereby accepts such engagements with the Company, in accordance with and subject to all of the terms, conditions, and covenants set forth in this Agreement.

1.2 Term. The terms of this Agreement shall commence on the date that this Agreement is fully executed (the "Effective Date") and, unless terminated earlier in accordance with the terms of Article IV hereof, shall continue for a period of two years ending on the second anniversary of the Effective Date (the "Term of Agreement"). The Agreement, thereafter, shall automatically terminate and Executive's employment with the Company will become "at will." "At will" employment means that the either the Company or Executive may terminate Executive's employment with or without cause and with or without notice.

1.3 Scope of Executive's Duties. Executive shall be the President and Chief Executive Officer of the Company, reporting to the Board of Directors of the Company (the "Board"). Executive shall have such duties, responsibilities and authority as shall be consistent

with that position and will operate within such established guidelines, plans, or policies as may be established or approved by the Board from time to time.

ARTICLE II. COMPENSATION AND BENEFITS

2.1 Compensation.

(a) Base Salary. Executive shall be paid a base salary of $20,833.33 per month ($250,000 per annum), less any deductions required by law, which shall be paid in accordance with the Company's normal and customary payroll practices, but no less frequently than monthly. The Executive's base salary shall be reviewed annually and may be reasonably adjusted in the sole discretion of the Company.

(b) Annual Bonus. The Executive shall be eligible to participate in the Company's annual bonus program and shall be eligible to earn an annual bonus in an amount not to exceed one (1) times his base salary. The exact amount of the Executive's annual bonus, if any, shall be determined by the Company pursuant to the attainment of performance goals as set forth in the matrix.

(c) Equity Compensation. Contingent on the Executive's continued employment on the date of grant, Company intends to grant the Executive stock options to purchase two hundred fifty thousand (250,000) shares of the Company's Common Stock, to be arranged under, and subject to the terms of, Company's 2006 Equity Compensation Plan or, at the discretion of the Company, any such subsequent equity compensation plan that may be adopted, as well as the terms and conditions of the stock option agreement (which will be provided to the Executive as soon as practicable after the grant date). The Company shall recommend to the Board of Directors that the 250,000 options be granted between the Effective Date and December 31, 2006. The exercise price for the stock options will be no less than the fair market value of the Company's Common Stock on the date of grant, as determined by the Board of Directors. Any additional terms governing the options (*i.e.*, vesting, conditions to exercise, etc.) shall be set forth in the applicable option agreement. The foregoing is not intended to preclude the Company, in its discretion, from making any additional awards of stock options or other types of equity compensation to the Executive.

2.2 Reimbursable Expenses. Upon submission of expense reports to the extent necessary to substantiate the Company's federal income tax deductions for such expenses under the Internal Revenue Code of 1986 (as amended) and the Regulations thereunder (the "Code") and subject to such expense report approval procedures as may be established by the Board, the Company shall reimburse Executive for all reasonable business expenses incurred and submitted in the performance of his duties hereunder on behalf of the Company.

2.3 Fringe Benefits.

(a) Executive and Executive's dependents shall be permitted to participate in all group health, medical, hospital, dental, prescription, vision, long-term disability and other insurance plans which the Company may establish for its executive employees and such other employee benefits or plans as the Company may establish for its employees generally, and which may be modified from time to time. The Executive shall receive, if insurable under usual

underwriting standards, term life insurance coverage on the Executive's life, payable to whomever the Executive directs, in an amount equal to two (2) times the Executive's base salary, subject to any cap imposed by the insurer, provided that Executive completes the required statement and application and that Executive's physical condition does not prevent Executive from qualifying for such insurance under reasonable terms and conditions. Executive shall be eligible to participate in any tax-qualified retirement plan sponsored by the Company, equity compensation plan, or deferred compensation plan, if any, pursuant to the terms of such plans, as the same may be modified from time to time, to the extent such plans are offered to other officers of employees of the Company.

2.4 Vacations. Executive shall earn annual vacations in accordance with the Company's standard policy for similarly situated employees. Once Executive has accrued the maximum of two (2) times the accrual rate cap applicable to the Executive as set forth in the standard policy, Executive shall be ineligible to earn further vacation until Executive has used vacation, at which time Executive may begin to accrue vacation again.

2.5 Taxes. The Executive acknowledges that he is responsible for all taxes relating to his Compensation and except for those taxes for which the Company is obligated to pay under applicable law or regulation, Executive agrees that the Company may withhold from Executive's cash compensations any amounts that the Company is required to withhold by law or regulation.

ARTICLE III. TERMINATION AND COMPENSATION UPON TERMINATION

3.1 Termination will be deemed to occur as follows:

(a) Termination for Good Cause by the Company. The Company may terminate this Agreement immediately for "Good Cause" upon written notice to Executive, the date of which shall specify the effective date of the termination. For purposes of this Agreement, "Good Cause" shall mean:

(i) Executive's performance of any act for which, if Executive were prosecuted, would constitute a felony or misdemeanor;

(ii) Executive's failure to carry out Executive's material duties;

(iii) Executive's dishonesty towards or fraud upon the Company which is injurious to the Company;

(iv) Executive's violation of confidentiality obligations to the Company or misappropriation of Company assets; or

(v) Executive's death or inability to carry out Executive's duties with reasonable accommodation, if any, unless prohibited by law.

(b) Voluntary Termination by the Executive. The Executive may terminate this Agreement at any time by providing the Company with thirty (30) days written notice. The effective date of the termination shall be the date specified in the notice. In the event of such a termination, the parties agree to act in good faith towards one another during any notice period.

(c) Notice of Termination. Any termination by the Company for Good Cause or by Executive shall be communicated by Notice of Termination to the other party hereto. For purposes of this Agreement, a "Notice of Termination" shall mean a written notice which shall indicate the specific termination provision in this Agreement relied upon, and shall set forth in reasonable detail the facts and circumstances claimed to provide a basis of termination of Executive's employment under the provision so indicated.

3.2 Compensation Upon Termination. Upon termination of this Agreement by either party, Executive shall be entitled to receive the following payments:

(a) Termination By the Company for Good Cause. Upon termination of this Agreement for "Good Cause" as defined under the provisions of Section 3.1(a) above, Executive shall be paid, in a lump sum, any and all base salary due and owing through the date of termination, plus an amount equal to earned but unused vacation through the date of termination and reimbursement of all reasonable expenses, plus any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the Executive's termination occurs. No pay continuance or other benefits will be provided.

(b) Termination By the Company Without Good Cause. Upon termination of this Agreement by the Company without "Good Cause" as defined under the provisions of Section 3.1(a) above, Executive shall be entitled to the following severance benefits:

(i) payment, in a lump sum, of any and all base salary due and owing to him through the date of termination, plus an amount equal to his earned but unused vacation through the date of termination, reimbursement for all reasonable expenses and any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the Executive's termination occurs; and

(ii) subject to the provisions of Section 5.1 below, payment, in a lump sum of an amount equal to seventy percent (70%) of Executive's current annual base salary, less deductions required by law.

(iii) immediate vesting of all unvested equity compensation held by the Executive as of the date of termination.

(iv) if the Executive (including, if applicable, the Executive's spouse and dependents) timely elects to continue Executive's medical, dental, and vision benefits under COBRA than, contingent upon the Executive paying his portion of the monthly COBRA premium, the Company shall pay its share of the monthly premium (if any) under COBRA to the same extent it pays for coverage for an active employee until the earliest of (a) the end of the twelve (12) month period that commences with the Executive's termination of employment or (b) the Executive becomes eligible for group medical, dental, and vision coverage through another employer. As a condition of the Company paying a pro rata portion of the monthly premium for a portion of the Executive's continuation coverage period the Executive will be required to notify the Company upon becoming eligible for group medical, dental and vision benefits from another employer during such twelve (12) month period. At the end of any

Company-paid period of COBRA coverage, the Executive may, at his own expense, continue COBRA coverage for the remainder of the period for which the Executive is eligible.

The payments provided for in Section 3.2(a) or 3.2(b)(i) and (ii) or 3.2(d), as applicable, shall be paid on the date immediately following the Executive's termination. All such payments will be subject to applicable payroll or other taxes required to be withheld by the Company. However, in the event it is determined that the Executive is a "Specified Employee" as defined in Section 409A(a)(2)(B)(i) of the Code any payment to be made under this Agreement that is "nonqualified deferred compensation" subject to Section 409A of the Code shall be delayed for six months following the Executive's termination of employment.

(c) Payments to Executive hereunder shall be considered severance pay in consideration of past service and continued service after the date of this Agreement and Executive shall not be required to mitigate the amount of any payment provided for in this Section 3.2 by seeking alternative employment or otherwise, and, with the exception of COBRA payments, the amount of any payment provided for in this Section 3.2 shall not be reduced by any compensation earned by Executive as the result of employment by another employer after the date of termination, or otherwise.

(d) Voluntary Termination by Executive. If Executive voluntarily resigns or terminates this Agreement, Executive shall be paid, in a lump sum, any and all base salary due and owing to him through the date of termination and an amount equal to his earned but unused vacation through the date of termination, plus any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the Executive's termination occurs. Executive, his family, or his estate shall be entitled to other benefits to the extent permitted by law, contract, or the terms of any benefit plan or program.

(e) Termination Pursuant to a Change of Control. If upon or at any time during the Term of Agreement there is a "Termination Event", as defined below, that occurs within one (1) year following a "Change in Control", as defined below, Executive shall be treated as if Executive had been terminated by the Company Without Good Cause pursuant to Section 3.2(b) and in addition to the severance benefits described therein shall be entitled to receive an additional Change in Control amount equal to thirty percent (30%) of the Executive's current annual base salary. The Change in Control amount shall be paid at the same time and in the same manner as the Executive's severance payments pursuant to Section 3.2(b)(ii).

(i) A Termination Event shall mean the occurrence of any one or more of the following but shall not include the Executive's termination due to death or disability:

A. the termination or material breach of this Agreement by the Company;

B. the failure by the Company to obtain the assumption of this Agreement by any successor to the Company or any assignee of all or substantially all of the Company's assets;

C. any material diminishment in the title, position, duties, responsibility or status that the Executive had with the Company immediately prior to the Change in Control;

D. any reduction, limitation or failure to pay or provide any of the compensation provided to the Executive under Section 2.1 of this Agreement or any other agreement or understanding between the Executive and the Company, or pursuant to the Company's policies and past practices, as of the date immediately prior to the Change in Control; or

E. any requirement that the Executive relocate more than 30 miles from his place of employment as of the date immediately prior to the Change in Control.

(ii) Change in Control shall mean any of the following, occurring during the term of the Executive's employment or employment relationship with the Company:

A. an acquisition by an individual, an entity or a group (excluding the Company, an employee benefit plan of the Company, or a corporation controlled by the Company's shareholders) of fifty percent (50%) or more of the Company's then outstanding common stock or voting securities;

B. a change in composition of the Board occurring within a rolling twelve-month period, as a result of which fewer than a majority of the directors are Incumbent Directors ("Incumbent Directors" shall mean directors who either (x) are members of the Board as of the Executive Date or (y) are elected, or nominated for election, to the Board with the affirmative votes of at least a majority of the Incumbent Directors at the time of such election or nomination, but shall not include an individual not otherwise an Incumbent Director whose election or nomination is in connection with an actual or threatened proxy contest (relating to the election of directors to the Board));

C. consummation of a complete liquidation or dissolution of the Company, or a merger, consolidation or sale of all or substantially all of the Company's then existing assets (collectively, a "Business Combination"), other than a Business Combination (x) in which the stockholders of the Company immediately prior to the Business Combination receive fifty percent (50%) or more of the voting stock resulting from the Business Combination, (y) at least a majority of the board of directors of the corporation resulting from the Business Combination were Incumbent Directors and (z) after which no individual, entity or group (excluding any corporation resulting from the Business Combination or any employee benefit plan of such corporation or if the Company owns fifty percent (50%) or more of the stock of the corporation resulting from the Business Combination who did not own such stock immediately before the Business Combination; or

D. change in the ownership of a substantial portion of a Company's assets. A change in the ownership of a substantial portion of the Company's assets occurs on the date that any individual or group of individuals acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such individual or group of individuals) assets from the Company that have a total gross fair market value equal to

or more than forty percent (40%) of the total gross fair market value of all of the assets of the Company immediately prior to such acquisition or acquisitions. For this purpose, gross fair market value means the value of the assets of the Company, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets.

(iii) To the extent that any or all of the payments and benefits provided for in this Agreement, either alone or in conjunction with other compensatory payments, would give rise to a "parachute payment" under Sections 280G and 4999 of the Code (collectively, the "Parachute Rules"):

A. If the Company so requests at a time when the Company's securities are not "readily tradable" (as defined in the Parachute Rules), the Company shall be permitted to solicit a shareholder vote or written consent to approve the parachute payment in order to avoid characterization as a parachute payment under the Parachute Rules. In that event, the Executive agrees, to the extent required by the Parachute Rules then in effect and without further consent or documentation, to waive and cancel all rights or parachute payments in connection with the Change of Control to the extent that shareholder approval is not obtained in accordance with the Parachute Rules.

B. Unless shareholder approval has avoided application of the Parachute Rules, the Company shall reduce and cancel, and the Executive hereby waives, the parachute payment to the minimum extent necessary to equal one dollar less than the amount which would result in any compensatory payments being subject to the excise tax imposed by Section 4999 of the Code and such that the Executive receives only the amount of such payment which would not constitute an "excess parachute payment" under the Parachute Rules.

C. Notwithstanding clauses A and B above, the Executive may elect not to subject a payment or benefit to stockholder approval and to instead receive either (i) the full amount of any parachute payment or (ii) 2.99 times the Executive's "base amount" (as such term is defined under the Parachute Rules), whichever of the foregoing amounts (after taking into account any applicable federal, state and local income taxes and the excise tax imposed by Section 4999 of the Code) results in the receipt by the Executive, on an after-tax basis, of the greater payment provided that (a) the acquiring person in the Change of Control, in its sole discretion, does not object thereto and does not impose on the Company or its shareholder any added cost, price reduction, or other detriment therefrom (economic or otherwise as determined in the Company's sole discretion), and (b) the Executive deposits at least three (3) business days prior to consummation of the Change of Control with a party designated by the Company a cash sum sufficient in the discretion of the Company to fund all withholding payments that may arise in connection with the Executive's parachute payments from any source.

D. In no event shall the Company be required to gross up any payment or benefit to the Executive to avoid the effects of the Parachute Rules or to pay any regular or excise taxes arising therefrom. Unless the Company and the Executive otherwise agree in writing, any parachute payment calculation shall be made in writing by independent pubic accounts agreed to by the Company and the Executive, whose calculations shall be conclusive and binding upon the Company and the Executive for all purposes. The Company

and the Executive shall furnish to the accountants such information and documents as the accountants may reasonably request in order to make a parachute payment determination.

ARTICLE IV. NONCOMPETITION AND NONSOLICITATION

4.1 Noncompetition During Employment. Executive agrees that, during the term hereof, Executive will devote his full productive time and best efforts to the performance of his duties hereunder pursuant to the supervision and direction of the Company's Board of Directors or its designee. Executive further agrees, as a condition to the performance by the Company of each and all of its obligations hereunder, that so long as Executive is employed by the Company, Executive will not directly or indirectly render services of any nature to otherwise become employed by or otherwise participate or engage in any other business without the Company's prior written consent. Nothing herein contained shall be deemed to preclude Executive from having outside personal investments and involvement with appropriate community and charitable activities, or from devoting a reasonable amount of time to such matters, provided that this shall in no manner interfere with or derogate from Executive's work for the Company.

4.2 Non-solicitation.

(a) Executive agrees that during Executive's employment and for a period of two (2) years after the termination of this Agreement for any reason, in the United States or any other equivalent geographical subdivision in foreign jurisdictions in which the Company does business, Executive shall not, in competition with the Company or any subsidiary or affiliates:

(i) directly call upon or solicit any of the customers of the Company or any subsidiary that were or became customers during the term of Executive's employment (as used herein "customer" shall mean any person or company as listed as such on the books of the Company or any affiliates); or

(ii) induce or attempt to induce any employee, agent, or consultant of the Company or any subsidiary or affiliates to terminate his or her association with the Company or any subsidiary or affiliates.

(b) The Company and Executive agree that the provisions of this Section 4.2 contain restrictions that are not greater than necessary to protect the interests of the Company. In the event of the breach or threatened breach by Executive of this Section 42, the Company, in addition to all other remedies available to it at law or in equity, will be entitled to seek injunctive relief and/or specific performance to enforce this Section 4.2.

ARTICLE V. MISCELLANEOUS PROVISIONS

5.1 General Release. Any other provision of this Agreement notwithstanding, Section 3.2(b)(ii)-(iv) above shall not apply unless Executive has executed a general release of all known and unknown claims that Executive may then have against the Company or persons affiliated with the Company and has expressly agreed in writing not to prosecute any legal action or other proceeding based on any of such claims.

5.2 Confidential Proprietary Information and Inventions Assignment Agreement. Concurrent with execution of this Agreement, Executive acknowledges receipt of an executed copy of the Company's standard Confidential Information and Inventions Assignment Agreement, signed by Executive on March 24, 2005, which shall be incorporated herein.

5.3 Fees and Expenses. The Company shall pay all legal fees and related expenses for counsel incurred by Executive as a result of preparation of and negotiation of the terms of Executive's employment.

5.4 Irrevocable Arbitration of Disputes.

(a) You and the Company agree that any dispute, controversy or claim arising hereunder or in any way related to your employment or termination of employment with the Company or this Agreement, its interpretation, enforceability, or applicability, that cannot be resolved by mutual agreement of the parties (the "arbitrable claims") shall be submitted to binding arbitration. The parties agree that arbitration is the parties' only recourse for such claims and hereby waive the right to pursue such claims in any other forum, unless otherwise provided by law, Any court action involving a dispute which is not subject to arbitration shall be stayed pending arbitration of arbitrable disputes.

(b) You and the Company agree that the arbitrator shall have the authority to issue provisional relief. You and the Company further agree that each has the right, pursuant to California Code of Civil Procedure section 1281.8, to apply to a court for a provisional remedy in connection with an arbitrable dispute so as to prevent the arbitration from being rendered ineffective.

(c) Any demand for arbitration shall be in writing and must be communicated to the other party prior to the expiration of the applicable statute of limitations.

(d) The arbitration shall be administered by JAMS pursuant to its Employment Arbitration Rules and Procedures. The arbitration shall be conducted in San Diego by a former or retired judge or attorney with at least 10 years experience in employment-related disputes, or a non-attorney with like experience in the area of dispute, who shall have the power to hear motions, control discovery, conduct hearings and otherwise do all that is necessary to resolve the matter. The parties must mutually agree on the arbitrator. If the parties cannot agree on the arbitrator after their best efforts, an arbitrator will be selected from JAMS pursuant to its Employment Arbitration Rules and Procedures. The Company shall pay the costs of the arbitrator's fees.

(e) The arbitration will be decided upon a written decision of the arbitrator stating the essential findings and conclusions upon which the award is based. The arbitrator shall have the authority to award damages, if any, to the extent that they are available under applicable law(s). The arbitration award shall be final and binding, and may be entered as a judgment in any court having competent jurisdiction. Either party may seek review pursuant to California Code of Civil Procedure section 1286, et seq.

(f) It is expressly understood that the parties have chosen arbitration to avoid the burdens, costs and publicity of a court proceeding, and the arbitrator is expected to handle all aspects of the matter, including discovery and any hearings, in such a way as to minimize the expense, time, burden and publicity of the process, while assuring a fair and just result. In particular, the parties expect that the arbitrator will limit discovery by controlling the amount of discovery that may be taken (e.g., the number of depositions or interrogatories) and by restricting the scope of discovery only to those matters clearly relevant to the dispute. However, at a minimum, each party will be entitled to at least one (1) deposition and shall have access to essential documents and witnesses as determined by the arbitrator.

(g) The provisions of this Section shall survive the expiration or termination of the Agreement, and shall be binding upon the parties.

THE PARTIES HAVE READ SECTION 5.4 AND IRREVOCABLY AGREE TO ARBITRATE ANY DISPUTE IDENTIFIED ABOVE.

GGP *(Executive)* HPM *(Company)]*

5.5 Settlement of Claims. The Company's obligation to make the payments provided for in this Agreement and otherwise to perform its obligations hereunder shall not be affected by any circumstances, including, without limitation, any set-off, counterclaim, recoupment, defense or other right which the Company may have against the Executive or others.

5.6 Legal Representatives. Upon the death or disability of Executive, any payments due under this Agreement shall be paid to Executive's legal representatives.

5.7 Notices. Any notice or other communication given hereunder or in connection herewith shall be sufficiently given if in writing and (a) sent by certified mail or overnight courier, postage or delivery costs prepaid and return receipt requested, (b) sent by facsimile transmission, or (c) delivered personally, to the parties hereto at the following addresses or to such addresses as the parties may from time to time provide in accordance herewith:

If to the Company:

Energy Recovery Inc.
1908 Doolittle Drive
San Leandro, CA 94577
Fax: (510) 483-7371
Attention: MariaElena Ross

If to Executive:

G. G. Pique

/s/ G. G. Pique
Fax: 5104652027

Such notice shall be deemed given on the date on which personally served or, if by mail, on the fifth (5th) day after being posted or on the date of actual receipt, whichever is earlier, or if by

facsimile transaction with confirmation of receipt, one (1) business day after the time sent or the time of actual receipt, whichever is earlier.

5.8 Compliance with Section 409A of the Code. It is the intent of this Agreement that no payment to the Executive shall result in nonqualified deferred compensation within the meaning of Section 409A of the Code. However, in the event that all, or a portion, of the payments set forth in this Agreement meet the definition of nonqualified deferred compensation, the Company intends that such payments be made in a manner that complies with Section 409A of the Code. The Company reserves the right, to the extent the Company deems necessary or advisable in its sole discretion, to unilaterally amend or modify this Agreement as may be necessary to ensure all benefits provided under this Agreement are made in a manner that qualifies for exemption from or complies with Section 409A of the Code, provided, however, that the Company makes no representations that the benefits provided under this Agreement will be exempt from Section 409A of the Code and makes no undertakings to preclude Section 409A of the Code from applying to the benefits provided under this Agreement.

5.9 Severability. If any term, provision, covenant, or condition of this Agreement is held to be invalid, void, or unenforceable, the remainder of the provisions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated thereby.

5.10 Survival. Sections 4.2, 5.2, and 5.4 shall survive the termination of this Agreement.

5.11 Entire Agreement; Employment Amendments; Waiver. This Agreement, together with all stock option agreements and/or stock repurchase agreements and any other equity grants, and the Confidential Proprietary Information and Inventions Assignment Agreement is the entire agreement between the parties hereto concerning the subject matter hereof and supersedes and replaces all prior or contemporaneous agreements or understandings between the parties. This Agreement may not be amended or modified in any manner, except by an instrument in writing signed by the Executive and the Company or as otherwise provided in Section 5.8. Failure of either party to enforce any of the provisions of this Agreement or any rights with respect thereto or failure to exercise any election provided for herein shall in no way be considered to be a waiver of such provisions, rights, or elections or in any way effect the validity of this Agreement. The failure of either party to exercise any of said provisions, rights, or elections shall not preclude or prejudice such party from later enforcing or exercising the same or other provisions, rights, or elections which it may have under this Agreement.

5.12 Governing Law. This Agreement shall be governed by and construed in all respects in accordance with the laws of the State of California. With the exception of "arbitrable claims" as defined in Section 5.4, the federal courts and/or state courts of the State of California, County of Alameda shall have exclusive jurisdiction to adjudicate any dispute arising out of this Agreement and/or employment relationship or termination thereof and Executive consents to such jurisdiction and venue.

5.13 Attorneys' Fees. In the event of any action for the breach of this Agreement, the prevailing party shall be entitled to reasonable attorneys' fees, costs, and expenses incurred in connection with such action.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the day and year first above written.

"Executive"

By: /s/ G.G. Pique
Title: President

"Company"

By: /s/ Hans Peter Michelet
Title: Chairman of the Board

Exhibit 10.7.1

AMENDMENT TO EXECUTIVE EMPLOYEE AGREEMENT DATED MARCH 1, 2006

This AMENDMENT TO THE EXECUTIVE EMPLOYMENT AGREEMENT (dated March 1, 2006) ("Amendment") is made as of **January 1, 2008** ("Amendment Effective Date") by and between Energy Recovery Inc., a Delaware corporation, with its principal offices at 1908 Doolittle Drive, San Leandro, CA 94577 (the "Company") and G. G. Pique, an individual (the "Executive") (together, the "Parties").

Pursuant to Article 5.11 of the Executive Employment Agreement, the parties hereby amend that Agreement as follows:

Article 1.2. The Parties amend and replace Article 1.2 to read as follows:

Term. The term of Executive's employment is hereby extended for two (2) years ending on the second anniversary of the Amendment Effective Date. Thereafter, the Executive Employment Agreement, as amended, shall automatically terminate and Executive's employment with the Company will become "at will." "At will" employment means that either the Company or Executive may terminate Executive's employment at any time with or without cause and with or without notice. Such at-will employment cannot be changed except by a writing signed by the Executive and a duly authorized executive or Board member of the Company.

Article 2.1(a). The Parties amend and replace Article 2.1(a) to read as follows:

Base Salary. Effective as of **January 1, 2008,** Executive's base salary will be **$29,166.67** per month (**$350,000** per annum), less any deductions required by law, which shall continue to be paid in accordance with the Company's normal and customary payroll practices, but no less frequently than monthly. The Executive's base salary shall be reviewed annually and may be reasonably adjusted in the sole discretion of the Company.

Article 2.1(b). The Parties amend and replace Article 2.1(b) to read as follows:

Annual Bonus.

(i) The Executive shall be eligible to participate in the Company's annual bonus program and shall be eligible to earn an annual bonus in an amount not to exceed one (1) times his base salary. If the Executive is eligible to earn an annual cash bonus, the exact amount of the Executive's annual cash bonus, if any, shall be determined by the Company pursuant to the attainment of performance goals as set forth in a performance matrix prepared by the Company.

(ii) At the end of the second year from the Amendment Effective Date, all of the Executive's stock options granted under his 2006 Equity Compensation

Grant pursuant to Article 2.1(c) of his Executive Employment Agreement shall immediately and fully vest.

Article 3.1(a)(iv). The Parties amend and replace Article 3.1(a)(iv) to read as follows:

~~Executive's violation of the Company's policies and Code of Conduct, if any~~,and as amended from time to time, confidentiality obligations to the Company or misappropriation of Company assets; or (TOO VAGUE TO CONSTITUTE CAUSE)

Article 3.2(e)(i)(D). The Parties amend and replace Article 3.2(e)(i)(D) to read as follows:

any material reduction, limitation or failure to pay or provide any of the compensation provided to the Executive under Article 2.1 of this Agreement or any other agreement or understanding between the Executive and the Company, or pursuant to the Company's policies and past practices, as of the date immediately prior to the Change in Control; or OK

Article 3.2(e)(ii). The Parties add Article 3.2(e)(ii)(E) as follows:

"Change in Control," as defined above, shall not in any instance be construed to include the Company's IPO or any event occurring in connection with or as a result of the Company's IPO. OK

All other terms contained in the Executive Employment Agreement shall continue in full force and effect.

WITNESS, the execution of this Amendment as of the date first above written.

"Employee"

By: /s/ G.G. Pique
G.G. Pique

7 January 08

"Company"

Energy Recovery Inc.

By: /s/ Hans Peter Michelet
Title: **[Company Representative]**

Exhibit 10.8

EXECUTIVE EMPLOYEE AGREEMENT

This EXECUTIVE EMPLOYEE AGREEMENT (the "Agreement") is made and entered into as of November 1, 2007, by and between Energy Recovery Inc., a Delaware corporation, with its principal offices at 1908 Doolittle Drive, San Leandro, CA 94577 (the "Company"), and Thomas Willardson, an individual (the "Executive").

RECITALS

A. WHEREAS, the Company is in the business of designing and manufacturing energy recovery devices.

B. WHEREAS, Executive will serve as Chief Financial Officer ("CFO") of the Company, and the Company desires to engage Executive as its CFO, and Executive desires to provide his services to the Company on all of the terms and conditions herein set forth.

C. WHEREAS, The Company desires to provide Executive with a compensation plan in recognition of Executive's valuable skills and services in his role as CFO.

NOW, THEREFORE, in consideration of the mutual covenants and conditions herein contained, the parties hereto agree as follows:

ARTICLE I. EMPLOYMENT

1.1 Employment. The Company hereby employs Executive as its CFO, and Executive hereby accepts such engagements with the Company, in accordance with and subject to all of the terms, conditions, and covenants set forth in this Agreement.

1.2 Term. The terms of this Agreement shall commence on the date that this Agreement is fully executed (the "Effective Date") and, unless terminated earlier in accordance with the terms of Article IV hereof, shall continue for a period of eight months ending eight calendar months from the Effective Date (the "Term of Agreement). The Agreement, thereafter, shall automatically terminate and Executive's employment with the Company will become "at will." "At will" employment means that the either the Company or Executive may terminate Executive's employment with or without cause and with or without notice.

1.3 Scope of Executive's Duties. Executive shall be the CFO of the Company, reporting to the President and CEO of the Company (CEO). Executive shall have such duties, responsibilities and authority as shall be consistent with that position and will operate within such established guidelines, plans, or policies as may be established or approved by the CEO and the company Board of Directors from time to time.

ARTICLE II. COMPENSATION AND BENEFITS

2.1 Compensation.

(a) Base Salary. Executive shall be paid a base salary of $20,833.34 per month ($250,000 per annum), less any deductions required by law, which shall be paid in accordance with the Company's normal and customary payroll practices, but no less frequently than monthly. The Executive's base salary shall be reviewed annually and may be reasonably adjusted in the sole discretion of the Company..

(b) Annual Bonus Program. The Executive shall be eligible to participate in the Company's annual bonus program and shall be eligible to earn an annual bonus in an amount not to exceed (1) times his base salary. The exact amount of the Executive's annual bonus, if any, shall be determined by the Company pursuant to the attainment of performance goals as set forth in the matrix.

(c) Company Bonus Program. Contingent on the Executive's successful completion of initial objectives, Executive will be eligible to receive 30% of base salary. Initial objectives include:

(1) Effective restructuring of ERI Financial Group

(2) Successful IPO or change in control

(d) Executive Financial Incentive Compensation. Upon completion of objectives initial objectives described in (c) above, Executive will be eligible for ERI's Financial Incentive Compensation Plan. The Plan includes a base salary as well as a financial goal bonus tied to EBITDA per the Matrix attached hereto.

2.2 Reimbursable Expenses. Upon submission of expense reports to the extent necessary to substantiate the Company's federal income tax deductions for such expenses under the Internal Revenue Code of 1986 (as amended) and the Regulations there under (the "Code") and subject to such expense report approval procedures as may be established by the Board, the Company shall reimburse Executive for all reasonable business expenses incurred and submitted in the performance of his duties hereunder on behalf of the Company.

2.3 Fringe Benefits.

(a) Executive and Executive's dependents shall be permitted to participate in all group health, medical, hospital, dental, prescription, vision, long-term disability and other insurance plans which the Company may establish for its executive employees and such other employee benefits or plans as the Company may establish for its employees generally, and which may be modified from time to time. The Executive shall receive, if insurable under usual underwriting standards, term life insurance coverage on the Executive's life, payable to whomever the Executive directs, in an amount equal to one (1) time the Executive's base salary, subject to any cap imposed by the insurer, provided that Executive completes the required statement and application and that Executive's physical condition does not prevent Executive from qualifying for such insurance under reasonable terms and conditions. Executive shall be

eligible to participate in any tax-qualified retirement plan sponsored by the Company, equity compensation plan, or deferred compensation plan, if any, pursuant to the terms of such plans, as the same may be modified from time to time, to the extent such plans are offered to other officers of employees of the Company.

2.4 Vacations. Executive shall earn annual vacations in accordance with the Company's standard policy for similarly situated employees. Once Executive has accrued the maximum of two (2) times the accrual rate cap applicable to the Executive as set forth in the standard policy, Executive shall be ineligible to earn further vacation until Executive has used vacation, at which time Executive may begin to accrue vacation again.

2.5 Taxes. The Executive acknowledges that he is responsible for all taxes relating to his Compensation and except for those taxes for which the Company is obligated to pay under applicable law or regulation, Executive agrees that the Company may withhold from Executive's cash compensations any amounts that the Company is required to withhold by law or regulation.

ARTICLE III. TERMINATION AND COMPENSATION UPON TERMINATION

3.1 Termination will be deemed to occur as follows:

(a) Termination for Good Cause by the Company. The Company may terminate this Agreement immediately for "Good Cause" upon written notice to Executive, the date of which shall specify the effective date of the termination. For purposes of this Agreement, "Good Cause" shall mean:

(i) Executive's performance of any act for which, if Executive were prosecuted, would constitute a felony or misdemeanor;

(ii) Executive's failure to carry out Executive's material duties;

(iii) Executive's dishonesty towards or fraud upon the Company which is injurious to the Company;

(iv) Executive's violation of confidentiality obligations to the Company or misappropriation of Company assets; or

(v) Executive's death or inability to carry out Executive's duties with reasonable accommodation, if any, unless prohibited by law.

(b) Voluntary Termination by the Executive. The Executive may terminate this Agreement at any time by providing the Company with thirty (30) days written notice. The effective date of the termination shall be the date specified in the notice. In the event of such a termination, the parties agree to act in good faith towards one another during any notice period.

(c) Notice of Termination. Any termination by the Company for Good Cause or by Executive shall be communicated by Notice of Termination to the other party hereto. For purposes of this Agreement, a "Notice of Termination" shall mean a written notice which shall indicate the specific termination provision in this Agreement relied upon, and shall set forth in

reasonable detail the facts and circumstances claimed to provide a basis of termination of Executive's employment under the provision so indicated.

3.2 Compensation Upon Termination. Upon termination of this Agreement by either party, Executive shall be entitled to receive the following payments:

(a) Termination By the Company for Good Cause. Upon termination of this Agreement for "Good Cause" as defined under the provisions of Section 3.1(a) above, Executive shall be paid, in a lump sum, any and all base salary due and owing through the date of termination, plus an amount equal to earned but unused vacation through the date of termination and reimbursement of all reasonable expenses, plus any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the Executive's termination occurs. No pay continuance or other benefits will be provided.

(b) Termination By the Company Without Good Cause. Upon termination of this Agreement by the Company without "Good Cause" as defined under the provisions of Section 3.1(a) above, Executive shall be entitled to the following severance benefits:

(i) payment, in a lump sum, of any and all base salary due and owing to him through the date of termination, plus an amount equal to his earned but unused vacation through the date of termination, reimbursement for all reasonable expenses and any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the Executive's termination occurs; and

(ii) subject to the provisions of Section 5.1 below, payment, in a lump sum of an amount equal to fifty percent (50%) of Executive's current annual base salary, less deductions required by law.

(iii) immediate vesting of all unvested equity compensation held by the Executive as of the date of termination.

(iv) if the Executive (including, if applicable, the Executive's spouse and dependents) timely elects to continue Executive's medical, dental, and vision benefits under COBRA than, contingent upon the Executive paying his portion of the monthly COBRA premium, the Company shall pay its share of the monthly premium (if any) under COBRA to the same extent it pays for coverage for an active employee until the earliest of (a) the end of the twelve (12) month period that commences with the Executive's termination of employment or (b) the Executive becomes eligible for group medical, dental, and vision coverage through another employer. As a condition of the Company paying a pro rata portion of the monthly premium for a portion of the Executive's continuation coverage period the Executive will be required to notify the Company upon becoming eligible for group medical, dental and vision benefits from another employer during such twelve (12) month period. At the end of any Company-paid period of COBRA coverage, the Executive may, at his own expense, continue COBRA coverage for the remainder of the period for which the Executive is eligible.

The payments provided for in Section 3.2(a) or 3.2(b)(1) and (ii) or 3.2(d), as applicable, shall be paid on the date immediately following the Executive's termination. All such payments will be subject to applicable payroll or other taxes required to be withheld by the Company.

However, in the event it is determined that the Executive is a "Specified Employee" as defined in Section 409A(a)(2)(B)(i) of the Code any payment to be made under this Agreement that is "nonqualified deferred compensation" subject to Section 409A of the Code shall be delayed for six months following the Executive's termination of employment.

(c) Payments to Executive hereunder shall be considered severance pay in consideration of past service and continued service after the date of this Agreement and Executive shall not be required to mitigate the amount of any payment provided for in this Section 3.2 by seeking alternative employment or otherwise, and, with the exception of COBRA payments, the amount of any payment provided for in this Section 3.2 shall not be reduced by any compensation earned by Executive as the result of employment by another employer after the date of termination, or otherwise.

(d) Voluntary Termination by Executive. If Executive voluntarily resigns or terminates this Agreement, Executive shall be paid, in a lump sum, any and all base salary due and owing to him through the date of termination and an amount equal to his earned but unused vacation through the date of termination, plus any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the Executive's termination occurs. Executive, his family, or his estate shall be entitled to other benefits to the extent permitted by law, contract, or the terms of any benefit plan or program.

(e) Termination Pursuant to a Change of Control. If upon or at any time during the Term of Agreement there is a "Termination Event", as defined below, that occurs within one (1) year following a "Change in Control", as defined below, Executive shall be treated as if Executive had been terminated by the Company Without Good Cause pursuant to Section 3.2(b) and in addition to the severance benefits described therein shall be entitled to receive an additional Change in Control amount equal to fifty percent (50%) of the Executive's current annual base salary. The Change in Control amount shall be paid at the same time and in the same manner as the Executive's severance payments pursuant to Section 3.2(b)(ii).

(i) A Termination Event shall mean the occurrence of any one or more of the following, but shall not include the Executive's termination due to death or disability:

A. the termination or material breach of this Agreement by the Company;

B. the failure by the Company to obtain the assumption of this Agreement by any successor to the Company or any assignee of all or substantially all of the Company's assets;

C. any material diminishment in the title, position, duties, responsibility or status that the Executive had with the Company immediately prior to the Change in Control;

D. any reduction, limitation or failure to pay or provide any of the compensation provided to the Executive under Section 2.1 of this Agreement or any other agreement or understanding between the Executive and the Company, or pursuant to the

Company's policies and past practices, as of the date immediately prior to the Change in Control; or

E. any requirement that the Executive relocate more than 30 miles from his place of employment as of the date immediately prior to the Change in Control.

(ii) Change in Control shall mean any of the following, occurring during the term of the Executive's employment or employment relationship with the Company:

A. an acquisition by an individual, an entity or a group (excluding the Company, an employee benefit plan of the Company, or a corporation controlled by the Company's shareholders) of fifty percent (50%) or more of the Company's then outstanding common stock or voting securities;

B. a change in composition of the Board occurring within a rolling twelve-month period, as a result of which fewer than a majority of the directors are Incumbent Directors ("Incumbent Directors" shall mean directors who either (x) are members of the Board as of the Executive Date or (y) are elected, or nominated for election, to the Board with the affirmative votes of at least a majority of the Incumbent Directors at the time of such election or nomination, but shall not include an individual not otherwise an Incumbent Director whose election or nomination is in connection with an actual or threatened proxy contest (relating to the election of directors to the Board));

C. consummation of a complete liquidation or dissolution of the Company, or a merger, consolidation or sale of all or substantially all of the Company's then existing assets (collectively, a "Business Combination"), other than a Business Combination (x) in which the stockholders of the Company immediately prior to the Business Combination receive fifty percent (50%) or more of the voting stock resulting from the Business Combination, (y) at least a majority of the board of directors of the corporation resulting from the Business Combination were Incumbent Directors and (z) after which no individual, entity or group (excluding any corporation resulting from the Business Combination or any employee benefit plan of such corporation or if the Company owns fifty percent (50%) or more of the stock of the corporation resulting from the Business Combination who did not own such stock immediately before the Business Combination; or

D. change in the ownership of a substantial portion of a Company's assets. A change in the ownership of a substantial portion of the Company's assets occurs on the date that any individual or group of individuals acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such individual or group of individuals) assets from the Company that have a total gross fair market value equal to or more than forty percent (40%) of the total gross fair market value of all of the assets of the Company immediately prior to such acquisition or acquisitions. For this purpose, gross fair market value means the value of the assets of the Company, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets.

(iii) To the extent that any or all of the payments and benefits provided for in this Agreement, either alone or in conjunction with other compensatory payments, would

give rise to a "parachute payment" under Sections 280G and 4999 of the Code (collectively, the "Parachute Rules"):

A. If the Company so requests at a time when the Company's securities are not "readily tradable" (as defined in the Parachute Rules), the Company shall be permitted to solicit a shareholder vote or written consent to approve the parachute payment in order to avoid characterization as a parachute payment under the Parachute Rules. In that event, the Executive agrees, to the extent required by the Parachute Rules then in effect and without further consent or documentation, to waive and cancel all rights or parachute payments in connection with the Change of Control to the extent that shareholder approval is not obtained in accordance with the Parachute Rules.

B. Unless shareholder approval has avoided application of the Parachute Rules, the Company shall reduce and cancel, and the Executive hereby waives, the parachute payment to the minimum extent necessary to equal one dollar less than the amount which would result in any compensatory payments being subject to the excise tax imposed by Section 4999 of the Code and such that the Executive receives only the amount of such payment which would not constitute an "excess parachute payment" under the Parachute Rules.

C. Notwithstanding clauses A and B above, the Executive may elect not to subject a payment or benefit to stockholder approval and to instead receive either (i) the full amount of any parachute payment or (ii) 2.99 times the Executive's "base amount" (as such term is defined under the Parachute Rules), whichever of the foregoing amounts (after taking into account any applicable federal, state and local income taxes and the excise tax imposed by Section 4999 of the Code) results in the receipt by the Executive, on an after-tax basis, of the greater payment provided that (a) the acquiring person in the Change of Control, in its sole discretion, does not object thereto and does not impose on the Company or its shareholder any added cost, price reduction, or other detriment therefrom (economic or otherwise as determined in the Company's sole discretion), and (b) the Executive deposits at least three (3) business days prior to consummation of the Change of Control with a party designated by the Company a cash sum sufficient in the discretion of the Company to fund all withholding payments that may arise in connection with the Executive's parachute payments from any source.

D. In no event shall the Company be required to gross up any payment or benefit to the Executive to avoid the effects of the Parachute Rules or to pay any regular or excise taxes arising therefrom. Unless the Company and the Executive otherwise agree in writing, any parachute payment calculation shall be made in writing by independent pubic accounts agreed to by the Company and the Executive, whose calculations shall be conclusive and binding upon the Company and the Executive for all purposes. The Company and the Executive shall furnish to the accountants such information and documents as the accountants may reasonably request in order to make a parachute payment determination.

ARTICLE IV. NONCOMPETITION AND NONSOLICITATION

4.1 Noncompetition During Employment. Executive agrees that, during the term hereof, Executive will devote his full productive time and best efforts to the performance of his

duties hereunder pursuant to the supervision and direction of the Company's Board of Directors or its designee. Executive further agrees, as a condition to the performance by the Company of each and all of its obligations hereunder, that so long as Executive is employed by the Company, Executive will not directly or indirectly render services of any nature to otherwise become employed by or otherwise participate or engage in any other business without the Company's prior written consent. Nothing herein contained shall be deemed to preclude Executive from having outside personal investments and involvement with appropriate community and charitable activities, or from devoting a reasonable amount of time to such matters, provided that this shall in no manner interfere with or derogate from Executive's work for the Company.

4.2 Non-solicitation.

(a) Executive agrees that during Executive's employment and for a period of two (2) years after the termination of this Agreement for any reason, in the United States or any other equivalent geographical subdivision in foreign jurisdictions in which the Company does business, Executive shall not, in competition with the Company or any subsidiary or affiliates:

(i) directly call upon or solicit any of the customers of the Company or any subsidiary that were or became customers during the term of Executive's employment (as used herein "customer" shall mean any person or company as listed as such on the books of the Company or any affiliates); or

(ii) induce or attempt to induce any employee, agent, or consultant of the Company or any subsidiary or affiliates to terminate his or her association with the Company or any subsidiary or affiliates.

(b) The Company and Executive agree that the provisions of this Section 4.2 contain restrictions that are not greater than necessary to protect the interests of the Company. In the event of the breach or threatened breach by Executive of this Section 4.2, the Company, in addition to all other remedies available to it at law or in equity, will be entitled to seek injunctive relief and/or specific performance to enforce this Section 4.2.

ARTICLE V. MISCELLANEOUS PROVISIONS

5.1 General Release. Any other provision of this Agreement notwithstanding, Section 3.2(b)(ii)-(iv) above shall not apply unless Executive has executed a general release of all known and unknown claims that Executive may then have against the Company or persons affiliated with the Company and has expressly agreed in writing not to prosecute any legal action or other proceeding based on any of such claims.

5.2 Confidential Proprietary Information and Inventions Assignment Agreement. Concurrent with execution of this Agreement, Executive acknowledges receipt of an executed copy of the Company's standard Confidential Information and Inventions Assignment Agreement, signed by Executive on November 1, 2007, which shall be incorporated herein.

5.3 Fees and Expenses. The Company shall pay all legal fees and related expenses for counsel incurred by Executive as a result of preparation of and negotiation of the terms of Executive's employment.

5.4 Irrevocable Arbitration of Disputes.

(a) You and the Company agree that any dispute, controversy or claim arising hereunder or in any way related to your employment or termination of employment with the Company or this Agreement, its interpretation, enforceability, or applicability, that cannot be resolved by mutual agreement of the parties (the "arbitrable claims") shall be submitted to binding arbitration. The parties agree that arbitration is the parties' only recourse for such claims and hereby waive the right to pursue such claims in any other forum, unless otherwise provided by law. Any court action involving a dispute which is not subject to arbitration shall be stayed pending arbitration of arbitrable disputes.

(b) You and the Company agree that the arbitrator shall have the authority to issue provisional relief. You and the Company further agree that each has the right, pursuant to California Code of Civil Procedure section 1281.8, to apply to a court for a provisional remedy in connection with an arbitrable dispute so as to prevent the arbitration from being rendered ineffective.

(c) Any demand for arbitration shall be in writing and must be communicated to the other party prior to the expiration of the applicable statute of limitations.

(d) The arbitration shall be administered by JAMS pursuant to its Employment Arbitration Rules and Procedures. The arbitration shall be conducted in San Diego by a former or retired judge or attorney with at least 10 years experience in employment-related disputes, or a non-attorney with like experience in the area of dispute, who shall have the power to hear motions, control discovery, conduct hearings and otherwise do all that is necessary to resolve the matter. The parties must mutually agree on the arbitrator. If the parties cannot agree on the arbitrator after their best efforts, an arbitrator will be selected from JAMS pursuant to its Employment Arbitration Rules and Procedures. The Company shall pay the costs of the arbitrator's fees.

(e) The arbitration will be decided upon a written decision of the arbitrator stating the essential findings and conclusions upon which the award is based. The arbitrator shall have the authority to award damages, if any, to the extent that they are available under applicable law(s). The arbitration award shall be final and binding, and may be entered as a judgment in any court having competent jurisdiction. Either party may seek review pursuant to California Code of Civil Procedure section 1286, et seq.

(f) It is expressly understood that the parties have chosen arbitration to avoid the burdens, costs and publicity of a court proceeding, and the arbitrator is expected to handle all aspects of the matter, including discovery and any hearings, in such a way as to minimize the expense, time, burden and publicity of the process, while assuring a fair and just result. In particular, the parties expect that the arbitrator will limit discovery by controlling the amount of discovery that may be taken (e.g., the number of depositions or interrogatories) and by restricting the scope of discovery only to those matters clearly relevant to the dispute. However, at a

minimum, each party will be entitled to at least one (1) deposition and shall have access to essential documents and witnesses as determined by the arbitrator.

(g) The provisions of this Section shall survive the expiration or termination of the Agreement, and shall be binding upon the parties.

THE PARTIES HAVE READ SECTION 5.4 AND IRREVOCABLY AGREE TO ARBITRATE ANY DISPUTE IDENTIFIED ABOVE.

/s/ TW *(Executive)* *(Company)]*

5.5 Settlement of Claims. The Company's obligation to make the payments provided for in this Agreement and otherwise to perform its obligations hereunder shall not be affected by any circumstances, including, without limitation, any set-off, counterclaim, recoupment, defense or other right which the Company may have against the Executive or others.

5.6 Legal Representatives. Upon the death or disability of Executive, any payments due under this Agreement shall be paid to Executive's legal representatives.

5.7 Notices. Any notice or other communication given hereunder or in connection herewith shall be sufficiently given if in writing and (a) sent by certified mail or overnight courier, postage or delivery costs prepaid and return receipt requested, (b) sent by facsimile transmission, or (c) delivered personally, to the parties hereto at the following addresses or to such addresses as the parties may from time to time provide in accordance herewith:

If to the Company: Energy Recovery Inc.
1908 Doolittle Drive
San Leandro, CA 94577
Fax: (510) 483-7371
Attention: MariaElena Ross

If to Executive: Thomas Willardson
21 BRIGHTWOOD CIRCLE
DANVILLE, CA 94506
Fax: _____

Such notice shall be deemed given on the date on which personally served or, if by mail, on the fifth (5th) day after being posted or on the date of actual receipt, whichever is earlier, or if by facsimile transaction with confirmation of receipt, one (1) business day after the time sent or the time of actual receipt, whichever is earlier.

5.8 Compliance with Section 409A of the Code. It is the intent of this Agreement that no payment to the Executive shall result in nonqualified deferred compensation within the meaning of Section 409A of the Code. However, in the event that all, or a portion, of the payments set forth in this Agreement meet the definition of nonqualified deferred compensation, the Company intends that such payments be made in a manner that complies with Section 409A

of the Code. The Company reserves the right, to the extent the Company deems necessary or advisable in its sole discretion, to unilaterally amend or modify this Agreement as may be necessary to ensure all benefits provided under this Agreement are made in a manner that qualifies for exemption from or complies with Section 409A of the Code, provided, however, that the Company makes no representations that the benefits provided under this Agreement will be exempt from Section 409A of the Code and makes no undertakings to preclude Section 409A of the Code from applying to the benefits provided under this Agreement.

5.9 Severability. If any term, provision, covenant, or condition of this Agreement is held to be invalid, void, or unenforceable, the remainder of the provisions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated thereby.

5.10 Survival. Sections 4.2, 5.2, and 5.4 shall survive the termination of this Agreement.

5.11 Entire Agreement; Employment Amendments; Waiver. This Agreement, together with all stock option agreements and/or stock repurchase agreements and any other equity grants, and the Confidential Proprietary Information and Inventions Assignment Agreement is the entire agreement between the parties hereto concerning the subject matter hereof and supersedes and replaces all prior or contemporaneous agreements or understandings between the parties. This Agreement may not be amended or modified in any manner, except by an instrument in writing signed by the Executive and the Company or as otherwise provided in Section 5.8. Failure of either party to enforce any of the provisions of this Agreement or any rights with respect thereto or failure to exercise any election provided for herein shall in no way be considered to be a waiver of such provisions, rights, or elections or in any way effect the validity of this Agreement. The failure of either party to exercise any of said provisions, rights, or elections shall not preclude or prejudice such party from later enforcing or exercising the same or other provisions, rights, or elections which it may have under this Agreement.

5.12 Governing Law. This Agreement shall be governed by and construed in all respects in accordance with the laws of the State of California. With the exception of "arbitrable claims" as defined in Section 5.4, the federal courts and/or state courts of the State of California, County of Alameda shall have exclusive jurisdiction to adjudicate any dispute arising out of this Agreement and/or employment relationship or termination thereof and Executive consents to such jurisdiction and venue.

5.13 Attorneys' Fees. In the event of any action for the breach of this Agreement, the prevailing party shall be entitled to reasonable attorneys' fees, costs, and expenses incurred in connection with such action.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the day and year first above written.

"Executive"	"Company"
By: /s/ Tom Willardson	By: _____
Title: CHIEF FINANCIAL OFFICER	Title: _____

Exhibit 10.8.1

AMENDMENT TO EXECUTIVE EMPLOYEE AGREEMENT DATED

February 25, 2008

This AMENDMENT TO THE EXECUTIVE EMPLOYMENT AGREEMENT dated**November 1, 2007)** ("Amendment") is made as of **July 1, 2008** ("Amendment Effective Date") by and between Energy Recovery Inc., a Delaware corporation, with its principal offices at 1908 Doolittle Drive, San Leandro, CA 94577 (the "Company") and **Thomas Willardson** , an individual (the "Executive") (together, the "Parties").

Pursuant to Article 5.11 of the Executive Employment Agreement, the Parties hereby amend that Agreement as follows:

Article 1.2. The Parties amend and replace Article 1*.2* to read as follows:

> Term. The term of Executive's employment is hereby extended through December 31, 2008. Thereafter, the Executive Employment Agreement, as amended, shall automatically terminate and Executive's employment with the Company will become "at will." "At will" employment means that either the Company or Executive may terminate Executive's employment at any time with or without cause and with or without notice. Such at-will employment cannot be changed except by a writing signed by the Executive and a duly authorized executive or Board member of the Company.

Article 2.l(a). The Parties amend and replace Article 2.1(a) to read as follows:

Base Salary. Effective as of January 1, 2008, Executive's base salary will be $20,833.33 per month ($250,000 per annum), less any deductions required by law, which shall continue to be paid in accordance with the Company's normal and customary payroll practices, but no less frequently than monthly. The Executive's base salary shall be reviewed annually and may be reasonably adjusted in the sole discretion of the Company.

Article 2.1(b). The Parties amend and replace Article 2.1 (b) to read as follows:

> Annual Bonus.
>
> (i) The Executive shall be eligible to participate in the Company's annual bonus program and shall be eligible to earn an annual bonus in an amount not to exceed one (1) times Executive's base salary. If the Executive is eligible to earn an annual cash bonus, the exact amount of the Executive's annual cash bonus, if any, shall be determined by the Company pursuant to the attainment of performance goals as set forth in the attached performance matrix prepared by the Company.
>
> (ii) Notwithstanding Article 2.1(b)(i) to the contrary, the Executive's receipt of any annual bonus attributable to Executive's performance

during the 2008 fiscal year is contingent upon the consummation of the Company's initial public offering of its common stock ("IPO") by **June 16, 2008.** However, in the event that the IPO is not consummated by **June 16, 2008** through no fault of the Executive, as determined by the Board (with the recusal by the Executive from such Board determination, as necessary) in good faith, although the Executive shall not be eligible to receive any annual cash bonus in 2008, all of the Executive's stock options granted under Executive's 2006 Equity Compensation Grant pursuant to Article 2.1(c) of Executive's Executive Employment Agreement shall immediately and fully vest effective as of December 31,2008.

Article 3.1(a)(iv). The Parties amend and replace Article 3.1(a)(iv) to read as follows:

Executive's violation of the Company's Code of Conduct, if any, and as amended from time to time, confidentiality obligations to the Company or misappropriation of Company assets; or

Article 3.2(e)(i)(D). The Parties amend and replace Article 3.2(e)(i)(D) to read as follows:

any material reduction, limitation or failure to pay or provide any of the compensation provided to the Executive under Article 2.1 of this Agreement or any other agreement or understanding between the Executive and the Company, or pursuant to the Company's policies and past practices, as of the date immediately prior to the Change in Control; or

Article 3.2(e)(ii). The Parties add Article 3.2(e)(ii)(E) as follows:

"Change in Control," as defined above, shall not in any instance be construed to include the Company's IPO or any event occurring in connection with or as a result of the Company's IPO.

All other terms contained in the Executive Employment Agreement shall continue in full force and effect.

WITNESS, the execution of this Amendment as of the date first above written.

"Executive"	"Company"
	Energy Recovery Inc.
By: /s/ Tom Willardson	By: _____
Thomas Willardson	Title: **President and CEO**

MEMORANDUM

TO: Tom Willardson
FROM: GG Pique
DATE: October 10, 2007
SUBJECT: Proposed ERI Financial Incentive Compensation Plan

Your financial compensation plan includes a base salary as well as a financial goal bonus. This bonus is a percentage of the base salary, and can increase or decrease applying a matrix that tracks financial goals as a function of actual EBITDA results.

a) Amount of Financial Goals Bonus
The Financial goals bonus will be 30% of annual salary payable for achieving profitability targets. A partial bonus will be paid if we reach 80% of financial goal. Additional bonus is payable if targets are exceeded. No bonus will be paid for performance results less than 80% of target. The financial bonus award calculation will be based upon the following matrix:

Financial Bonus earned as a percentage of base salary
Based on achieving EBITDA target to be set by mutual agreement

% of EBITDA achieved	80%	90%	95%	**100%**	140%	160%	180%	200%	300%
Financial Goals Bonus payable	10%	20%	25%	**30%**	40%	50%	60%	80%	140%

b) Bonus Payments
20% of target bonus at end of 1st Quarter, if at or above plan
20% of target bonus at end of 2nd Quarter, if at or above plan
20% of target bonus at end of 3rd Quarter, if at or above plan
40% of target bonus, plus / minus any adjustments at end of fiscal year.

Note 1: Financial Bonuses will be calculated using audited revenue and financial results. In the event of doubtful receivables a proportional portion of the bonus may be held in escrow

Note 2: Bonuses will be calculated on performance during a specific year, and should be accrued in the fiscal year they are earned, not paid.

/s/ G.G. Pique	10/[Illegible]/07	/s/ Tom Willardson	10/12/07
G.G. Pique	Date	Thomas D. Willardson	Date

Exhibit 10.9

EXECUTIVE EMPLOYEE AGREEMENT

This EXECUTIVE EMPLOYEE AGREEMENT (the "Agreement") is made and entered into as of July 1, 2006, by and between Energy Recovery Inc., a Delaware corporation, with its principal offices at 1908 Doolittle Drive, San Leandro, CA 94577 (the "Company"), and Richard Stover, an individual (the "Executive").

RECITALS

A. WHEREAS, the Company is in the business of designing and manufacturing energy recovery devices.

B. WHEREAS, Executive has been serving as Chief Technology Officer (CTO) of the Company, and the Company desires to continue its relationship with Executive as its CTO, and Executive desires to provide his services to the Company on all of the terms and conditions herein set forth.

C. WHEREAS, The Company desires to provide Executive with a compensation plan in recognition of Executive's valuable skills and services.

NOW, THEREFORE, in consideration of the mutual covenants and conditions herein contained, the parties hereto agree as follows:

ARTICLE I. EMPLOYMENT

1.1 Employment. The Company hereby employs Executive as its CTO, and Executive hereby accepts such engagements with the Company, in accordance with and subject to all of the terms, conditions, and covenants set forth in this Agreement.

1.2 Term. The terms of this Agreement shall commence on the date that this Agreement is fully executed (the "Effective Date") and, unless terminated earlier in accordance with the terms of Article IV hereof, shall continue for a period of two years from the Effective Date (the "Term of Agreement). The Agreement, thereafter, shall automatically terminate and Executive's employment with the Company will become "at will" "At will" employment means that the either the Company or Executive may terminate Executive's employment with or without cause and with or without notice.

1.3 Scope of Executive's Duties. Executive shall be the CTO of the Company, reporting to the President and CEO of the Company (CEO). Executive shall have such duties, responsibilities and authority as shall be consistent with that position and will operate within such established guidelines, plans, or policies as may be established or approved by the CEO and the company Board of Directors from time to time.

ARTICLE II. COMPENSATION AND BENEFITS

2.1 Compensation.

(a) Base Salary. Executive shall be paid a base salary of $17,500 per month ($210,000 per annum), less any deductions required by law, which shall be paid in accordance with the Company's normal and customary payroll practices, but no less frequently than monthly. The Executive's base salary shall be reviewed annually and may be reasonably adjusted in the sole discretion of the Company.

(b) Annual Bonus. The Executive shall be eligible to participate in the Company's annual bonus program and shall be eligible to earn an annual bonus in an amount not to exceed (1) times his base salary. The exact amount of the Executive's annual bonus, if any, shall be determined by the Company pursuant to the attainment of performance goals as set forth in the matrix.

(c) Equity Compensation. Contingent on the Executive's continued employment on the date of grant, Company intends to grant the Executive stock options to purchase an additional thirty thousand (30,000) shares of the Company's Common Stock, to be arranged under, and subject to the terms of, Company's 2006 Equity Compensation Plan or, at the discretion of the Company, any such subsequent equity compensation plan that may be adopted, as well as the terms and conditions of the stock option agreement (which will be provided to the Executive as soon as practicable after the grant date). Any additional terms governing the options *(i.e.,* vesting, conditions to exercise, etc.) shall be set forth in the applicable option agreement. The foregoing is not intended to preclude the Company, in its discretion, from making any additional awards of stock options or other types of equity compensation to the Executive.

2.2 Reimbursable Expenses. Upon submission of expense reports to the extent necessary to substantiate the Company's federal income tax deductions for such expenses under the Internal Revenue Code of 1986 (as amended) and the Regulations thereunder (the "Code") and subject to such expense report approval procedures as may be established by the Board, the Company shall reimburse Executive for all reasonable business expenses incurred and submitted in the performance of his duties hereunder on behalf of the Company.

2.3 Fringe Benefits.

(a) Executive and Executive's dependents shall be permitted to participate in all group health, medical, hospital, dental, prescription, vision, long-term disability and other insurance plans which the Company may establish for its executive employees and such other employee benefits or plans as the Company may establish for its employees generally, and which may be modified from time to time. When such program is implemented, the Executive shall receive, if insurable under usual underwriting standards, term life insurance coverage on the Executive's life, payable to whomever the Executive directs, in an amount equal to one (1) time the Executive's base salary, subject to any cap imposed by the insurer, provided that Executive completes the required statement and application and that Executive's physical condition does not prevent Executive from qualifying for such insurance under reasonable terms and conditions.

Until such time as a term life insurance program is implemented, the Company shall reimburse Executive the premium for individual term life insurance equal to one (1) times the Executive's base salary. Executive shall be eligible to participate in any tax-qualified retirement plan sponsored by the Company, equity compensation plan, or deferred compensation plan, if any, pursuant to the terms of such plans, as the same may be modified from time to time, to the extent such plans are offered to other officers of employees of the Company.

2.4 Vacations. Executive shall earn annual vacations in accordance v\with the Company's standard policy for similarly situated employees. Once Executive has accrued the maximum of two (2) times the accrual rate cap applicable to the Executive as set forth in the standard policy, Executive shall be ineligible to earn further vacation until Executive has used vacation, at which time Executive may begin to accrue vacation again.

2.5 Taxes. The Executive acknowledges that he is responsible for all taxes relating to his Compensation and except for those taxes for which the Company is obligated to pay under applicable law or regulation, Executive agrees that the Company may withhold from Executive's cash compensations any amounts that the Company is required to withhold by law or regulation.

ARTICLE III. TERMINATION AND COMPENSATION UPON TERMINATION

3.1 Termination will be deemed to occur as follows:

(a) Termination for Good Cause by the Company. The Company may terminate this Agreement immediately for "Good Cause" upon written notice to Executive, the date of which shall specify the effective date of the termination. For purposes of this Agreement, "Good Cause" shall mean:

(i) Executive's performance of any act for which, if Executive were prosecuted, would constitute a felony or misdemeanor;

(ii) Executive's failure to carry out Executive's material duties;

(iii) Executive's dishonesty towards or fraud upon the Company which is injurious to the Company;

(iv) Executive's violation of confidentiality obligations to the Company or misappropriation of Company assets; or

(v) Executive's death or inability to carry out Executive's duties with reasonable accommodation, if any, unless prohibited by law.

(b) Voluntary Termination by the Executive. The Executive may terminate this Agreement at any time by providing the Company with thirty (30) days written notice. The effective date of the termination shall be the date specified in the notice. In the event of such a termination, the parties agree to act in good faith towards one another during any notice period.

(c) Notice of Termination. Any termination by the Company for Good Cause or by Executive shall be communicated by Notice of Termination to the other party hereto. For purposes of this Agreement, a "Notice of Termination" shall mean a written notice which shall indicate the specific termination provision in this Agreement relied upon, and shall set forth in reasonable detail the facts and circumstances claimed to provide a basis of termination of Executive's employment under the provision so indicated.

3.2 Compensation Upon Termination. Upon termination of this Agreement by either party, Executive shall be entitled to receive the following payments:

(a) Termination By the Company for Good Cause. Upon termination of this Agreement for "Good Cause" as defined under the provisions of Section 3.1(a) above, Executive shall be paid, in a lump sum, any and all base salary due and owing through the date of termination, plus an amount equal to earned but unused vacation through the date of termination and reimbursement of all reasonable expenses, plus any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the Executive's termination occurs. No pay continuance or other benefits will be provided.

(b) Termination By the Company Without Good Cause. Upon termination of this Agreement by the Company without "Good Cause" as defined under the provisions of Section 3.1(a) above, Executive shall be entitled to the following severance benefits:

(i) payment, in a lump sum, of any and all base salary due and owing to him through the date of termination, plus an amount equal to his earned but unused vacation through the date of termination, reimbursement for all reasonable expenses and any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the Executive's termination occurs; and

(ii) subject to the provisions of Section 5.1 below, payment, in a lump sum of an amount equal to fifty percent (50%) of Executive's current annual base salary, less deductions required by law.

(iii) immediate vesting of all unvested equity compensation held by the Executive as of the date of termination.

(iv) if the Executive (including, if applicable, the Executive's spouse and dependents) timely elects to continue Executive's medical, dental, and vision benefits under COBRA than, contingent upon the Executive paying his portion of the monthly COBRA premium, the Company shall pay its share of the monthly premium (if any) under COBRA to the same extent it pays for coverage for an active employee until the earliest of (a) the end of the twelve (12) month period that commences with the Executive's termination of employment or (b) the Executive becomes eligible for group medical, dental, and vision coverage through another employer. As a condition of the Company paying a pro rata portion of the monthly premium for a portion of the Executive's continuation coverage period the Executive will be required to notify the Company upon becoming eligible for group medical, dental and vision benefits from another employer during such twelve (12) month period. At the end of any

Company-paid period of COBRA coverage, the Executive may, at his own expense, continue COBRA coverage for the remainder of the period for which the Executive is eligible.

The payments provided for in Section 3.2(a) or 3.2(b)(i) and (ii) or 3.2(d), as applicable, shall be paid on the date immediately following the Executive's termination. All such payments will be subject to applicable payroll or other taxes required to be withheld by the Company. However, in the event it is determined that the Executive is a "Specified Employee'' as defined in Section 409A(a)(2)(B)(i) of the Code any payment to be made under this Agreement that is "nonqualified deferred compensation" subject to Section 409A of the Code shall be delayed for six months following the Executive's termination of employment.

(c) Payments to Executive hereunder shall be considered severance pay in consideration of past service and continued service after the date of this Agreement and Executive shall not be required to mitigate the amount of any payment provided for in this Section 3.2 by seeking alternative employment or otherwise, and, with the exception of COBRA payments, the amount of any payment provided for in this Section 3.2 shall not be reduced by any compensation earned by Executive as the result of employment by another employer after the date of termination, or otherwise.

(d) Voluntary Termination by Executive. If Executive voluntarily resigns or terminates this Agreement, Executive shall be paid, in a lump sum, any and all base salary due and owing to him through the date of termination and an amount equal to his earned but unused vacation through the date of termination, plus any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the Executive's termination occurs. Executive, his family, or his estate shall be entitled to other benefits to the extent permitted by law, contract, or the terms of any benefit plan or program.

(e) Termination Pursuant to a Change of Control. If upon or at any time during the Term of Agreement there is a "Termination Event", as defined below, that occurs within one (1) year following a "Change in Control", as defined below, Executive shall be treated as if Executive had been terminated by the Company Without Good Cause pursuant to Section 3.2(b) and in addition to the severance benefits described therein shall be entitled to receive an additional Change in Control amount equal to fifty percent (50%) of the Executive's current annual base salary. The Change in Control amount shall be paid at the same time and in the same manner as the Executive's severance payments pursuant to Section 3.2(b)(ii).

(i) A Termination Event shall mean the occurrence of any one or more of the following, but shall not include the Executive's termination due to death or disability:

A. the termination or material breach of this Agreement by the Company;

B. the failure by the Company to obtain the assumption of this Agreement by any successor to the Company or any assignee of all or substantially all of the Company's assets;

C. any material diminishment in the title, position, duties, responsibility or status that the Executive had with the Company immediately prior to the Change in Control;

D. any reduction, limitation or failure to pay or provide any of the compensation provided to the Executive under Section 2.1 of this Agreement or any other agreement or understanding between the Executive and the Company, or pursuant to the Company's policies and past practices, as of the date immediately prior to the Change in Control; or

E. any requirement that the Executive relocate more than 30 miles from his place of employment as of the date immediately prior to the Change in Control.

(ii) Change in Control shall mean any of the following, occurring during the term of the Executive's employment or employment relationship with the Company:

A. an acquisition by an individual, an entity or a group (excluding the Company, an employee benefit plan of the Company, or a corporation controlled by the Company's shareholders) of fifty percent (50%) or more of the Company's then- outstanding common stock or voting securities;

B. a change in composition of the Board occurring within a roiling twelve-month period, as a result of which fewer than a majority of the directors are Incumbent Directors ("Incumbent Directors" shall mean directors who either (x) are members of the Board as of the Executive Date or (y) are elected, or nominated for election, to the Board with the affirmative votes of at least a majority of the Incumbent Directors at the time of such election or nomination, but shall not include an individual not otherwise an Incumbent Director whose election or nomination is in connection with an actual or threatened proxy contest (relating to the election of directors to the Board));

C. consummation of a complete liquidation or dissolution of the Company, or a merger, consolidation or sale of all or substantially all of the Company's then-existing assets (collectively, a "Business Combination"), other than a Business Combination (x) in which the stockholders of the Company immediately prior to the Business Combination receive fifty percent (50%) or more of the voting stock resulting from the Business Combination, (y) at least a majority of the board of directors of the corporation resulting from the Business Combination were Incumbent Directors and (z) after which no individual, entity or group
(excluding any corporation resulting from the Business Combination or any employee benefit plan of such corporation or if the Company owns fifty percent (50%) or more of the stock of the corporation resulting from the Business Combination who did not own such stock immediately
before the Business Combination; or

D. change in the ownership of a substantial portion of a Company's assets. A change in the ownership of a substantial portion of the Company's assets occurs on the date that any individual or group of individuals acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such individual or group of individuals) assets from the Company that have a total gross fair market value equal to

or more than forty percent (40%) of the total gross fair market value of all of the assets of the Company immediately prior to such acquisition or acquisitions. For this purpose, gross fair market value means the value of the assets of the Company, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets.

(iii) To the extent that any or all of the payments and benefits provided for in this Agreement, either alone or in conjunction with other compensatory payments, would give rise to a "parachute payment" under Sections 280G and 4999 of the Code (collectively, the "Parachute Rules"):

A. If the Company so requests at a time when the Company's securities are not "readily tradable" (as defined in the Parachute Rules), the Company shall be permitted to solicit a shareholder vote or written consent to approve the parachute payment in order to avoid characterization as a parachute payment under the Parachute Rules. In that event, the Executive agrees, to the extent required by the Parachute Rules then in effect and without further consent or documentation, to waive and cancel all rights or parachute payments in connection with the Change of Control to the extent that shareholder approval is not obtained in accordance with the Parachute Rules.

B. Unless shareholder approval has avoided application of the Parachute Rules, the Company shall reduce and cancel, and the Executive hereby waives, the parachute payment to the minimum extent necessary to equal one dollar less than the amount which would result in any compensatory payments being subject to the excise tax imposed by Section 4999 of the Code and such that the Executive receives only the amount of such payment which would not constitute an "excess parachute payment" under the Parachute Rules.

C. Notwithstanding clauses A and B above, the Executive may elect not to subject a payment or benefit to stockholder approval and to instead receive either (i) the full amount of any parachute payment or (ii) 2.99 times the Executive's "base amount" (as such term is defined under the Parachute Rules), whichever of the foregoing amounts (after taking into account any applicable federal, state and local income taxes and the excise tax imposed by Section 4999 of the Code) results in the receipt by the Executive, on an after-tax basis, of the greater payment provided that (a) the acquiring person in the Change of Control, in its sole discretion, does not object thereto and docs not impose on the Company or its shareholder any added cost, price reduction, or other detriment therefrom (economic or otherwise as determined in the Company's sole discretion), and (b) the Executive deposits at least three (3) business days prior to consummation of the Change of Control with a party designated by the Company a cash sum sufficient in the discretion of the Company to fund all withholding payments that may arise in connection with the Executive's parachute payments from any source.

D. In no event shall the Company be required to gross up any payment or benefit to the Executive to avoid the effects of the Parachute Rules or to pay any regular or excise taxes arising therefrom. Unless the Company and the Executive otherwise agree in writing, any parachute payment calculation shall be made in writing by independent pubic accounts agreed to by the Company and the Executive, whose calculations shall be conclusive and binding upon the Company and the Executive for all purposes. The Company

and the Executive shall furnish to the accountants such information and documents as the accountants may reasonably request in order to make a parachute payment determination.

ARTICLE IV. NONCOMPETITION AND NONSOLICITATION

4.1 Noncompetition During Employment. Executive agrees that, during the term hereof, Executive will devote his full productive time and best efforts to the performance of his duties hereunder pursuant to the supervision and direction of the Company's Board of Directors or its designee. Executive further agrees, as a condition to the performance by the Company of each and all of its obligations hereunder, that so long as Executive is employed by the Company, Executive will not directly or indirectly render services of any nature to otherwise become employed by or otherwise participate or engage in any other business without the Company's prior written consent. Nothing herein contained shall be deemed to preclude Executive from having outside personal investments and involvement with appropriate community and charitable activities, or from devoting a reasonable amount of time to such matters, provided that this shall in no manner interfere with or derogate from Executive's work for the Company.

4.2 Non-solicitation.

(a) Executive agrees that during Executive's employment and for a period of two (2) years after the termination of this Agreement for any reason, in the United States or any-other equivalent geographical subdivision in foreign jurisdictions in which the Company does business, Executive shall not, in competition with the Company or any subsidiary or affiliates:

(i) directly call upon or solicit any of the customers of the Company or any subsidiary that were or became customers during the term of Executive's employment (as used herein "customer" shall mean any person or company as listed as such on the books of the Company or any affiliates); or

(ii) induce or attempt to induce any employee, agent, or consultant of the Company or any subsidiary or affiliates to terminate his or her association with the Company or any subsidiary or affiliates.

(b) The Company and Executive agree that the provisions of this Section 4.2 contain restrictions that are not greater than necessary to protect the interests of the Company. In the event of the breach or threatened breach by Executive of this Section 4.2, the Company, in addition to all other remedies available to it at law or in equity, will be entitled to seek injunctive relief and/or specific performance to enforce this Section 4.2.

ARTICLE V. MISCELLANEOUS PROVISIONS

5.1 General Release. Any other provision of this Agreement notwithstanding, Section 3.2(b)(ii)-(iv) above shall not apply unless Executive has executed a general release of all known and unknown claims that Executive may then have against the Company or persons affiliated

with the Company and has expressly agreed in writing not to prosecute any legal action or other proceeding based on any of such claims.

5.2 Confidential Proprietary Information and Inventions Assignment Agreement. Concurrent with execution of this Agreement, Executive acknowledges receipt of an executed copy of the Company's standard Confidential Information and Inventions Assignment Agreement, signed by Executive on April 19, 2005, which shall be incorporated herein.

5.3 Fees and Expenses. The Company shall pay all legal fees and related expenses for counsel incurred by Executive as a result of preparation of and negotiation of the terms of Executive's employment.

5.4 Irrevocable Arbitration of Disputes.

(a) You and the Company agree that any dispute, controversy or claim arising hereunder or in any way related to your employment or termination of employment with the Company or this Agreement, its interpretation, enforceability, or applicability, that cannot be resolved by mutual agreement of the parties (the "arbitrable claims") shall be submitted to binding arbitration. The parties agree that arbitration is the parties" only recourse for such claims and hereby waive the right to pursue such claims in any other forum, unless otherwise provided by law. Any court action involving a dispute which is not subject to arbitration shall be stayed pending arbitration of arbitrable disputes.

(b) You and the Company agree that the arbitrator shall have the authority to issue provisional relief. You and the Company further agree that each has the right, pursuant to California Code of Civil Procedure section 1281.8, to apply to a court for a provisional remedy in connection with an arbitrable dispute so as to prevent the arbitration from being rendered ineffective.

(c) Any demand for arbitration shall be in writing and must be communicated to the other party prior to the expiration of the applicable statute of limitations.

(d) The arbitration shall be administered by JAMS pursuant to its Employment Arbitration Rules and Procedures. The arbitration shall be conducted in San Diego by a former or retired judge or attorney with at least 10 years experience in employment-related disputes, or a non-attorney with like experience in the area of dispute, who shall have the power to hear motions, control discovery, conduct hearings and otherwise do all that is necessary to resolve the matter. The parties must mutually agree on the arbitrator. If the parties cannot agree on the arbitrator after their best efforts, an arbitrator will be selected from JAMS pursuant to its Employment Arbitration Rules and Procedures. The Company shall pay the costs of the arbitrator's fees.

(e) The arbitration will be decided upon a written decision of the arbitrator stating the essential findings and conclusions upon which the award is based. The arbitrator shall have the authority to award damages, if any, to the extent that they are available under applicable

law(s). The arbitration award shall be final and binding, and may be entered as a judgment in any court having competent jurisdiction. Either party may seek review pursuant to California Code of Civil Procedure section 1286, et seq.

(f) It is expressly understood that the parties have chosen arbitration to avoid the burdens, costs and publicity of a court proceeding, and the arbitrator is expected to handle all aspects of the matter, including discovery and any hearings, in such a way as to minimize the expense, time, burden and publicity of the process, while assuring a fair and just result. In particular, the parties expect that the arbitrator will limit discovery by controlling the amount of discovery that may be taken (e.g., the number of depositions or interrogatories) and by restricting the scope of discovery only to those matters clearly relevant to the dispute. However, at a minimum, each party will be entitled to at least one (1) deposition and shall have access to essential documents and witnesses as determined by the arbitrator.

(g) The provisions of this Section shall survive the expiration or termination of the Agreement, and shall be binding upon the parties.

THE PARTIES HAVE READ SECTION 5.4 AND IRREVOCABLY AGREE TO ARBITRATE ANY DISPUTE IDENTIFIED ABOVE.

_____ *(Executive)* GGP _____ *(Company)*

5.5 Settlement of Claims. The Company's obligation to make the payments provided for in this Agreement and otherwise to perform its obligations hereunder shall not be affected by any circumstances, including, without limitation, any set-off, counterclaim, recoupment, defense or other right which the Company may have against the Executive or others.

5.6 Legal Representatives. Upon the death or disability of Executive, any payments due under this Agreement shall be paid to Executive's legal representatives.

5.7 Notices. Any notice or other communication given hereunder or in connection herewith shall be sufficiently given if in writing and (a) sent by certified mail or overnight courier, postage or delivery costs prepaid and return receipt requested, (b) sent by facsimile transmission, or (c) delivered personally, to the parties hereto at the following addresses or to such addresses as the parties may from time to time provide in accordance herewith:

If to the Company: Energy Recovery Inc.
1908 Doolittle Drive San
Leandro, CA 94577 Fax:
(510)483-7371 Attention:
MariaElena Ross

If to Executive: Richard Stover

_____

_____

Fax: _____

Such notice shall be deemed given on the date on which personally served or, if by mail, on the fifth (5th) day after being posted or on the date of actual receipt, whichever is earlier, or if by facsimile transaction with confirmation of receipt, one (1) business day after the time sent or the time of actual receipt, whichever is earlier.

5.8 Compliance with Section 409A of the Code. It is the intent of this Agreement that no payment to the Executive shall result in nonqualified deferred compensation within the meaning of Section 409 A of the Code. However, in the event that all, or a portion, of the payments set forth in this Agreement meet the definition of nonqualified deferred compensation, the Company intends that such payments be made in a manner that complies with Section 409A of the Code. The Company reserves the right, to the extent the Company deems necessary or advisable in its sole discretion, to unilaterally amend or modify this Agreement as may be necessary to ensure all benefits provided under this Agreement are made in a manner that qualifies for exemption from or complies with Section 409A of the Code, provided, however. that the Company makes no representations that the benefits provided under this Agreement will be exempt from Section 409A of the Code and makes no undertakings to preclude Section 409A of the Code from applying to the benefits provided under this Agreement.

5.9 Severability. If any term, provision, covenant, or condition of this Agreement is held to be invalid, void, or unenforceable, the remainder of the provisions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated thereby.

5.10 Survival. Sections 4.2, 5.2. and 5.4 shall survive the termination of this Agreement.

5.11 Entire Agreement; Employment Amendments; Waiver. This Agreement, together with all stock option agreements and/or stock repurchase agreements and any other equity grants, and the Confidential Proprietary Information and Inventions Assignment_Agreement is the entire agreement between the parties hereto concerning the subject matter hereof and supersedes and replaces all prior or contemporaneous agreements or understandings between the parties. This Agreement may not be amended or modified in any manner, except by an instrument in writing signed by the Executive and the Company or as otherwise provided in Section 5.8. Failure of either party to enforce any of the provisions of this Agreement or any rights with respect thereto or failure to exercise any election provided for herein shall in no way be considered to be a waiver of such provisions, rights, or elections or in any way effect the validity of this Agreement. The failure of either party to exercise any of said provisions, rights, or elections shall not preclude or prejudice such party from later enforcing or exercising the same or other provisions, rights, or elections which it may have under this Agreement.

5.12 Governing Law. This Agreement shall be governed by and construed in all respects in accordance with the laws of the State of California. With the exception of “arbitrable claims” as defined in Section 5.4, the federal courts and/or state courts of the State of California, County of Alameda shall have exclusive jurisdiction to adjudicate any dispute arising out of this Agreement and/or employment relationship or termination thereof and Executive consents to such jurisdiction and venue.

5.13 Attorneys' Fees. In the event of any action for the breach of this Agreement, the prevailing party shall be entitled to reasonable attorneys' fees, costs, and expenses incurred in connection with such action.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the day and year first above written.

"Executive"

By: /s/ Richard S. Stover
Title: VP/CTO

"Company"

By: /s/ G.G. Pique
Title: President

Exhibit 10.9.1

AMENDMENT TO EXECUTIVE EMPLOYEE AGREEMENT DATED

February 25, 2008

This AMENDMENT TO THE EXECUTIVE EMPLOYMENT AGREEMENT dated**July 1, 2006** ("Amendment") is made as of **July 1, 2008** ("Amendment Effective Date") by and between Energy Recovery Inc., a Delaware corporation, with its principal offices at 1908 Doolittle Drive, San Leandro, CA 94577 (the "Company") and **Richard Stover,** an individual {the "Executive") (together, the "Parties").

Pursuant to Article 5.11 of the Executive Employment Agreement, the Parties hereby amend that Agreement as follows:

Article 1.2. The Parties amend and replace Article 1.2 to read as follows:

Term. The term of Executive's employment is hereby extended through December 31, 2008. Thereafter, the Executive Employment Agreement, as amended, shall automatically terminate and Executive's employment with the Company will become "at will." "At will" employment means that either the Company or Executive may terminate Executive's employment at any time with or without cause and with or without notice. Such at-will employment cannot be changed except by a writing signed by the Executive and a duly authorized executive or Board member of the Company.

Article 2.1(a). The Parties amend and replace Article 2.1(a) to read as follows:

Base Salary. Effective as of January 1, 2008, Executive's base salary will be $19,250 per month ($231,000 per annum), less any deductions required by law, which shall continue to be paid in accordance with the Company's normal and customary payroll practices, but no less frequently than monthly. The Executive's base salary shall be reviewed annually and may be reasonably adjusted in the sole discretion of the Company.

Article 2.1(b). The Parties amend and replace Article 2.1(b) to read as follows:

Annual Bonus.

(i) The Executive shall be eligible to participate in the Company's annual bonus program and shall be eligible to earn an annual bonus in an amount not to exceed one (1) times Executive's base salary. If the Executive is eligible to earn an annual cash bonus, the exact amount of the Executive's annual cash bonus, if any, shall be determined by the Company pursuant to the attainment of performance goals as set forth in the attached Performance Matrix prepared by the Company.

(ii) Notwithstanding Article 2.1(b)(i) to the contrary, however, in the event that the scheduled IPO is not consummated through no fault of the Executive, as determined by the Board (with the recusal by the Executive from such Board determination, as necessary) in good faith, although the Executive may not be eligible to receive any annual cash bonus in 2008, all of the Executive's stock options granted under Executive's 2006 Equity Compensation Grant pursuant to Article 2.1 (c) of Executive's Executive Employment Agreement shall immediately and fully vest effective as of December 31, 2008.

Article 3.1(a)(iv). The Parties amend and replace Article 3.1(a)(iv) to read as follows:

Executive's violation of the Company's Code of Conduct, if any, and as amended from time to time, confidentiality obligations to the Company or misappropriation of Company assets; or

Article 3.2(e)(i)(D). The Parties amend and replace Article 3.2(e)(i)(D) to read as follows:

any material reduction, limitation or failure to pay or provide any of the compensation provided to the Executive under Article 2.1 of this Agreement or any other agreement or understanding between the Executive and the Company, or pursuant to the Company's policies and past practices, as of the date immediately prior to the Change in Control; or

Article 3.2(e)(ii). The Parties add Article 3.2(e)(ii)(E) as follows:

"Change in Control," as defined above, shall not in any instance be construed to include the Company's IPO or any event occurring in connection with or as a result of the Company's IPO.

All other terms contained in the Executive Employment Agreement shall continue in full force and effect.

WITNESS, the execution of this Amendment as of the date first above written.

"Executive"

By: /s/ Richard Stover
Richard Stover

"Company"

Energy Recovery Inc.

By: /s/ G.G. Pique
Title: **President and CEO**

TO: Rick Stover
FROM: GG Pique
DATE: March 3, 2008
SUBJECT: 2008 Performance Bonus

ERI will pay a maximum of 10% of base salary at the end of the year for exceeding the following performance objectives:

1) Continue to control and defend ERI technical risk

2) Continue to manage patents

3) Publish one (1) technical paper in 2008. Cause others in ERI to publish 2 more.

4) Help development and support of Engineering team

The actual amount payable will be based on a subjective appraisal of each performance objective per the following rating schedule:

100%	Exceeded objective
75%	Met objective
50%	Met objective late or incompletely
25%	Substantially initiated effort to meet objective
0%	Did not meet objective

G.G. Pique Date

/s/ Rick Stover
Rick Stover Date

Exhibit 10.10

EXECUTIVE EMPLOYEE AGREEMENT

This EXECUTIVE EMPLOYEE AGREEMENT (the "Agreement") is made and entered into as of July 1, 2006, by and between Energy Recovery Inc., a Delaware corporation, with its principal offices at 1908 Doolittle Drive, San Leandro, CA 94577 (the "Company"), and Terrill Sandlin, an individual (the "Executive").

RECITALS

A. WHEREAS, the Company is in the business of designing and manufacturing energy recovery devices.

B. WHEREAS, Executive has been serving as VP of Manufacturing (VP of Manufacturing) of the Company, and the Company desires to continue its relationship with Executive as its VP of Manufacturing, and Executive desires to provide his services to the Company on all of the terms and conditions herein set forth.

C. WHEREAS, The Company desires to provide Executive with a compensation plan in recognition of Executive's valuable skills and services.

NOW, THEREFORE, in consideration of the mutual covenants and conditions herein contained, the parties hereto agree as follows:

ARTICLE I. EMPLOYMENT

1.1 Employment. The Company hereby employs Executive as its VP of Manufacturing, and Executive hereby accepts such engagements with the Company, in accordance with and subject to all of the terms, conditions, and covenants set forth in this Agreement.

1.2 Term. The terms of this Agreement shall commence on the date that this Agreement is fully executed (the "Effective Date") and, unless terminated earlier in accordance with the terms of Article IV hereof, shall continue for a period of two years ending 24 calendar months from the Effective Date (the "Term of Agreement). The Agreement, thereafter, shall automatically terminate and Executive's employment with the Company will become "at will." "At will" employment means that either the Company or Executive may terminate Executive's employment with or without cause and with or without notice.

1.3 Scope of Executive's Duties. Executive shall be the VP of Manufacturing of the Company, reporting to the President and CEO of the Company (CEO). Executive shall have such duties, responsibilities and authority as shall be consistent with that position and will operate within such established guidelines, plans, or policies as may be established or approved by the CEO and the company Board of Directors from time to time.

ARTICLE II. COMPENSATION AND BENEFITS

2.1 Compensation.

(a) Base Salary. Executive shall be paid a base salary of $10,833 per month ($130,000 per annum), less any deductions required by law, which shall be paid in accordance with the Company's normal and customary payroll practices, but no less frequently than monthly. The Executive's base salary shall be reviewed annually and may be reasonably adjusted in the sole discretion of the Company.

(b) Annual Bonus. The Executive shall be eligible to participate in the Company's annual bonus program and shall be eligible to earn an annual bonus in an amount not to exceed (1) times his base salary. The exact amount of the Executive's annual bonus, if any, shall be determined by the Company pursuant to the attainment of performance goals as set forth in the matrix.

(c) Equity Compensation. Contingent on the Executive's continued employment on the date of grant, Company intends to grant the Executive stock options to purchase an additional thirty thousand (30,000) shares of the Company's Common Stock, to be arranged under, and subject to the terms of, Company's 2006 Equity Compensation Plan or, at the discretion of the Company, any such subsequent equity compensation plan that may be adopted, as well as the terms and conditions of the stock option agreement (which will be provided to the Executive as soon as practicable after the grant date). Any additional terms governing the options *(i.e.,* vesting, conditions to exercise, etc.) shall be set forth in the applicable option agreement. The foregoing is not intended to preclude the Company, in its discretion, from making any additional awards of stock options or other types of equity compensation to the Executive.

2.2 Reimbursable Expenses. Upon submission of expense reports to the extent necessary to substantiate the Company's federal income tax deductions for such expenses under the Internal Revenue Code of 1986 (as amended) and the Regulations thereunder (the "Code") and subject to such expense report approval procedures as may be established by the Board, the Company shall reimburse Executive for all reasonable business expenses incurred and submitted in the performance of his duties hereunder on behalf of the Company.

2.3 Fringe Benefits.

(a) Executive and Executive's dependents shall be permitted to participate in all group health, medical, hospital, dental, prescription, vision, long-term disability and other insurance plans which the Company may establish for its executive employees and such other employee benefits or plans as the Company may establish for its employees generally, and which may be modified from time to time. Upon implementation of the Company's new executive life insurance program, the Executive shall receive, if insurable under usual underwriting standards, term life insurance coverage on the Executive's life, payable to whomever the Executive directs, in an amount equal to one (1) time the Executive's base salary, subject to any cap imposed by the insurer, provided that Executive completes the required statement and application and that Executive's physical condition does not prevent Executive from qualifying for such insurance

under reasonable terms and conditions. In the interim, the Company shall reimburse the Executive's monthly premium for such coverage during the term of this agreement. Executive shall be eligible to participate in any tax-qualified retirement plan sponsored by the Company, equity compensation plan, or deferred compensation plan, if any, pursuant to the terms of such plans, as the same may be modified from time to time, to the extent such plans are offered to other officers of employees of the Company.

2.4 Vacations. Executive shall earn annual vacations in accordance with the Company's standard policy. Once the Executive has accrued the maximum of two (2) times the accrual rate cap applicable to the Executive as set forth in the standard policy, Executive shall be ineligible to earn further vacation until Executive has used vacation, at which time Executive may begin to accrue vacation again.

2.5 Taxes. The Executive acknowledges that he is responsible for all taxes relating to his Compensation and except for those taxes for which the Company is obligated to pay under applicable law or regulation, Executive agrees that the Company may withhold from Executive's cash compensations any amounts that the Company is required to withhold by law or regulation.

ARTICLE III. TERMINATION AND COMPENSATION UPON TERMINATION

3.1 Termination will be deemed to occur as follows:

(a) Termination for Good Cause by the Company. The Company may terminate this Agreement immediately for "Good Cause" upon written notice to Executive, the date of which shall specify the effective date of the termination. For purposes of this Agreement, "Good Cause" shall mean:

(i) Executive's performance of any act for which, if Executive were prosecuted, would constitute a felony or misdemeanor;

(ii) Executive's failure to carry out Executive's material duties;

(iii) Executive's dishonesty towards or fraud upon the Company which is injurious to the Company;

(iv) Executive's violation of confidentiality obligations to the Company or misappropriation of Company assets; or

(v) Executive's death or inability to carry out Executive's duties with reasonable accommodation, if any, unless prohibited by law.

(b) Voluntary Termination by the Executive. The Executive may terminate this Agreement at any time by providing the Company with thirty (30) days written notice. The effective date of the termination shall be the date specified in the notice. In the event of such a termination, the parties agree to act in good faith towards one another during any notice period.

(c) Notice of Termination. Any termination by the Company for Good Cause or by Executive shall be communicated by Notice of Termination to the other party hereto. For

purposes of this Agreement, a "Notice of Termination" shall mean a written notice which shall indicate the specific termination provision in this Agreement relied upon, and shall set forth in reasonable detail the facts and circumstances claimed to provide a basis of termination of Executive's employment under the provision so indicated.

3.2 Compensation Upon Termination. Upon termination of this Agreement by either party, Executive shall be entitled to receive the following payments:

(a) Termination By the Company for Good Cause. Upon termination of this Agreement for "Good Cause" as defined under the provisions of Section 3.1 (a) above, Executive shall be paid, in a lump sum, any and all base salary due and owing through the date of termination, plus an amount equal to earned but unused vacation through the date of termination and reimbursement of all reasonable expenses, plus any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the Executive's termination occurs. No pay continuance or other benefits will be provided.

(b) Termination By the Company Without Good Cause. Upon termination of this Agreement by the Company without "Good Cause" as defined under the provisions of Section 3.1(a) above, Executive shall be entitled to the following severance benefits:

(i) payment, in a lump sum, of any all base salary due and owing to him through the date of termination, plus an amount equal to his earned but unused vacation through the date of termination, reimbursement for all reasonable expenses and any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the Executive's termination occurs; and

(ii) subject to the provisions of Section 5.1 below, payment, in a lump sum of an amount equal to fifty percent (50%) of Executive's current annual base salary, less deductions required by law.

(iii) immediate vesting of all unvested equity compensation held by the Executive as of the date of termination.

(iv) if the Executive (including, if applicable, the Executive's spouse and dependents) timely elects to continue Executive's medical, dental, and vision benefits under COBRA then, contingent upon the Executive paying his portion of the monthly COBRA premium, the Company shall pay its share of the monthly premium (if any) under COBRA to the same extent it pays for coverage for an active employee until the earliest of (a) the end of the twelve (12) month period that commences with the Executive's termination of employment or (b) the Executive becomes eligible for group medical, dental, and vision coverage through another employer. As a condition of the Company paying a pro rata portion of the monthly premium for a portion of the Executive's continuation coverage period the Executive will be required to notify the Company upon becoming eligible for group medical, dental and vision benefits from another employer during such twelve (12) month period. At the end of any Company-paid period of COBRA coverage, the Executive may, at his own expense, continue COBRA coverage for the remainder of the period for which the Executive is eligible.

The payments provided for in Section 3.2(a) or 3.2(b)(i) and (ii) or 3.2(d), as applicable, shall be paid on the date immediately following the Executive's termination. All such payments will be subject to applicable payroll or other taxes required to be withheld by the Company. However, in the event it is determined that the Executive is a "Specified Employee" as defined in Section 409A(a)(2)(B)(i) of the Code any payment to be made under this Agreement that is "nonqualified deferred compensation" subject to Section 409A of the Code shall be delayed for six months following the Executive's termination of employment.

(c) Payments to Executive hereunder shall be considered severance pay in consideration of past service and continued service after the date of this Agreement and Executive shall not be required to mitigate the amount of any payment provided for in this Section 3.2 by seeking alternative employment or otherwise, and, with the exception of COBRA payments, the amount of any payment provided for in this Section 3.2 shall not be reduced by any compensation earned by Executive as the result of employment by another employer after the date of termination, or otherwise.

(d) Voluntary Termination by Executive. If Executive Voluntarily resigns or terminates this Agreement, Executive shall be paid, in a lump sum , any and all base salary due and owing to him through the date of termination and an amount equal to his earned but unused vacation through the date of termination, plus any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the Executive's termination occurs. Executive, his family, or his estate shall be entitled to other benefits to the extent permitted by law, contract, or the terms of any benefit plan or program.

(e) Termination Pursuant to a Change of Control. If upon or at any time during the Term of Agreement there is a "Termination Event", as defined below, that occurs within one (1) year following a "Change in Control", as defined below, Executive shall be treated as if Executive had been terminated by the Company Without Good Cause pursuant to Section 3.2(b) and in addition to the severance benefits described therein shall be entitled to receive an additional Change in Control amount equal to fifty percent (50%) of the Executive's current annual base salary. The Change in Control amount shall be paid at the same time and in the same manner as the Executive's severance payments pursuant to Section 3.2(b)(ii).

(i) A Termination Event shall mean the occurrence of any one or more of the following, but shall not include the Executive's termination due to death or disability:

A. the termination or material breach of this Agreement by the Company;

B. the failure by the Company to obtain the assumption of this Agreement by any successor to the Company or any assignee of all or substantially all of the Company's assets;

C. any material diminishment in the title, position, duties, responsibility or status that the Executive had with the Company immediately prior to the Change in Control;

D. any reduction, limitation or failure to pay or provide any of the compensation provided to the Executive under Section 2.1 of this Agreement or any other agreement or understanding between the Executive and the Company, or pursuant to the Company's policies and past practices, as of the date immediately prior to the Change in Control; or

E. any requirement that the Executive relocate more than 30 miles from his place of employment as of the date immediately prior to the Change in Control.

(ii) Change in Control shall mean any of the following, occurring during the term of the Executive's employment or employment relationship with the Company:

A. an acquisition by an individual, an entity or a group (excluding the Company, an employee benefit plan of the Company, or a corporation controlled by the Company's shareholders) of fifty percent (50%) or more of the Company's then- outstanding common stock or voting securities;

B. a change in composition of the Board occurring within a rolling twelve-month period, as a result of which fewer than a majority of the directors are Incumbent Directors ("Incumbent Directors" shall mean directors who either (x) are members of the Board as of the Executive Date or (y) are elected, or nominated for election, to the Board with the affirmative votes of at least a majority of the Incumbent Directors at the time of such election or nomination, but shall not include an individual not otherwise an Incumbent Director whose election or nomination is in connection with an actual or threatened proxy contest (relating to the election of directors to the Board));

C. consummation of a complete liquidation or dissolution of the Company, or a merger, consolidation or sale of all or substantially all of the Company's then-existing assets (collectively, a "Business Combination"), other than a Business Combination (x) in which the stockholders of the Company immediately prior to the Business Combination receive fifty percent (50%) or more of the voting stock resulting from the Business Combination, (y) at least a majority of the board of directors of the corporation resulting from the Business Combination were Incumbent Directors and (z) after which no individual, entity or group (excluding any corporation resulting from the Business Combination or any employee benefit plan of such corporation or if the Company owns fifty percent (50%) or more of the stock of the corporation resulting from the Business Combination who did not own such stock immediately before the Business Combination; or

D. change in the ownership of a substantial portion of a Company's assets. A change in the ownership of a substantial portion of the Company's assets occurs on the date that any individual or group of individuals acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such individual or group of individuals assets from the Company that have a total gross fair market value equal to or more than forty percent (40%) of the total gross fair market value of all of the assets of the Company immediately prior to such acquisition or acquisitions. For this purpose, gross fair market value means the value of the assets of the Company, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets.

(iii) To the extent that any or all of the payments and benefits provided for in this Agreement, either alone or in conjunction with other compensatory payments, would give rise to a "parachute payment" under Sections 280G and 4999 of the Code (collectively, the "Parachute Rules"):

A. If the Company so requests at a time when the Company's securities are not "readily tradable" (as defined in the Parachute Rules), the Company shall be permitted to solicit a shareholder vote or written consent to approve the parachute payment in order to avoid characterization as a parachute payment under the Parachute Rules. In that event, the Executive agrees, to the extent required by the Parachute Rules then in effect and without further consent or documentation, to waive and cancel all rights or parachute payments in connection with the Change of Control to the extent that shareholder approval is not obtained in accordance with the Parachute Rules.

B. Unless shareholder approval has avoided application of the Parachute Rules, the Company shall reduce and cancel, and the Executive hereby waives, the parachute payment to the minimum extent necessary to equal one dollar less than the amount which would result in any compensatory payments being subject to the excise tax imposed by Section 4999 of the Code and such that the Executive receives only the amount of such payment which would not constitute an "excess parachute payment" under the Parachute Rules.

C. Notwithstanding clauses A and B above, the Executive may elect not to subject a payment or benefit to stockholder approval and to instead receive either (i) the full amount of any parachute payment or (ii) 2.99 times the Executive's "base amount" (as such term is defined under the Parachute Rules), whichever of the foregoing amounts (after taking into account any applicable federal, state and local income taxes and the excise tax imposed by Section 4999 of the Code) results in the receipt by the Executive, on an after-tax basis, of the greater payment provided that (a) the acquiring person in the Change of Control, in its sole discretion, does not object thereto and does not impose on the Company or its shareholder any added cost, price reduction, or other detriment therefrom (economic or otherwise as determined in the Company's sole discretion), and (b) the Executive deposits at least three (3) business days prior to consummation of the Change of Control with a party designated by the Company a cash sum sufficient in the discretion of the Company to fund all withholding payments that may arise in connection with the Executive's parachute payments from any source.

D. In no event shall the Company be required to gross up any payment or benefit to the Executive to avoid the effects of the Parachute Rules or to pay any regular or excise taxes arising therefrom. Unless the Company and the Executive otherwise agree in writing, any parachute payment calculation shall be made in writing by independent pubic accounts agreed to by the Company and the Executive, whose calculations shall be conclusive and binding upon the Company and the Executive for all purposes. The Company and the Executive shall furnish to the accountants such information and documents as the accountants may reasonably request in order to make a parachute payment determination.

ARTICLE IV. NONCOMPETITION AND NONSOLICITATION

4.1 Noncompetition During Employment. Executive agrees that, during the term hereof, Executive will devote his full productive time and best efforts to the performance of his duties hereunder pursuant to the supervision and direction of the Company's Board of Directors or its designee. Executive further agrees, as a condition to the performance by the Company of each and all of its obligations hereunder, that so long as Executive is employed by the Company, Executive will not directly or indirectly render services of any nature to otherwise become employed by or otherwise participate or engage in any other business without the Company's prior written consent. Nothing herein contained shall be deemed to preclude Executive from having outside personal investments and involvement with appropriate community and charitable activities, or from devoting a reasonable amount of time to such matters, provided that this shall in no manner interfere with or derogate from Executive's work for the Company.

4.2 Non-solicitation.

(a) Executive agrees that during Executive's employment and for a period of two (2) years after the termination of this Agreement for any reason, in the United States or any other equivalent geographical subdivision in foreign jurisdictions in which the Company does business, Executive shall not, in competition with the Company or any subsidiary or affiliates:

(i) directly call upon or solicit any of the customers of the Company or any subsidiary that were or became customers during the term of Executive's employment (as used herein "customer" shall mean any person or company as listed as such on the books of the Company or any affiliates); or

(ii) induce or attempt to induce any employee, agent, or consultant of the Company or any subsidiary or affiliates to terminate his or her association with the Company or any subsidiary or affiliates.

(b) The Company and Executive agree that the provisions of this Section 4.2 contain restrictions that are not greater than necessary to protect the interests of the Company. In the event of the breach or threatened breach by Executive of this Section 4.2, the Company, in addition to all other remedies available to it at law or in equity, will be entitled to seek injunctive relief and/or specific performance to enforce this Section 4.2.

ARTICLE V. MISCELLANEOUS PROVISIONS

5.1 General Release. Any other provision of this Agreement notwithstanding, Section 3.2(b)(ii)-(iv) above shall not apply unless Executive has executed a general release of all known and unknown claims that Executive may then have against the Company or persons affiliated with the Company and has expressly agreed in writing not to prosecute any legal action or other proceeding based on any of such claims.

5.2 Confidential Proprietary Information and Inventions Assignment Agreement. Concurrent with execution of this Agreement, Executive acknowledges receipt of an executed copy of the Company's standard Confidential Information and Inventions Assignment Agreement, signed by Executive on May 28, 2005, which shall be incorporated herein.

5.3 Fees and Expenses. The Company shall pay all legal fees and related expenses for counsel incurred by Executive as a result of preparation of and negotiation of the terms of Executive's employment.

5.4 Irrevocable Arbitration of Disputes.

(a) You and the Company agree that any dispute, controversy or claim arising hereunder or in any way related to your employment or termination of employment with the Company or this Agreement, its interpretation, enforceability, or applicability, that cannot be resolved by mutual agreement of the parties (the "arbitrable claims") shall be submitted to binding arbitration. The parties agree that arbitration is the parties' only recourse for such claims and hereby waive the right to pursue such claims in any other forum, unless otherwise provided by law. Any court action involving a dispute which is not subject to arbitration shall be stayed pending arbitration of arbitrable disputes.

(b) You and the Company agree that the arbitrator shall have the authority to issue provisional relief. You and the Company further agree that each has the right, pursuant to California Code of Civil Procedure section 1281.8, to apply to a court for a provisional remedy in connection with an arbitrable dispute so as to prevent the arbitration from being rendered ineffective.

(c) Any demand for arbitration shall be in writing and must be communicated to the other party prior to the expiration of the applicable statute of limitations.

(d) The arbitration shall be administered by JAMS pursuant to its Employment Arbitration Rules and Procedures. The arbitration shall be conducted in San Diego by a former or retired judge or attorney with at least 10 years experience in employment-related disputes, or a non-attorney with like experience in the area of dispute, who shall have the power to hear motions, control discovery, conduct hearings and otherwise do all that is necessary to resolve the matter. The parties must mutually agree on the arbitrator. If the parties cannot agree on the arbitrator after their best efforts, an arbitrator will be selected from JAMS pursuant to its Employment Arbitration Rules and Procedures. The Company shall pay the costs of the arbitrator's fees.

(e) The arbitration will be decided upon a written decision of the arbitrator stating the essential findings and conclusions upon which the award is based. The arbitrator shall have the authority to award damages, if any, to the extent that they are available under applicable law(s). The arbitration award shall be final and binding, and may be entered as a judgment in any court having competent jurisdiction. Either party may seek review pursuant to California Code of Civil Procedure section 1286, et seq.

(f) It is expressly understood that the parties have chosen arbitration to avoid the burdens, costs and publicity of a court proceeding, and the arbitrator is expected to handle all aspects of the matter, including discovery and any hearings, in such a way as to minimize the expense, time, burden and publicity of the process, while assuring a fair and just result. In

particular, the parties expect that the arbitrator will limit discovery by controlling the amount of discovery that may be taken (e.g., the number of depositions or interrogatories) and by restricting the scope of discovery only to those matters clearly relevant to the dispute. However, at a minimum, each party will be entitled to at least one (1) deposition and shall have access to essential documents and witnesses as determined by the arbitrator.

(g) The provisions of this Section shall survive the expiration or termination of the Agreement, and shall be binding upon the parties.

THE PARTIES HAVE READ SECTION 5.4 AND IRREVOCABLY AGREE TO ARBITRATE ANY DISPUTE IDENTIFIED ABOVE.

/s/ TS *(Executive)* /s/ GGP *(Company)]*

5.5 Settlement of Claims. The Company's obligation to make the payments provided for in this Agreement and otherwise to perform its obligations hereunder shall not be affected by any circumstances, including, without limitation, any set-off, counterclaim, recoupment, defense or other right which the Company may have against the Executive or others.

5.6 Legal Representatives. Upon the death or disability of Executive, any payments due under this Agreement shall be paid to Executive's legal representatives.

5.7 Notices. Any notice or other communication given hereunder or in connection herewith shall be sufficiently given if in writing and (a) sent by certified mail or overnight courier, postage or delivery costs prepaid and return receipt requested, (b) sent by facsimile transmission, or (c) delivered personally, to the parties hereto at the following addresses or to such addresses as the parties may from time to time provide in accordance herewith:

If to the Company:
Energy Recovery Inc.
l908 Doolittle Drive
San Leandro, CA 94577
Fax: (5l0) 483-7371
Attention: MariaElena Ross

If to Executive:
Terrill Sandlin
2928 Von Doolen CT
Pinole, CA 94564
Tel: 5l0-758-5722

Such notice shall be deemed given on the date on which personally served or, if by mail, on the fifth (5th) day after being being posted or on the date of actual receipt, whichever is earlier, or if by facsimile transaction with confirmation of receipt, one (1) business day after the time sent or the time of actual receipt, whichever is earlier.

5.8 Compliance with Section 409A of the Code. It is the intent of this Agreement that no payment to the Executive shall result in nonqualified deferred compensation within the

meaning of Section 409A of the Code. However, in the event that all, or a portion, of the payments set forth in this Agreement meet the definition of nonqualified deferred compensation, the Company intends that such payments be made in a manner that complies with Section 409A of the Code. The Company reserves the right, to the extent the Company deems necessary or advisable in its sole discretion, to unilaterally amend or modify this Agreement as may be necessary to ensure all benefits provided under this Agreement are made in a manner that qualifies for exemption from or complies with Section 409A of the Code, provided, however, that the Company makes no representations that the benefits provided under this Agreement will be exempt from Section 409A of the Code and makes no undertakings to preclude Section 409A of the Code from applying to the benefits provided under this Agreement.

5.9 Severability. If any term, provision, covenant, or condition of this Agreement is held to be invalid, void, or unenforceable, the remainder of the provisions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated thereby.

5.10 Survival. Sections 4.2, 5.2, and 5.4 shall survive the termination of this Agreement.

5.11 Entire Agreement; Employment Amendments; Waiver. This Agreement, together with all stock option agreements and/or stock repurchase agreements and any other equity grants, and the Confidential Proprietary Information and Inventions Assignment Agreement is the entire agreement between the parties hereto concerning the subject matter hereof and supersedes and replaces all prior or contemporaneous agreements or understandings between the parties. This Agreement may not be amended or modified in any manner, except by an instrument in writing signed by the Executive and the Company or as otherwise provided in Section 5.8. Failure of either party to enforce any of the provisions of this Agreement or any rights with respect thereto or failure to exercise any election provided for herein shall in no way be considered to be a waiver of such provisions, rights, or in any way effect the validity of this Agreement. The failure of either party to exercise any of said provisions, rights, or elections shall not preclude or prejudice such party from later enforcing or exercising the same or other provisions, rights, or elections which it may have under this Agreement.

5.12 Governing Law. This Agreement shall be governed by and construed in all respects in accordance with the laws of the State of California. With the exception of "arbitrable claims" as defined in 5.4, the federal courts and/or state courts of the State of California, County of Alameda shall have exclusive jurisdiction to adjudicate any dispute arising out of this Agreement and/or employment relationship or termination thereof and Executive consents to such jurisdiction and venue.

5.13 Attorneys' Fees. In the event of any action for the breach of this Agreement, the prevailing party shall be entitled to reasonable attorneys' fees, costs, and expenses incurred in connection with such action.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the day and year first above written.

"Executive"	"Company"
By: /s/ Terrill Sandlin	By: /s/ G.G. Pique
Title: VP of Manufacturing	Title: President

Exhibit 10.10.1

AMENDMENT TO EXECUTIVE EMPLOYEE AGREEMENT DATED

February 25, 2008

This AMENDMENT TO THE EXECUTIVE EMPLOYMENT AGREEMENT dated**July 1, 2006** ("Amendment") is made as of **July 1, 2008** ("Amendment Effective Date") by and between Energy Recovery Inc., a Delaware corporation, with its principal offices at 1908 Doolittle Drive, San Leandro, CA 94577 (the "Company") and **Terrill Sandlin,** an individual (the "Executive") (together, the "Parties").

Pursuant to Article 5.11 of the Executive Employment Agreement, the Parties hereby amend that Agreement as follows:

Article 1.2. The Parties amend and replace Article 1.2 to read as follows:

Term. The term of Executive's employment is hereby extended through December 31, 2008. Thereafter, the Executive Employment Agreement, as amended, shall automatically terminate and Executive's employment with the Company will become "at will." "At will" employment means that either the Company or Executive may terminate Executive's employment at any time with or without cause and with or without notice. Such at-will employment cannot be changed except by a writing signed by the Executive and a duly authorized executive or Board member of the Company.

Article 2.1(a). The Parties amend and replace Article 2.1(a) to read as follows:

Base Salary. Effective as of January 1, 2008, Executive's base salary will be $11,916.67 per month ($143,000 per annum), less any deductions required by law, which shall continue to be paid in accordance with the Company's normal and customary payroll practices, but no less frequently than monthly. The Executive's base salary shall be reviewed annually and may be reasonably adjusted in the sole discretion of the Company.

Article 2.1(b). The Parties amend and replace Article 2.1(b) to read as follows:

Annual Bonus.

(i) The Executive shall be eligible to participate in the Company's annual bonus program and shall be eligible to earn an annual bonus in an amount not to exceed one (1) times Executive's base salary. If the Executive is eligible to earn an annual cash bonus, the exact amount of the Executive's annual cash bonus, if any, shall be determined by the Company pursuant to the attainment of performance goals as set forth in the attached performance matrix prepared by the Company.

(ii) Notwithstanding Article 2. l(b)(i) to the contrary, however, in the event that the scheduled IPO is not consummated through no fault of the Executive, as determined by the Board (with the recusal by the Executive from such Board determination, as necessary) in good faith, although the Executive may not be eligible to receive any annual cash bonus in 2008, all of the Executive's stock options granted under Executive's 2006 Equity Compensation Grant pursuant to Article 2.1(c) of Executive's Executive Employment Agreement shall immediately and fully vest effective as of December 31, 2008.

Article 3.1(a)(iv). The Parties amend and replace Article 3.1(a)(iv) to read as follows:

Executive's violation of the Company's Code of Conduct, if any, and as amended from time to time, confidentiality obligations to the Company or misappropriation of Company assets; or

Article 3.2(e)(i)(D). The Parties amend and replace Article 3.2(e)(i)(D) to read as follows:

any material reduction, limitation or failure to pay or provide any of the compensation provided to the Executive under Article 2.1 of this Agreement or any other agreement or understanding between the Executive and the Company, or pursuant to the Company's policies and past practices, as of the date immediately prior to the Change in Control; or

Article 3.2(e)(ii). The Parties add Article 3.2(e)(ii){E) as follows:

"Change in Control," as defined above, shall not in any instance be construed to include the Company's IPO or any event occurring in connection with or as a result of the Company's IPO.

All other terms contained in the Executive Employment Agreement shall continue in full force and effect.

WITNESS, the execution of this Amendment as of the date first above written.

"Executive"

By: /s/ Terrill Sandlin
Terrill Sandlin

"Company"

Energy Recovery Inc.

By: /s/ G.G. Pique
Title: **President and CEO**

TO: Terry Sandlin
FROM: GG Pique
DATE: March 3, 2008
SUBJECT: 2008 Performance Bonus

ERI will pay a maximum of 30% of base salary at the end of the year for exceeding the following performance objectives:

1) Work with Production team to improve morale

2) Get San Leandro plant and vendor structure ready to ship $60M in 2008

3) Implement formal disaster contingency plan. Work with City officials.

4) Harden IT security

The actual amount payable will be based on a subjective appraisal of each performance objective per the following rating schedule:

100%	Exceeded objective
75%	Met objective
50%	Met objective late or incompletely
25%	Substantially initiated effort to meet objective
0%	Did not meet objective

/s/ G.G. Pique
G.G. Pique Date

/s/ Terry Sandlin 3/12/08
Terry Sandlin Date

Exhibit 10.11

EXECUTIVE EMPLOYEE AGREEMENT

This EXECUTIVE EMPLOYEE AGREEMENT (the "Agreement") is made and entered into as of July 1, 2006, by and between Energy Recovery Inc., a Delaware corporation, with its principal offices at 1908 Doolittle Drive, San Leandro, CA 94577 (the "Company"), and Maria Elena Ross, an individual (the "Executive").

RECITALS

A. WHEREAS, the Company is in the business of designing and manufacturing energy recovery devices.

B. WHEREAS, Executive has been serving as Corporate HR Director of ERI (ERI HR Director) of the Company, and the Company desires to continue its relationship with Executive as its Corporate HR Director, and Executive desires to provide his services to the Company on all of the terms and conditions herein set forth.

C. WHEREAS, The Company desires to provide Executive with a compensation plan in recognition of Executive's valuable skills and services.

NOW, THEREFORE, in consideration of the mutual covenants and conditions herein contained, the parties hereto agree as follows:

ARTICLE I. EMPLOYMENT

1.1 Employment. The Company hereby employs Executive as its Corporate HR Director, and Executive hereby accepts such engagements with the Company, in accordance with and subject to all of the terms, conditions, and covenants set forth in this Agreement.

1.2 Term. The terms of this Agreement shall commence on the date that this Agreement is fully executed (the "Effective Date")and, unless terminated earlier in accordance with the terms of Article IV hereof, shall continue for a period of two years ending 24 calendar months from the Effective Date (the "Term of Agreement). The Agreement, thereafter, shall automatically terminate and Executive's employment with the Company will become "at will." "At will" employment means that the either the Company or Executive may terminate Executive's employment with or without cause and with or without notice.

1.3 Scope of Executive's Duties. Executive shall be the Corporate HR Director of the Company, reporting to the President and CEO of the Company (CEO). Executive shall have such duties, responsibilities and authority as shall be consistent with that position and will operate within such established guidelines, plans, or policies as may be established or approved by the CEO and the company Board of Directors from time to time.

ARTICLE II. COMPENSATION AND BENEFITS

2.1 Compensation.

(a) Base Salary. Executive shall be paid a base salary of $10,833 per month ($130,000 per annum), less any deductions required by law, which shall be paid in accordance with the Company's normal and customary payroll practices, but no less frequently than monthly. The Executive's base salary shall be reviewed annually and may be reasonably adjusted in the sole discretion of the Company.

(b) Annual Bonus. The Executive shall be eligible to participate in the Company's annual bonus program and shall be eligible to earn an annual bonus in an amount not to exceed (1) times his base salary. The exact amount of the Executive's annual bonus, if any, shall be determined by the Company pursuant to the attainment of performance goals as set forth in the matrix.

(c) Equity Compensation. Contingent on the Executive's Continued employment on the date of grant, Company intends to grant the Executive stock options to purchase an additional thirty thousand (30,000) shares of the Company's Common Stock, to be arranged under, and subject to the terms of, Company's 2006 Equity Compensation Plan or, at the discretion of the Company, any such subsequent equity compensation plan that may be adopted, as well as the terms and conditions of the stock option agreement (which will be provided to the Executive as soon as practicable after the grant date). Any additional terms governing the options (i.e., vesting, conditions to exercise, etc.) shall be set forth in the applicable option agreement. The foregoing is not intended to preclude the Company, in its discretion, from making any additional awards of stock options or other types of equity compensation to the Executive.

2.2 Reimbursable Expenses. Upon submission of expense reports to the extent necessary to substantiate the Company's federal income tax deductions for such expenses under the Internal Revenue Code of 1986 (as amended) and the Regulations thereunder (the "Code") and subject to such expense report approval procedures as may be established by the Board, the Company shall reimburse Executive for all reasonable business expenses incurred and submitted in the performance of his duties hereunder on behalf of the Company.

2.3 Fringe Benefits.

(a) Executive and Executive's dependents shall be permitted to participate in all group health, medical, hospital, dental, prescription, vision, long-term disability and other insurance plans which the Company establish for its executive employees and such other employee benefits or plans as the Company may establish for its employees generally, and which may be modified from time to time. Upon implementation of the Company's new executive life insurance program, the Executive shall receive, if insurable under usual underwriting standards, term life insurance coverage on the Executive's life, payable to whomever the Executive directs, in an amount equal to one (1) time the Executive's base salary, subject to any cap imposed by the insurer, provided that Executive completes the required statement and application and that Executive's physical condition does not prevent Executive from qualifying for such insurance under reasonable terms and conditions. In the interim, the Company shall reimburse the Executive's monthly premium for such coverage during the term of this agreement, Executive shall be eligible to participate in any tax-qualified retirement plan sponsored by the Company, equity compensation plan, or deferred compensation plan, if any, pursuant

to the terms of such plans, as the same may be modified from time to time, to the extent such plans are offered to other officers of employees of the Company.

2.4 Vacations. Executive shall earn annual vacations in accordance with the Company's standard policy. Once the Executive has accrued the maximum of two (2) times the accrual rate cap applicable to the Executive as set forth in the standard policy, Executive shall be ineligible to earn further vacation until Executive has used vacation, at which time Executive may begin to accrue vacation again.

2.5 Taxes. The Executive acknowledges that he is responsible for all taxes relating to his Compensation and except for those taxes for which the Company is obligated to pay under applicable law or regulation, Executive agrees that the Company may withhold from Executive's cash compensations any amounts that the Company is required to withhold by law or regulation.

ARTICLE III. TERMINATION AND COMPENSATION UPON TERMINATION

3.1 Termination will be deemed to occur as follows:

(a) Termination for Good Cause by the Company.The Company may terminate this Agreement immediately for "Good Cause" upon written notice to Executive, the date of which shall specify the effective date of the termination. For purposes of this Agreement, "Good Cause" shall mean:

(i) Executive's performance of any act for which, if Executive were prosecuted, would constitute a felony or misdemeanor;

(ii) Executive's failure to carry out Executive's material duties;

(iii) Executive's dishonesty towards or fraud upon the Company which is injurious to the Company;

(iv) Executive's violation of confidentiality obligations to the Company or misappropriation of Company assets; or

(v) Executive's death or inability to carry out Executive's duties with reasonable accommodation, if any, unless prohibited by law.

(b) Voluntary Termination by the Executive. The Executive may terminate this Agreement at any time by providing the Company with thirty (30) days written notice. The effective date of the termination shall be the date specified in the notice. In the event of such a termination, the parties agree to act in good faith towards one another during any notice period.

(c) Notice of Termination. Any termination by the Company for Good Cause or by Executive shall be communicated by Notice of Termination to the other party hereto. For purposes of this Agreement, a "Notice of Termination" shall mean a written notice which shall indicate the specific termination provision in this Agreement relied upon, and shall set forth in reasonable detail the facts and circumstances claimed to provide a basis of termination of Executive's employment under the provision so indicated.

3.2 Compensation Upon Termination. Upon termination of this Agreement by either party, Executive shall be entitled to receive the following payments:

(a) Termination By the Company for Good Cause. Upon termination of this Agreement for "Good Cause" as defined under the provisions of Section 3.l(a) above, Executive shall be paid, in a lump sum, any and all base salary due and owing through the date of termination, plus an amount equal to earned but unused vacation through the date of termination and reimbursement of all reasonable expenses, plus any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the Executive's termination occurs. No pay continuance or other benefits will be provided.

(b) Termination By the Company Without Good Cause. Upon termination of this Agreement by the Company without "Good Cause" as defined under the provisions of Section 3.1(a) above, Executive shall be entitled to the following severance benefits:

(i) payment, in a lump sum, of any and all base salary due and owing to him through the date of termination, plus an amount equal to his earned but unused vacation through the date of termination, reimbursement for all reasonable expenses and any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the Executive's termination occurs; and

(ii) subject to the provisions of Section 5.1 below, payment, in a lump sum of an amount equal to fifty percent (50%) of Executive's current annual base salary, less deductions required by law.

(iii) immediate vesting of all unvested equity compensation held by the Executive as of the date of termination.

(iv) if the Executive (including, if applicable, the Executive's spouse and dependents) timely elects to continue Executive's medical, dental, and vision benefits under COBRA then, contingent upon the Executive paying his portion of the monthly COBRA premium, the Company shall pay its share of the monthly premium (if any) under COBRA to the same extent it pays for coverage for an active employee until the earliest of (a) the end of the twelve (12) month period that commences with the Executive's termination of employment or (b) the Executive becomes eligible for group medical, dental, and vision coverage through another employer. As a condition of the Company paying a pro rata portion of the monthly premium for a portion of the Executive's continuation coverage period the Executive will be required to notify the Company upon becoming eligible for group medical, dental and vision benefits from another employer during such twelve (12) month period. At the end of any Company-paid period of COBRA coverage, the Executive may, at his own expense, continue COBRA coverage for the remainder of the period for which the Executive is eligible.

The payments provided for in Section 3.2(a) or 3.2(b)(i) and (ii) or 3.2(d), as applicable, shall be paid on the date immediately following the Executive's termination. All such payments will be subject to applicable payroll or other taxes required to be withheld by the Company. However, in the event it is determined that the Executive is a "Specified Employee" as defined in Section 409A(a)(2)(B)(i) of the Code any payment to be made under this Agreement that is "nonqualified

deferred compensation" subject to Section 409A of the Code shall be delayed for six months following the Executive's termination of employment.

(c) Payments to Executive hereunder shall be considered severance pay in consideration of past service and continued service after the date of this Agreement and Executive shall not be required to mitigate the amount of any payment provided for in this Section 3.2 by seeking alternative employment or otherwise, and, with the exception of COBRA payments, the amount of any payment provided for in this Section 3.2 shall not be reduced by any compensation earned by Executive as the result of employment by another employer after the date of termination, or otherwise.

(d) Voluntary Termination by Executive. If Executive voluntarily resigns or terminates this Agreement, Executive shall be paid, in a lump sum, any and all base salary due and owing to him through the date of termination and an amount equal to his earned but unused vacation through the date of termination, plus any earned but unpaid and undeferred bonus attributable to the year that ends immediately before the year in which the Executive's termination occurs. Executive, his family, or his estate shall be entitled to other benefits to the extent permitted by law, contract, or the terms of any benefit plan or program.

(e) Termination Pursuant to a Change of Control. If upon or at any time during the Term of Agreement there is a "Termination Event", as defined below, that occurs within one (1) year following a "Change in Control", as defined below, Executive shall be treated as if Executive had been terminated by the Company Without Good Cause pursuant to Section 3.2(b) and in addition to the severance benefits described therein shall be entitled to receive an additional Change in Control amount equal to fifty percent (50%) of the Executive's current annual base salary. The Change in Control amount shall be paid at the same time and in the same manner as the Executive's severance payments pursuant to Section 3.2(b)(ii).

(i) A Termination Event shall mean the occurrence of any one or more of the following, but shall not include Executive's termination due to death or disability:

A. the termination or material breach of this Agreement by the Company;

B. the failure by the Company to obtain the assumption of this Agreement by any successor to the Company or any assignee of all or substantially all of the Company's assets;

C. any material diminishment in the title, position, duties, responsibility or status that the Executive had with the Company immediately prior to the Change in Control;

D. any reduction, limitation or failure to pay or provide any of the compensation provided to the Executive under Section 2.1 of this Agreement or any other agreement or understanding between the Executive and the Company, or pursuant to the Company's policies and past practices, as of the date immediately prior to the Change in Control; or

E. any requirement that the Executive relocate more than 30 miles from his place of employment as of the date immediately prior to the Change in Control.

(ii) Change in Control shall mean any of the following, occurring during the term of the Executive's employment or employment relationship with the Company:

A. an acquisition by an individual, an entity or a group (excluding the Company, an employee benefit plan of the Company, or a corporation controlled Company's shareholders) of fifty percent (50%) or more of the Company's then-outstading common stock or voting securities;

B. a change in composition of the Board occurring within a rolling twelve-month period, as a result of which fewer than a majority of the director are Incumbent Directors ("Incumbent Directors" shall mean directors who either (x) are member of the Board as of the Executive Date or (y) are elected, or nominated for election, to the Board with the affirmative votes of at least a majority of the Incumbent Directors at the time of such election or nomination, but shall not include an individual not otherwise an Incumbent Director whose election or nomination is in connection with an actual or threatened proxy contest (relating to the election of directors to the Board));

C. consummation of a complete liquidation or dissolution of the Company, or a merger, consolidation or sale of all or substantially all of the Company's then-existing assets (collectively, a "Business Combination"), other than a Business Combination (x) in which the stockholders of the Company immediately prior to the Business Combination receive fifty percent (50%) or more of the voting stock resulting from the Business Combination, (y) at least a majority of the board of directors of the corporation resulting from the Business Combination were Incumbent Directors and (z) after which no individual, entity or group (excluding any corporation resulting from the Business Combination or any employee benefit plan of such corporation or if the Company owns fifty percent (50%) or more of the stock of the corporation resulting from the Business Combination who did not own such stock immediately before the Business Combination; or

E. Change in the ownership of a substantial portion of a Company's assets. A change in the ownership of a substantial portion of the Company's assets occurs on the date that any individual or group of individuals acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such individual or group of individuals) assets from the Company that have a total gross fair market value equal to or more than forty percent (40%) of the total gross fair market value of all of the assets of the Company immediately prior to such acquisition or acquisitions. For this purpose, gross fair market value means the value of the assets of the Company, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets.

(iii) To the extent that any or all of the payments and benefits provided for in this Agreement, either alone or in conjunction with other compensatory payments, would give rise to a "parachute payment " under Sections 280G and 4999 of the Code (collectively, the "Parachute Rules"):

A. If the Company so requests at a time when the Company's securities,are not "readily tradable" (as defined in the Parachute Rules), the Company shall be

permitted to solicit a shareholder vote or written consent to approve the parachute payment in order to avoid characterization as a parachute payment under the Parachute Rules. In that event, the Executive agrees, to the extent required by the Parachute Rules then in effect and without further consent documentation, to waive and cancel all rights or parachute payments in connection with the Change of Control to the extent that shareholder approval is not obtained in accordance with the Parachute Rules.

B. Unless shareholder approval has avoided application of the Parachute Rules, the Company shall reduce and cancel, and the Executive hereby waives, the parachute payment to the minimum extent necessary to equal one dollar less than the amount which would result in any compensatory payments being subject to the excise tax imposed by Section 4999 of the Code and such that the Executive receives only the amount of such payment which would not constitute an "excess parachute payment" under the Parachute Rules.

C. Notwithstanding clauses A and B above,the Executive may elect not to subject a payment or benefit to stockholder approval and to insted receive either (i) the full amount of any parachute payment or (ii) 2.99 times the Executive's " base amount" (as such term is defined under the Parachute Rules), whichever of the foregoing amounts (after taking into account any applicable federal, state and local income taxes and the excise tax imposed by Section 4999 of the Code) results in the receipt by the Executive, on an after - tax basis, of the greater payment provided that (a) the acquiring person in the Change of Control,in its sole discretion does not object thereto and does not impose on the Company or its shareholder any added cost, price reduction, or other detriment therefrom (economic or otherwise as determined in the Company's sole discretion), and (b) the Executive deposits at least three (3) business days prior to consummation of the Change of Control with a party designated by the Company a cash sum sufficient the discretion of the Company to fund all withholding payments that may arise in connection with the Executive's parachute payments from any source.

D. In no event shall the Company be required to gross up any payment or benefit to the Executive to avoid the effects of the Parachute Rules or to pay any regular or excise taxes arising therefrom. Unless the Company and the Executive otherwise agree in writing, any parachute payment calculation shall be made in writing by independent pubic accounts agreed to by the Company and the Executive, whose calculations shall be conclusive and binding upon the Company and the Executive for all purposes. The Company and the Executive shall furnish to the accountants such information and documents as the accountants may reasonably request in order to make a parachute payment determination.

ARTICLE IV. NONCOMPETITION AND NONSOLICITATION

4.1 Noncompetition During Employment. Executive agrees that, during the term hereof, Executive will devote his full productive time and best efforts to the performance of his duties hereunder pursunt to the supervision and direction of the Company's Board of Directors or its designee. Executive further agrees, as a condition to the performance by the Company of each and all of its obligations hereunder, that so long as Executive is employed by the Company, Executive will not directly or indirectly render services of any nature to otherwise become employed by or otherwise participate or engage in any other business without the Company's prior written consent. Nothing herein contained shall be deemed to preclude Executive from having outside personal investments and involvement with appropriate community and charitable activities, or from devoting a reasonable

amount of time to such matters, provided that this shall in no manner interfere with or derogate from Executive's work for the Company.

4.2 Non-solicitation.

(a) Executive agrees that during Executive's employment and for a period of two (2) years after the termination of this Agreement for any reason, in the United States or any other equivalent geographical subdivision in foreign jurisdictions in which the Company does business Executive shall not, in competition with the Company or any subsidiary or affiliates:

(i) directly call upon or solicit any of the customers of the company or any subsidiary that were or became customers during the term of Executive's employment (as used herein "customer" shall mean any person or company as listed as such on the books of the Company or any affiliates); or

(ii) induce or attempt to induce any employee, agent,or consultant of the Company or any subsidiary or affiliates to terminate his or her association with the Company or any subsidiary or affiliates.

(b) The Company and Executive agree that the provisions of this Section 4.2 contain restrictions that are not greater than necessary to protect the interests of the Company. In the event of the breach or threatened breach by Executive of this Section 4.2, the Company, in addition to all other remedies available to it at law or in equity,will be entitled to seek injunctive relief and/or specific performance to enforce this Section 4.2.

ARTICLE V. MISCELLANEOUS PROVISIONS

5.1 General Release. Any other provision of this Agreement notwithstanding, Section 3.2(b)(ii)-(iv) above shall not apply unless Executive has executed a general release of all known and unknown claims that Executive may then have against the Company or persons affiliated with the Company and has expressly agreed in writing not to prosecute any legal action or other proceeding based on any of such claims.

5.2 Confidential Proprietary Information and Inventions Assignment Agreement.Concurrent with execution of this Agreement, Executive acknowledges receipt of an executed copy of the Company's standard Confidential Information and Inventions Assignment_Agreement, signed by Executive on May 19,2005,which shall be incorporated herein.

5.3 Fees and Expenses. The Company shall pay all legal fees and related expenses for counsel incurred by Executive as a result of preparation of and negotiation of the terms of Executive's employment.

5.4 Irrevocable Arbitration of Disputes.

(a) You and the Company agree that any dispute, controversy or claim arising hereunder or in any way related to your employment or termination of employment with the Company or this Agreement, its interpretation, enforceability, or applicability, that cannot be resolved by mutual

agreement of the parties (the "arbitrable claims") shall be submitted to binding arbitration. The parties agree that arbitration is the parties' only recourse for such claims and hereby waive the right to pursue such claims in any other forum, unless otherwise provided by law. Any court action involving a dispute which is not subject to arbitration shall be stayed pending arbitration of arbitrable disputes.

(b) You and the Company agree that the arbitrator shall have the authority to issue provisional relief. You and the Company further agree that each has the right, pursuant to California Code of Civil Procedure section 1281.8, to apply to a court for a provisional remedy in connection with an arbitrable dispute so as to prevent the arbitration from being rendered ineffective.

(c) Any demand for arbitration shall be in writing and must be communicated to the other party prior to the expiration of the applicable statute of limitations.

(d) The arbitration shall be administered by JAMS pursuant to its Employment Arbitration Rules and Procedures. The arbitration shall be conducted in San Diego by a former or retired judge or attorney with at least 10 years experience in employment — related disputes, or a non-attorney with like experience in the area of dispute, who shall have the power to hear motions, control discovery, conduct hearings and otherwise do all that is necessary to resolve the matter. The parties must mutually agree on the arbitrator. If the parties cannot agree on the arbitrator after their best efforts, an arbitrator will be selected from JAMS pursuant to its Epmployment Arbitration Rules and Procedures, The Company shall pay the costs of the arbitrator's fees.

(e) The arbitration will be decided upon a written decision of the arbitrator stating the essential findings and conclusions upon which the award is based. The arbitrator shall have the authority to award damages, if any, to the extent that they are available under applicable law(s). The arbitration award shall be final and binding, and may be entered as a judgment in any court having competent jurisdiction. Either party may seek review pursuant to California Code of Civil Procedure section 1286, et seq.

(f) It is expressly understood that the parties have chosen arbitration to avoid the burdens, costs and publicity of a court proceeding, and the arbitrator is expected to handle all aspects of the matter, including discovery and any hearings, in such a way as to minimize the expense, time, burden and publicity of the process, while assuring a fair and just result. In particular, the parties expect that the arbitrator will limit discovery by controlling the amount of discovery that may be taken (e.g., the number of depositions or interrogatories) and by restricting the scope of discovery only to those matters clearly relevent to the dispute. However, at a minimum, each party will be entitled to at least one (1) deposition and shall have access to essential documents and witnesses as determined by the arbitrator.

(g) The provisions of this Section shall survive the expiration or termination of the Agreement, and shall be binding upon the parties.

THE PARTIES HAVE READ SECTION 5.4 AND IRREVOCABLY AGREE TO ARBITRATE ANY DISPUTE IDENTIFIED ABOVE.

/s/ M E Ross *(Executive)* /s/ GGP *Company)]*

5.5 Settlement of Claims. The Company's obligation to make the payments provided for in this Agreement and otherwise to perform its obligations hereunder shall not be affected by any circumstances, including, without limitation, any set-off, counterclaim, recoupment, defense or other right which the Company may have against the Executive or others.

5.6 Legal Representatives. Upon the death or disability of Executive, any payments due under this Agreement shall be paid to Executive's legal representatives.

5.7 Notices. Any notice or other communication given here under or in connection herewith shall be sufficiently given if in writing and (a) sent by certified mail or overnight courier, postage or delivery costs prepaid and return receipt requested, (b) sent by facsimile transmission, or (c) delivered personally, to the parties hereto at the following addresses or to such addresses as the parties may from time to time provide in accordance herewith:

If to the Company:

Energy Recovery Inc.
1908 Doolittle Drive
San Leandro, CA 94577
Fax: (510) 483-7371
Attention: Gonzalo G Pique

If to Executive:

Maria Elena Ross
141 Cavendish Court
Brentwood, CA 94513
925-513 7558

Such notice shall be deemed givin on the date on which personally served or, if by mail on the fifth (5th) day after being posted on the date of actual receipt, whichever is earlier, or if by facsimile transaction with confirmation of receipt, one (1) business day after the time sent or the time of actual receipt, whichever is earlier.

5.8 Compliance with Section 409A of the Code. It is the intent of this Agreement that no payment to the Executive shall result in nonqualified deferred compensation within the meaning of Section 409A of the Code. However, in the event that all, or a portion, of the payments set forth in this Agreement meet the definition of nonqualified deferred compensation, the Company intends that such payments be made in a manner that complies with Section 409A of the Code. The Company reserves the right, to the extent the Company deems necessary or advisable in its sole discretion, to unilaterally amend or modify this Agreement as may be necessary to ensure all benefits provided under this Agreement are made in a manner that qualifies for exemption from or complies with Section 409A of

the Code, provided, however, that the Company makes no representations that the benefits provided under this Agreement will be exempt from Section 409A of the Code and makes no undertakings to preclude Section 409A of the Code from applying to the benefits provided under this Agreement.

5.9 Severability. If any term, provision, covenant, or condition of this Agreement is held to be invalid, void, or unenforceable, the remainder of the provisions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated thereby.

5.10 Survival. Sections 4.2, 5.2, and 5.4 shall survive the termination of this Agreement.

5.11 Entire Agreement; Employment Amendments; Waiver. This Agreement, together with all stock option agreements and/or stock repurchase agreements and any other equity grants, and the Confidential Proprietary Information and Inventions Assignment Agreement agreement between the parties hereto concerning the subject matter hereof and supersedes and replaces all prior or contemporaneous agreements or understandings between the parties This agreement may not be amended or modified in any manner, except by an instrument in writing signed by the Executive and the Company or as otherwise provided in Section 5.8. Failure of either party to enforce any of the provisions of this Agreement or any rights with respect thereto or failure to exercise any election provided for herein shall in no way be considered to be a waiver of such provisions, rights, or elections or in any way effect the validity of this Agreement. The failure of either party to exercise any of said provisions, rights, or elections shall not preclude or prejudice such party from later enforcing or exercising the same or other provisions, rights, or elections which it may have under this Agreement.

5.12 Governing Law. This Agreement shall be governed by and construed in all respects in accordance with the laws of the State of California. With the exception of "arbitrable claims" as defined in Section 5.4, the federal courts and/ or state courts of the State of California, County of Alameda shall have exclusive jurisdiction to adjudicate any dispute arising out of this Agreement and/or employment relationship or termination thereof and Executive consents to such jurisdiction and venue

5.13 Attorneys' Fees. In the event of any action for the breach of this Agreement, the prevailing party shall be entitled to reasonable attorneys' fees, costs, and expenses incurred in connection with such action.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the day and year first above written.

"Executive"		"Company"	
By:	/s/ MariaElena Ross	By:	/s/ G.G. Pique
Title:	Executive Director, HR	Title:	President

Exhibit 10.11.1

AMENDMENT TO EXECUTIVE EMPLOYEE AGREEMENT DATED

February 25, 2008

This AMENDMENT TO THE EXECUTIVE EMPLOYMENT AGREEMENT dated **July 1, 2006** ("Amendment") is made as of **July 1, 2008** ("Amendment Effective Date") by and between Energy Recovery Inc., a Delaware corporation, with its principal offices at 1908 Doolittle Drive, San Leandro, CA 94577 (the "Company") and **MariaElena Ross,** an individual (the "Executive") (together, the "Parties").

Pursuant to Article 5.11 of the Executive Employment Agreement, the Parties hereby amend that Agreement as follows:

Article 1.2. The Parties amend and replace Article 1.2 to read as follows:

Term. The term of Executive's employment is hereby extended through December 31, 2008. Thereafter, the Executive Employment Agreement, as amended, shall automatically terminate and Executive's employment with the Company will become "at will." "At will" employment means that either the Company or Executive may terminate Executive's employment at any time with or without cause and with or without notice. Such at-will employment cannot be changed except by a writing signed by the Executive and a duly authorized executive or Board member of the Company.

Article 2.1(a). The Parties amend and replace Article 2.1(a) to read as follows:

Base Salary. Effective as of January 1, 2008, Executive's base salary will be $12,083.34 per month ($145,000 per annum), less any deductions required by law, which shall continue to be paid in accordance with the Company's normal and customary payroll practices, but no less frequently than monthly. The Executive's base salary shall be reviewed annually and may be reasonably adjusted in the sole discretion of the Company.

Article 2.1(b). The Parties amend and replace Article 2.1 (b) to read as follows:

Annual Bonus.

(i) The Executive shall be eligible to participate in the Company's annual bonus program and shall be eligible to earn an annual bonus in an amount not to exceed one (1) times Executive's base salary. If the Executive is eligible to earn an annual cash bonus, the exact amount of the Executive's annual cash bonus, if any, shall be determined by the Company pursuant to the attainment of performance goals as set forth in the attached performance matrix prepared by the Company.

(ii) Notwithstanding Article 2. l(b)(i) to the contrary, however, in the event that the scheduled IPO is not consummated through no fault of the Executive, as determined by the Board (with the recusal by the Executive from such Board determination, as necessary) in good faith, although the Executive may not be eligible to receive any annual cash bonus in 2008, all of the Executive's stock options granted under Executive's 2006 Equity Compensation Grant pursuant to Article 2.1(c) of Executive's Executive Employment Agreement shall immediately and fully vest effective as of December 31, 2008,

Article 3.1(a)(iv). The Parties amend and replace Article 3.1(a)(iv) to read as follows:

Executive's violation of the Company's Code of Conduct, if any, and as amended from time to time, confidentiality obligations to the Company or misappropriation of Company assets; or

Article 3.2(e)(i)(D). The Parties amend and replace Article 3.2(e)(i)(D) to read as follows:

any material reduction, limitation or failure to pay or provide any of the compensation provided to the Executive under Article 2.1 of this Agreement or any other agreement or understanding between the Executive and the Company, or pursuant to the Company's policies and past practices, as of the date immediately prior to the Change in Control; or

Article 3.2(e)(ii). The Parties add Article 3.2(e)(ii)(E) as follows:

"Change in Control," as defined above, shall not in any instance be construed to include the Company's IPO or any event occurring in connection with or as a result of the Company's IPO.

All other terms contained in the Executive Employment Agreement shall continue in full force and effect.

WITNESS, the execution of this Amendment as of the date first above written.

"Executive"

By: /s/ MariaElena Ross 3/4/08
MariaElena Ross

"Company"

Energy Recovery Inc.

By: /s/ G.G. Pique
Title: **President and CEO**

TO: MariaElena Ross
FROM: GG Pique
DATE: March 3, 2008
SUBJECT: 2008 Performance Bonus

ERI will pay a maximum of 30% of base salary at the end of the year for exceeding the following performance objectives:

1) Hire Sr. HR person to delegate HR administrative function

2) Establish long-term incentive program for retention

3) Up-graded benefits program

4) Employee training seminars on taxes, IPO, stock, estate planning, etc.

The actual amount payable will be based on a subjective appraisal of each performance objective per the following rating schedule:

100%	Exceeded objective
75%	Met objective
50%	Met objective late or incompletely
25%	Substantially initiated effort to meet objective
0%	Did not meet objective

/s/ G.G. Pique
G.G. Pique Date

/s/ MariaElena Ross 3/4/08
MariaElena Ross Date

Exhibit 10.12

INDEPENDENT CONTRACTOR AGREEMENT

This Independent Contractor Agreement ("Agreement") is entered into as of January 23, 2008, by and between Darby Engineering, LLC ("Independent Contractor") and Energy Recovery, Inc., a Delaware corporation ("Company").

1. Position. Company agrees to engage Contractor as an independent contractor to provide engineering consulting services ("Services") for the Company identified on the attached Appendix A. Contractor will furnish at Contractor's sole expense, all applicable licenses and permits required to perform the Services.

2. Term and Termination. This Agreement will become effective as of January 23, 2008 and shall continue for an initial minimum period of twelve (12) months after that date, and thereafter on a month-to-month basis.

This Agreement may be terminated by Company at any time for cause effective immediately upon notice of termination from Company. Upon termination for cause, Contractor shall be entitled to receive only accrued but unpaid compensation as of the date of termination for authorized Services of its Employee actually performed as of that date. For purposes of this Agreement, "termination for cause" shall include, but not be limited to: (a) material violation of this Agreement not cured within thirty (30) days after written notice of the breach from Company; (b) any act of Contractor or the Employee exposing Company to liability to others for personal injury or property damage; or (c) automatically on the occurrence of any of the following: (i) bankruptcy or insolvency of Contractor, (ii) any attempted assignment of this Agreement by Contractor, or (iii) the death or permanent and total disability of the Employee.

This Agreement may be terminated by Contractor by providing thirty days written notice. Said notice shall be properly addressed and delivered to the Company in accordance with the provisions of Section 12 of this Agreement. Contractor will insure that all property belonging to the Company will be returned by the effective date of termination. In addition, Contractor will insure that all invoices for services performed prior to the date of termination will be submitted no later than thirty days from the termination effective date.

3. Compensation. In consideration for Services to be rendered by Contractor, and provided that Contractor performs all of its obligations hereunder, Company shall pay Contractor pursuant to the terms set forth in the attached Appendix B. Except for the compensation specified in this Agreement, Contractor shall receive no other compensation or reimbursement of any nature from Company, with respect to the services to be provided under this Agreement by Employee, and specifically shall not receive medical, life or other insurance, workers' compensation, vacation, sick days or holiday benefits, or any other benefits. If any local, state or federal or other governmental license, excise or other taxes are imposed on any sums due Contractor, Company is authorized, if so required, to withhold or deduct such taxes applicable or proportionate to the sums otherwise due Contractor.

4. No Reimbursement. Contractor will not be reimbursed for any expenses, whether or not reasonable and necessary, incurred in the rendering of services under this Agreement, unless the Company has approved such expenses in writing in advance.

5. Contractor's Responsibilities.

(a) Contractor shall not have the power to enter into contracts on behalf of Company, nor shall Contractor represent that it has such power.

(b) Contractor will determine the method, details, and means of performing the Services and may at its own expense, employ such agents or employees as it deems necessary to perform the Services. Company may not control, direct, or supervise Contractor's agents or employees in the performance of the Services and it shall not be liable for any expenses or costs relating to Contractor's agents or employees unless Company has agreed in writing, prior to the time such expenses or costs are incurred, to reimburse Contractor for such expenses.

(c) Contractor agrees to accept exclusive liability for the payment of any and all payroll taxes, self-employment taxes, and social security and other contributions that are based on the compensation paid to Contractor hereunder or on the wages, salaries, or other remuneration paid to the agents or employees of Contractor, if any. Contractor shall reimburse and indemnify and defend Company for and against any such taxes or contributions that Company may be compelled to pay.

(d) Contractor may select its own specific time or period of time to perform the Services.

(e) Contractor agrees to act in a manner that will not detrimentally affect the operation or reputation of Company while performing the Services pursuant to this Agreement. Company will not provide Contractor with any training as to the methods or techniques to be used by Contractor in performing Services, and Company shall have no control as to the manner and means, techniques or methods by which Contractor accomplishes the Services.

(f) Contractor and Employee acknowledge that the Company will continually develop Confidential Information, that the Employee may develop Confidential Information for the Company and that the Employee may learn of Confidential Information during the course of employment under this engagement. Each of Contractor and the Employee agrees that, except as required for the proper performance of their respective duties for the Company, they will not, directly or indirectly, use or disclose any Confidential Information, as defined below. The Employee understands and agrees that this restriction will continue to apply after his employment terminates, regardless of the reason for termination. The term "Confidential Information" shall mean any and all confidential and/or proprietary knowledge, data or information of the Company. By way of illustration but not limitation, "Proprietary Information" includes (i) trade secrets, inventions (including computer programs and any upgrades thereto), mask works, ideas, processes, formulas, source and object codes, data, programs, other works of authorship, know-how, improvements, discoveries, developments, designs and techniques whether in draft, preliminary or final form; and (ii) information regarding plans for research, development, new products, marketing and selling, business plans, budgets and unpublished financial statements, licenses, prices and costs, suppliers and customers; and (c) information regarding the skills and compensation of other employees of the Company.

(g) Contractor agrees that all Confidential Information which it creates or to which it has access as a result of its engagement is and shall remain the sole and exclusive property of the Company. Except as required for the proper performance of their respective duties, neither the

Contractor nor the Employee will copy any documents, discs, tapes or other media containing Confidential Information ("Documents"). Each will return to the Company immediately after this engagement terminates, and at such other times as may be specified by the Company, all Documents and copies of Confidential Information and all other property of the Company then in their respective possession or control, including, but not limited to, computers, mobile telephones, facsimile machines, and paging and other communications devices.

(h) The parties agree that the damages to Company caused by breach of this Agreement by either Contractor or Employee are impracticable of ascertainment, and that Company's remedy at law would therefore be inadequate; consequently, the obligations of each of Contractor and the Employee hereunder may be specifically enforced by injunction or other equitable remedies. The existence of a claim of any nature by either of them against Company shall not constitute a defense to the enforcement by Company of this Agreement.

6. Independent Contractor Status. The Services rendered pursuant to this Agreement are for a specified price for a specified result, and Contractor is under the control of Company as to the result of the Services only, and not as to the means by which such result is accomplished. Contractor acknowledges that it is an independent contractor and that:

(a) Company is under no obligation to Contractor to maintain public, professional, product or other liability insurance to covet risks, if any, to Contractor.

(b) Contractor is excluded from the benefits of any workers' compensation insurance maintained by Company. To the extent desired by Contractor, adequate levels of medical and disability insurance coverage should be maintained by Contractor to provide benefits in the event that Contractor or its personnel sustain injuries while performing Services pursuant to this Agreement. Contractor is excluded from receiving any unemployment and disability insurance benefits through Company.

(c) Company shall not make deductions from the compensation of Contractor for any foreign, federal or state income tax withholding, Federal Insurance Contribution Act, state disability funds, or Federal Unemployment Tax Act

(d) Contractor is excluded from coverage of any foreign, state and/or federal labor laws that regulate the payment of wages, included but not limited to, minimum wage and overtime provisions.

7. Outside Activities. During the term of this Agreement, Contractor is free to offer its services to the general public. This Agreement is not intended to create an exclusive contractual relationship between Contractor and Company.

8. Cooperation After Notice of Termination of Agreement. Following any notice of termination of this Agreement or the expiration of this Agreement pursuant to Section 2 above, Contractor shall cooperate with Company in all matters relating to the winding up of its pending work on behalf of Company and the orderly transfer of any such pending work to such other persons as may be designated by Company prior to termination.

9. Assignment. The rights and obligations of Company under this Agreement shall inure to the benefit of and shall be binding upon the successors and assigns of Company. The rights and

obligations of Contractor are personal in nature and may not be assigned without Company's prior written consent, which may be withheld in the absolute discretion of Company.

10. Arbitration —Damages —Governing Law. Any dispute, claim or controversy arising out of or related to this Agreement, except with respect to a claim for equitable relief, shall be resolved by arbitration in San Francisco, California, USA, under the Commercial Rules and auspices of the American Arbitration Association , San Francisco Regional Office (the "Association"). Any such arbitration shall be conducted by a panel of three arbitrators, one nominated by each of Company, on the one hand, and all other parties, on the other hand, within 15 days after confirmation of notice of filing of the demand is sent by the Association, and the third, who shall be an attorney at law admitted to practice in California, and who shall be selected by the Association from its Commercial Panel of Arbitrators in accordance with Rule R-15 of the Commercial Rules of the Association. THE ARBITRATORS SHALL HAVE NO POWER TO AWARD, NOR SHALL ANY PARTY HAVE ANY RIGHT TO, ANY PUNITIVE, SPECIAL OR CONSEQUENTIAL DAMAGES, SUCH AS, BUT NOT LIMITED TO, LOSS OF USE OR LOST PROFITS, EVEN IF SUCH PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES. The award of the arbitrators shall be in writing and shall be in accord with applicable law and shall be binding and conclusive on all parties, and an award based thereon may be entered in any court of competent jurisdiction. All costs, (including without limitation arbitrators' fees and reasonable attorneys' fees) of the prevailing party (or parties) shall be borne by the losing party; or in the event of a partial award for a party hereto, such costs shall be awarded in proportion to such partial award as determined by the arbitrators. Furthermore, in any action with respect to a claim for equitable relief, or for any provisional remedy pending arbitration, or for confirmation of the awards of the arbitrators following arbitration, the prevailing party shall be entitled to recover its costs and reasonable attorneys' fees. Notwithstanding the foregoing, nothing in this Section 10 shall be construed to preclude either party from seeking provisional remedies, including, without limitation, temporary restraining orders and preliminary injunctions, from any court of competent jurisdiction, in order to protect its rights under this Agreement pending arbitration (provided that no such provisional remedies shall be sought as a means to avoid arbitration. This Agreement shall be construed in accordance with the laws of the State of California, USA, applying to contracts made and to be performed in California, USA.

11. Entire Agreement. This Agreement and its attached appendices constitute the entire Agreement between the parties respecting the provision of Services on behalf of Contractor to Company, and there are no other representations, warranties or commitments concerning such subject matter. This Agreement supersedes all prior or contemporaneous agreements, commitments, representations, writings, and discussions with respect to the subject matter of this Agreement between Contractor and Company, whether oral or written. This Agreement may be amended only by an instrument in writing executed by each party. CONTRACTOR AND EMPLOYEE EXPRESSLY ACKNOWLEDGE THAT THEY HAVE READ THE TERMS OF THIS AGREEMENT AND HAVE HAD THE OPPORTUNITY TO DISCUSS THOSE TERMS WITH CONTRACTOR'S COUNSEL.

12. Notices. Any notice, request, demand or other communication hereunder shall be in writing and shall be deemed to be duly given when personally delivered by hand or facsimile transmission to any officer of Company or to Contractor, as the case may be, transmitted or addressed as provided beneath each party's signature to this Agreement (or such other address as either party may designate by written notice to the other party in accordance with this Section 12).

13. Section Headings. Section and other headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement.

14. Savings Clause. Should any valid and applicable foreign, federal or state law or final determination of any administrative agency or court of competent jurisdiction affect any provision of this Agreement, the provision or provisions so affected shall be automatically conformed to the law or determination and otherwise this Agreement shall continue in full force and effect.

15. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original.

16. Number and Gender. As used in this Agreement, the singular number shall include the plural, and the masculine gender shall include the feminine and neuter, and vice versa, as the context requires.

17. Language. This Agreement is written in the English language. If it is translated into any other language, the provisions of the English language version shall prevail over those of any translation.

IN WITNESS WHEREOF, Company and Contractor have executed this Agreement as of the day and year first hereinabove set forth.

Contractor:

Darby Engineering, LLC

By: /s/ C. Peter Darby
Print Name C. Peter Darby
Title: Managing Member

1421 Glenwood Drive

Gardnerville, NV 89460

FAX: 775-265-1023

Company:

Energy Recovery, Inc.

By: /s/ Rick Stover
Print Name Rick Stover
Title: CTO

Address: 1908 Doolittle Drive

San Leandro, California 94577 USA

Fax: 510-483-7371

Contractor's Employee Information if Different from above: (as to Sections 5, 10 and 11 only):

Name: _____ Telephone: _____

Address: _____ Mobil Phone: _____

_____ Fax: _____

APPENDIX A

DESCRIPTION OF SERVICES TO BE PERFORMED

Consulting engineering and project management services on various projects specified from time to time by the Company and generally described as product and business development projects.

APPENDIX B

Payment of Fees for Services

The Company and Contractor mutually commit to providing a minimum of eight days of work per month.

Billing and payment shall be monthly in an amount equal to the sum total of the amount due for each day worked in the month, or in the case of partial days worked, day equivalents based on ten hours per day, according to the following schedule:

1. For each day worked at Darby Engineering LLC office:	$1,000
2. For each day worked at ERI, San Leandro:	$1,200 plus reimbursement of
	* out-of-pocket expenses for transportation only
3. For each day worked away from Contractor's office and ERI:	$1,200 plus reimbursement of all normal and customary
	* out-of-pocket travel expenses

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* Expenses out of scope of assigned projects

Where service is requested by the Company for a client, Contractor will be provided a request in writing with a description of services to be performed as well as payment method.

Where service is contracted independently by a third party approved by Company, Contractor shall bill the third-party client directly unless instructed otherwise in writing.

Expenses that are outside the scope of this agreement shall be reimbursed to the Contractor by Company upon presentation of original receipts. Expenses for airfare will be “economy” rate; hotels must be at 3-star hotels if possible.

STANDARD INDUSTRIAL/COMMERCIAL
MULTI-TENANT LEASE — GROSS
AMERICAN INDUSTRIAL REAL ESTATE ASSOCIATION

1. Basic Provisions (**"Basic Provisions"**).

1.1 **Parties:** This Lease (**"Lease"**), dated for reference purposes only February 28, 2005, is made by and between 2101 Williams Associates, LLC, a California Limited Liability Company (**"Lessor"**) and Energy Recovery, Inc., a Delaware Corporation (ERI) (**"Lessee"**), (collectively the **"Parties"**, or individually a **"Party"**).

1.2(a) **Premises:** That certain portion of the Project (as defined below), including all improvements therein or to be provided by Lessor under the terms of this Lease, commonly known by the street address of 1908 Doolittle Drive, located in the City of San Leandro, County of Alameda, State of California, with zip code 94577, as outlined on Exhibit A attached hereto ("**Premises**") and generally described as (describe briefly the nature of the Premises): that certain approx. 22,182 s.f. light industrial space incl. 8,017 s.f. offices and 14,165 s.f. warehouse & mfg. as shown in red, being a portion of that larger multi-tenant project. See also Para. 50.

In addition to Lessee's rights to use and occupy the Premises as hereinafter specified, Lessee shall have non-exclusive rights to the Common Areas (as defined in Paragraph 2.7 below) as hereinafter specified, but shall not have any rights to the roof, exterior walls or utility raceways of the building containing the Premises ("**Building**") or to any other buildings in the Project. The Premises, the Building, the Common Areas, the land upon which they are located, along with all other buildings and improvements thereon, are herein collectively referred to as the "**Project**." (See also Paragraph 2.)

1.2(b) **Parking:** See par. 59 ~~unreserved vehicle parking spaces ("Unreserved Parking Spaces"); and _____ reserved vehicle parking spaces ("Reserved Parking Spaces").~~ (See also Paragraph 2.6.)

1.3 **Term:** Five (5) years and -0- months ("**Original Term**") commencing May 1, 2005 (**"Commencement Date"**) and ending April 30, 2010 (**"Expiration Date"**). (See also Paragraph 3.) & 51.

1.4 **Early Possession:** See par. 51. (**"Early Possession Date"**). (See also Paragraphs 3.2 and 3.3.)

1.5 **Base Rent:** $17,300.00 per month ("**Base Rent**"), payable on the First day of each month commencing May 1, 2005. (See also Paragraph 4.) & Par 51.

☑ If this box is checked, there are provisions in this Lease for the Base Rent to be adjusted.

1.6 **Lessee's Share of Common Area Operating Expenses:** seventy-seven & 20/100 percent (77.20%) ("Lessee's Share").

1.7 **Base Rent and Other Monies Paid Upon Execution:**

(a) **Base Rent: $** _____ for the period _____.

(b) **Common Area Operating Expenses: $** _____ for the period _____.

(c) **Security Deposit: $**34,600 ("**Security Deposit**"). (See also Paragraph 5.) & Par. 53.

(d) **Other: $** _____ for _____.

(e) **Total Due Upon Execution of this Lease: $**_____.

1.8 **Agreed Use:** General commercial & light manufacturing with related office use. (See also Paragraph 6.)

1.9 **Insuring Party.** Lessor is the **"Insuring Party"**. (See also Paragraph 8.)

1.10 **Real Estate Brokers:** (See also Paragraph 15.)

(a) **Representation:** The following real estate brokers (the **"Brokers"**) and brokerage relationships exist in this transaction (check applicable boxes):

☑ Donald L. Jones Company represents Lessor exclusively **("Lessor's Broker")**;

☐ _____ represents Lessee exclusively **("Lessee's Broker")**; or

☐ _____ represents both Lessor and Lessee (**"Dual Agency"**).

(b) **Payment to Brokers:** Upon execution and delivery of this Lease by both Parties, Lessor shall pay to the Brokers the brokerage fee agreed to in a separate written agreement ~~(or if there is no such agreement, the sum of _____or _____% of the total Base Rent for the brokerage services rendered by the Brokers.~~)See Par. 56.

1.11 **Guarantor.** The obligations of the Lessee under this Lease are to be guaranteed by See Par. 53.**("Guarantor")**. (See also Paragraph 37.)

1.12 **Addenda and Exhibits.** Attached hereto is an Addendum or Addenda consisting of Paragraphs 50 through 65 and Exhibit A through D, all of which constitute a part of this Lease.

2. **Premises.**

2.1 **Letting**. Lessor hereby leases to Lessee, and Lessee hereby leases from Lessor, the Premises, for the term, at the rental, and upon all of the terms, covenants and conditions set forth in this Lease. Unless otherwise provided herein, any statement of size set forth in this Lease, or that may have been used in calculating Rent, is an approximation which the Parties agree is reasonable and any payments based thereon are not subject to revision whether or not the actual size is more or less,

2.2 **Condition**. Lessor shall deliver that portion of the Premises contained within the Building **("Unit")** to Lessee broom clean and free of debris on the Commencement Date or the Early Possession Date, whichever first occurs (**"Start Date"**), and, so long as the required service contracts described in Paragraph 7.1(b) below are obtained by Lessee and in effect within thirty days following the Start Date, warrants that the existing electrical, plumbing, fire sprinkler, lighting, heating, ventilating and air conditioning systems (**"HVAC"**), loading doors, if any, and all other such elements in the Unit other than those constructed by Lessee, shall be in good operating condition on said date and that the structural elements of the roof, bearing walls and foundation of the Unit shall be free of material defects. If a non-compliance with such warranty exists as of the Start Date, or if one of such systems or elements should malfunction or fall within the appropriate warranty period, Lessor shall, as Lessor's sole obligation with respect to such matter, except as otherwise provided in this Lease, promptly alter receipt of written notice from Lessee setting forth with specificity the nature and extent of such non-compliance, malfunction or failure, rectify same at Lesso's expense. The warranty periods shall be as follows: (i) 6 months as to the HVAC systems, and (ii) 30 days as to the remaining systems and other elements of the Unit. If Lessee does not give Lessor the required notice within the appropriate warranty period, correction of any such non-compliance, malfunction or failure shall be the obligation of Lessee at Lessee's sole cost and expense (except for

/s/

the repairs to the fire sprinkler systems, roof, foundations, and/or bearing walls — see Paragraph 7). See also Paragraph 51.

2.3 **Compliance.** Lessor warrants that the improvements on the Premises and the Common Areas comply with the building codes that were in effect at the time that each such improvement, or portion thereof, was constructed, and also with all applicable laws, covenants or restrictions of record, and ordinances in effect on the Start Date **("Applicable Requirements").** Said warranty does not apply to the use to which Lessee will put the Premises or to any Alterations or Utility Installations (as defined in Paragraph 7.3(a).) made or to be made by Lessee. **NOTE: Lessee is responsible for determining whether or not the zoning is appropriate for Lessee's intended use, and acknowledges that past uses of the Premises may no longer be allowed.** If the Premises do not comply with said warranty, Lessor shall, except as otherwise provided, promptly after receipt of written notice from Lessee setting forth with specificity the nature and extent of such non-compliance, rectify the same at Lessor's expense. If Lessee does not give Lessor written notice of a non-compliance with this warranty within 6 months following the Start Date, correction of that non-compliance shall be the obligation of Lessee at Lessee's sole cost and expense. If the Applicable Requirements are hereafter changed so as to require during the term of this Lease the construction of an addition to or an alteration of the Unit, Premises and/or Building, the remediation of any Hazardous Substance, or the reinforcement or other physical modification of the Unit, Premises and/or Building (**"Capital Expenditure"**), Lessor and Lessee shall allocate the cost of such work as follows:

(a) Subject to Paragraph 2.3(c) below, if such Capital Expenditures are required as a result of the specific and unique use of the Premises by Lessee as compared with uses by tenants in general, Lessee shall be fully responsible for the cost thereof, provided, however, that if such Capital Expenditure is required during the last 2 years of this Lease and the cost thereof exceeds 6 months' Base Rent, Lessee may instead terminate this Lease unless Lessor notifies Lessee, in writing, within 10 days after receipt of Lessee's termination notice that Lessor has elected to pay the difference between the actual cost thereof and the amount equal to 6 months' Base Rent. If Lessee elects termination, Lessee shall immediately cease the use of the Premises which requires such Capital Expenditure and deliver to Lessor written notice specifying a termination date at least 90 days thereafter. Such termination date shall, however, in no event be earlier than the last day that Lessee could legally utilize the Premises without commencing such Capital Expenditure.

(b) If such Capital Expenditure is not the result of the specific and unique use of the Premises by Lessee (such as, governmentally mandated seismic modifications), then Lessor and Lessee shall allocate the obligation to pay for the portion of such costs reasonably attributable to the Premises pursuant to the formula set out in Paragraph 7.1(d); provided, however, that if such Capital Expenditure is required during the last 2 years of this Lease or if Lessor reasonably determines that it is not economically feasible to pay its share thereof, Lessor shall have the option to terminate this Lease upon 90 days prior written notice to Lessee unless Lessee notifies Lessor, in writing, within 10 days after receipt of Lessor's termination notice that Lessee will pay for such Capital Expenditure. If Lessor does not elect to terminate, and falls to tender its share of any such Capital Expenditure, Lessee may advance such funds and deduct same, with interest, from Rent until Lessor's share of such costs have been fully paid. If Lessee is unable to finance Lessor's share, or if the balance of the Rent due and payable for the remainder of this Lease is not sufficient to fully reimburse Lessee on an offset basis, Lessee shall have the right to terminate this Lease upon 30 days written notice to Lessor.

(c) Notwithstanding the above, the provisions concerning Capital Expenditures are intended to apply only to non-voluntary, unexpected, and new Applicable Requirements. If the Capital Expenditures are instead triggered by Lessee as a result of an actual or proposed change in use, change in intensity of use, or modification to the Premises then, and in that event, Lessee shall be fully responsible for the cost thereof, and Lessee shall not have any right to terminate this Lease.

2.4 **Acknowledgements.** Lessee acknowledges that: (a) it has been advised by Lessor and/or Brokers to satisfy itself with respect to the condition of the Premises (including but not limited to the electrical, HVAC and fire sprinkler systems, security, environmental aspects, and compliance with Applicable Requirements and the Americans with Disabilities Act), and their suitability for Lessee's intended use, (b) Lessee has made such investigation as it deems necessary with reference to such matters and assumes all responsibility therefor as the same relate to its occupancy of the Premises, and (c) neither Lessor, Lessor's agents, nor Brokers have made any oral or written representations or warranties with respect to said matters other than as set forth in this Lease. In addition, Lessor acknowledges that: (i) Brokers have made no representations, promises or warranties concerning Lessee's ability to honor the Lease or suitability to occupy the Premises, and (ii) it is Lessor's sole responsibility to investigate the financial capability and/or suitability of all proposed tenants.

2.5 **Lessee as Prior Owner/Occupant.** The warranties made by Lessor in Paragraph 2 shall be of no force or effect if immediately prior to the Start Date Lessee was the owner or occupant of the Premises. In such event, Lessee shall be responsible for any necessary corrective work.

2.6 **Vehicle Parking.** Lessee shall be entitled to use the number of Unreserved Parking Spaces and Reserved Parking Spaces specified in Paragraph 1.2(b) on those portions of the Common Areas designated from time to time by Lessor for parking. Lessee shall not use more parking spaces than said number. Said parking spaces shall be used for parking by vehicles no larger than full-size passenger automobiles or pick-up trucks, herein called **"Permitted Size Vehicles."** Lessor may regulate the loading and unloading of vehicles by adopting Rules and Regulations as provided in Paragraph 2.9. No vehicles other than Permitted Size Vehicles may be parked in the Common Area without the prior written permission of Lessor.

(a) Lessee shall not permit or allow any vehicles that belong to or are controlled by Lessee or Lessee's employees, suppliers, shippers, customers, contractors or invitees to be loaded, unloaded, or parked in areas other than those designated by Lessor for such activities.

(b) Lessee shall not service or store any vehicles in the Common Areas.

(c) If Lessee permits or allows any of the prohibited activities described in this Paragraph 2.6, then Lessor shall have the right, without notice, in addition to such other rights and remedies that it may have, to remove or tow away the vehicle involved and charge the cost to Lessee, which cost shall be immediately payable upon demand by Lessor.

2.7 **Common Areas — Definition**. The term **"Common Areas"** is defined as all areas and facilities outside the Premises and within the exterior boundary line of the Project and interior utility raceways and installations within the Unit that are provided and designated by the Lessor from time to time for the general non-exclusive use of Lessor, Lessee and other tenants of the Project and their respective employees, suppliers, shippers, customers, contractors and invitees, including parking areas, loading and unloading areas, trash areas, roadways, walkways, driveways and landscaped areas.

2.8 **Common Areas — Lessee's Rights**. Lessor grants to Lessee, for the benefit of Lessee and its employees, suppliers, shippers, contractors, customers and invitees, during the term of this Lease, the non-exclusive right to use, in common with others entitled to such use, the Common Areas as they exist from time to time, subject to any rights, powers, and privileges reserved by Lessor under the terms hereof or under the terms of any rules and regulations or restrictions governing the use of the Project. Under no circumstances shall the right herein granted to use the Common Areas be deemed to include the right to store any property, temporarily or permanently, in the Common Areas. Any such storage shall be permitted only by the prior written consent of Lessor or Lessor's designated agent, which consent may be revoked at any time. In the event that any unauthorized storage shall occur, then Lessor shall have the right, without notice, in addition to such other rights and remedies that it may have, to remove the property and charge the cost to Lessee, which cost shall be immediately payable upon demand by Lessor.

2.9 **Common Areas — Rules and Regulations**. Lessor or such other person(s) as Lessor may appoint shall have the exclusive control and management of the Common Areas and shall have the right, from time to time, to establish, modify, amend and enforce reasonable rules and regulations (**"Rules and Regulations"**) for the management, safety, care, and cleanliness of the grounds, the parking and unloading of vehicles and the preservation of good order, as well as for the convenience of other occupants or tenants of the Building and the Project and their invitees. Lessee agrees to abide by and conform to all such Rules and Regulations, and to cause its employees, suppliers, shippers, customers, contractors and invitees to so abide and conform. Lessor shall not be responsible to Lessee for the non-compliance with said Rules and Regulations by other tenants of the Project.

2.10 **Common Areas — Changes**. Lessor shall have the right, in Lessor's sole discretion, from time to time:

(a) To make changes to the Common Areas, including, without limitation, changes in the location, size, shape and number of driveways, entrances, parking spaces, parking areas, loading and unloading areas, ingress, egress, direction of traffic, landscaped areas, walkways and utility raceways;

(b) To close temporarily any of the Common Areas for maintenance purposes so long as reasonable access to the Premises remains available;

(c) To designate other land outside the boundaries of the Project to be a part of the Common Areas;

(d) To add additional buildings and improvements to the Common Areas;

(e) To use the Common Areas while engaged in making additional improvements, repairs or alterations to the Project, or any portion thereof;

(f) To do and perform such other acts and make such other changes in, to or with respect to the Common Areas and Project as Lessor may, in the exercise of sound business judgment, deem to be appropriate.

3. **Term.**

3.1 **Term.** The Commencement Date, Expiration Date and Original Term of this Lease are as specified in Paragraph 1.3.

3.2 **Early Possession.** If Lessee totally or partially occupies the Premises prior to the Commencement Date, the obligation to pay Base Rent shall be abated for the period of such early possession. All other terms of this Lease (including but not limited to the obligations to pay Lessee's Share of Common Area Operating Expenses, Real Property Taxes and insurance premiums and to maintain the Premises) shall, however, be in effect during such period. Any such early possession shall not affect the Expiration Date.

3.3 **Delay in Possession.** Lessor agrees to use its best commercially reasonable efforts to deliver possession of the Premises to Lessee by the Commencement Date. If, despite said efforts, Lessor is unable to deliver possession as agreed, Lessor shall not be subject to any liability therefore, nor shall such failure affect the validity of this Lease. Lessee shall not, however, be obligated to pay Rent or perform its other obligations until it receives possession of the Premises. ~~If possession is not delivered within 60 days after the Commencement Date, Lessee may, at its option, by notice in writing within 10 days after the end of such 60 day period, cancel this lease, in which event the Parties shall be discharged from all obligations hereunder. If such written notice is not received by Lessor within said 10 day period, Lessee's right to cancel shall terminate. Except as otherwise provided, if possession is not tendered to Lessee by the Start Date and Lessee does not terminate this Lease, as aforesaid, any period of rent abatement that Lessee would otherwise have enjoyed shall run from the date of delivery of possession and continue for a period equal to what Lessee would otherwise have enjoyed under the terms~~

~~hereof, but minus any days of delay caused by the acts or omissions of Lessee. If possession of the premises is not delivered within 4 months after the Commencement Date, this Lease shall terminate unless other agreements are reached between Lessor and Lessee, in writing.~~

3.4 **Lessee Compliance.** Lessor shall not be required to tender possession of the Premises to Lessee until Lessee compiles with its obligation to provide evidence of insurance (Paragraph 8.5). Pending delivery of such evidence, Lessee shall be required to perform all of its obligations under this Lease from and after the Start Date, including the payment of Rent, notwithstanding Lessor's election to withhold possession pending receipt of such evidence of insurance. Further, if Lessee is required to perform any other conditions prior to or concurrent with the Start Date, the Start Date shall occur but Lessor may elect to withhold possession until such conditions are satisfied.

4. **Rent.**

4.1. **Rent Defined.** All monetary obligations of Lessee to Lessor under the terms of this Lease (except for the Security Deposit) are deemed to be rent ("Rent").

4.2 **Common Area Operating Expenses.** Lessee shall pay to Lessor during the term hereof, in addition to the Base Rent, Lessee's Share (as specified in Paragraph 1.6.) of all Common Area Operating Expenses, as hereinafter defined, during each calendar year of the term of this Lease, in accordance with the following provisions:

(a) **"Common Area Operating Expenses"** are defined, for purposes of this Lease, as all costs incurred by Lessor relating to the ownership and operation of the Project, including, but not limited to, the following:

(i) The operation, repair and maintenance, in neat, clean, good order and condition, but not the replacement (see subparagraph (e)), of the following:

(aa) The Common Areas and Common Area Improvements, including parking areas, loading and unloading areas, trash areas, roadways, parkways, walkways, driveways, landscaped areas, bumpers, irrigation systems, Common Area lighting facilities, fences and gates, elevators, ~~roofs, and roof drainage systems.~~

(bb) Exterior signs and any tenant directories.

(cc) Any fire sprinkler systems.

(ii) The cost of water, gas, electricity and telephone to service the Common Areas and any utilities not separately metered.

(iii) Trash disposal, pest control services, ~~property management~~, security services, and the costs of any environmental inspections.

(iv) Reserves set aside for maintenance and repair of Common Areas.

(v) Any increase above the Base Real Property Taxes (as defined in Paragraph 10).

(vi) Any "Insurance Cost Increase" (as defined in Paragraph 8).

(vii) Any deductible portion of an insured loss concerning the Building or the Common Areas.

(viii) The cost of any Capital Expenditure to the Building or the Project not covered under the provisions of Paragraph 2.3 provided; however, that Lessor shall allocate the cost of any such Capital Expenditure over a 12 year period and Lessee shall not be required to pay more than Lessee's Share of 1/144th of the cost of such Capital Expenditure in any given month.

(ix) Any other services to be provided by Lessor that are stated elsewhere in this Lease to be a Common Area Operating Expense.

(b) Any Common Area Operating Expenses and Real Property Taxes that are specifically attributable to the Unit, the building or to any other building in the Project or to the operation, repair and maintenance thereof, shall be allocated entirely to such Unit, Building, or other building. However, any Common Area Operating Expenses and Real Property Taxes that are not specifically attributable to the Building or to any other building or to the operation, repair and maintenance thereof, shall be equitably allocated by Lessor to all buildings in the Project.

(c) The inclusion of the improvements, facilities and services set forth in Subparagraph 4.2(a) shall not be deemed to impose an obligation upon Lessor to either have said improvements or facilities or to provide those services unless the Project already has the same, Lessor already provides the services, or Lessor has agreed elsewhere in this Lease to provide the same or some of them.

(d) Lessee's Share of Common Area Operating Expenses shall be payable by Lessee within 10 days after a reasonably detailed statement of actual expenses is presented to Lessee. At Lessor's option, however, an amount may be estimated by Lessor from time to time of Lessee's Share of annual Common Area Operating Expenses and the same shall be payable monthly or quarterly, as Lessor shall designate, during, each 12 month period of the Lease term, on the same day as the Base Rent is due hereunder. Lessor shall deliver to Lessee within 60 days after the expiration of each calendar year a reasonably detailed statement showing Lessee's Share of the actual Common Area Operating Expenses incurred during the preceding year. If Lessee's payments under this Paragraph 4.2(d) during the preceding year exceed Lessee's Share as indicated on such statement, Lessor shall credit the amount of such over-payment against Lessee's Share of Common Area Operating Expenses next becoming due. If Lessee's payments under this Paragraph 4.2(d) during the preceding year were less than Lessee's Share as indicated on such statement, Lessee shall pay to Lessor the amount of the deficiency within 10 days after delivery by Lessor to Lessee of the statement.

(e) When a capital component such as the roof, foundations, exterior walls or a Common Area capital improvement, such as the parking lot paving, elevators, fences, etc. requires replacement, rather than repair or maintenance, Lessor shall, at Lessor's expense, be responsible for such replacement. Such expenses and/or costs are not Common Area Operating Expenses.

4.3 **Payment**. Lessee shall cause payment of Rent to be received by Lessor in lawful money of the United States, without offset or deduction (except as specifically permitted in this Lease), on or before the day on which it is due. Rent for any period during the term hereof which is for less than one full calendar month shall be prorated based upon the actual number of days of said month. Payment of Rent shall be made to Lessor at its address stated herein or to such other persons or place as Lessor may from time to time designate in writing. Acceptance of a payment which is less than the amount then due shall not be a waiver of Lessor's rights to the balance of such Rent, regardless of Lessor's endorsement of any check so stating. In the event that any check, draft, or other instrument of payment given by Lessee to Lessor is dishonored for any reason, Lessee agrees to pay to Lessor the sum of $25.

5. **Security Deposit**. Lessee shall deposit with Lessor upon execution hereof the Security Deposit as security for Lessee's faithful performance of its obligations under this Lease. If Lessee fails to pay Rent, or otherwise Defaults under this Lease, Lessor may use, apply or retain all or any portion of said Security Deposit for the payment of any amount due Lessor or to reimburse or compensate Lessor for any liability, expense, loss or damage which Lessor may suffer or incur by reason thereof. If Lessor uses or applies all or any portion of the Security Deposit, Lessee shall within 10 days after written request therefore deposit monies with Lessor sufficient to restore said Security Deposit to the full amount required by this Lease. ~~If the Base Rent increases during the term of this Lease, Lessee shall, upon written request from Lesser, deposit additional monies with Lesser so that the total amount of the Security Deposit shall at all times bear the same proportion to the increased Base Rent as the initial Security Deposit bore to the initial Base Rent.~~ Should the Agreed Use be amended to accommodate a material change in the business of Lessee or to accommodate a sublessee or assignee, Lessor shall have the right to increase the Security Deposit to the extent necessary, in Lessor's reasonable judgment, to account for any increased wear and tear that the Premises may suffer as a result thereof. If a change in control of Lessee occurs during this Lease and following such change the financial condition of Lessee is, in Lessor's reasonable judgment, significantly reduced, Lessee shall deposit such additional monies with Lessor as shall be sufficient to cause the Security Deposit to be at a commercially reasonable level based on such change in financial condition. Lessor shall not be required to keep the Security Deposit separate from its general accounts. Within 14 days after the expiration or termination of this Lease, if Lessor elects to apply the Security Deposit only to unpaid Rent, and otherwise within 30 days after the Premises have been vacated pursuant to Paragraph 7.4(c) below, Lessor shall return that portion of the Security Deposit not used or applied by Lessor. No part of the Security Deposit shall be considered to be held In trust, to bear interest or to be prepayment for any monies to be paid by Lessee under this Lease.

6. **Use.**

6.1 **Use.** Lessee shall use and occupy the Premises only for the Agreed Use, or any other legal use which is reasonably comparable thereto, and for no other purpose.

Lessee shall not use or permit the use of the Premises in a manner that is unlawful, creates damage, waste or a nuisance, or that disturbs occupants of or causes damage to neighboring premises or properties. Lessor shall not unreasonably withhold or delay its consent to any written request for a modification of the Agreed Use, so long as the same will not impair the structural integrity of the improvements on the Premises or the mechanical or electrical systems therein, and/or is not significantly more burdensome to the Premises. If Lessor elects to withhold consent. Lessor shall within 7 days after such request give written notification of same, which notice shall include an explanation of Lessor's objections to the change in the Agreed Use.

6.2 **Hazardous Substances.**

(a) **Reportable Uses Require Consent**. The term **"Hazardous Substance"** as used in this Lease shall mean any product, substance, or waste whose presence, use, manufacture, disposal, transportation, or release, either by itself or in combination with other materials expected to be on the Premises, is other: (i) potentially Injurious to the public health, safety or welfare, the environment or the Premises, (ii) regulated or monitored by any governmental authority, or (iii) a basis for potential liability of Lessor to any governmental agency or third party under any applicable statute or common law theory. Hazardous Substances shall include, but not be limited to, hydrocarbons, petroleum, gasoline, and/or crude oil or any products, by-products or fractions thereof. Lessee shall not engage in any activity in or on the Premises which constitutes a Reportable Use of Hazardous Substances without the express prior written consent of Lessor and timely compliance (at Lessee's expense) with all Applicable Requirements. **"Reportable Use"** shall mean (i) the installation or use of any above or below ground storage tank, (ii) the generation, possession, storage, use, transportation, or disposal of a Hazardous Substance that requires a permit from, or with respect to which a report, notice, registration or business plan is required to be filled with, any governmental authority, and/or (iii) the presence at the Premises of a Hazardous Substance with respect to which any Applicable Requirements requires that a notice be

given to persons entering or occupying the Premises or neighboring properties. “Notwithstanding the foregoing, Lessee may use any ordinary and customary materials reasonably required to be used in the normal course of the Agreed use, so long as such use is in compliance with all Applicable Requirements, is not Reportable Use , and does not expose the Premises or neighboring property to any meaningful risk of contamination of damage or expose Lessor to any liability therefor. In addition, Lessor may condition its consent to any Reportable Use upon receiving such additional assurances as Lessor reasonably deems necessary to protect itself, the public, the premises and/or the environment against damage, contamination, injury and/or liability, including, but not limited to the installation (and removal on or before Lease expiration of termination) of protective modifications (such as concrete encasements) and/or increasing the Security Deposits.

(b) **Duty to Inform Lessor**. If Lessee knows, or has reasonable cause to believe, that a Hazardous Substance has come to be located in, on under or about the Premises, other than as previously consented to by Lessor , Lessee shall immediately give written notice of such fact to Lessor, and provide Lessor with a copy of any report, notice, claim or other documentation which it has concerning the presence of such Hazardous Substance.

(c) **Lessee Remediation**. Lessee shall not cause or permit any Hazardous Substance to be spilled or released in, on under or about the Premises (including through the plumbing or sanitary sewer system) and shall promptly, at Lessee’s expense, take all investigatory and/or remedial action reasonably recommended, whether or not formally ordered or required, for the cleanup of any contamination of, and for the maintenance, security and/or monitoring of the Premises or neighboring properties, that was caused or materially contributed to by Lessee, or pertaining to or involving any Hazardous Substance brought onto the Premises during the term of this Lease, by or for Lessee, or any third party.

(d) **Lessee Indemnification**. Lessee shall indemnify, defend and hold Lessor, its agents, employees, lenders and ground Lessor, if any, harmless from and against any and all loss of rents and/or damages, liabilities, judgments, claims, expenses, penalties, and attorneys’ and consultants’ fees arising out of or involving any Hazardous Substance brought onto the Premises by or for Lessee, or any third party (provided, however, that Lessee shall have no liability under this Lease with respect to underground migration of any Hazardous Substance under the Premises from areas outside of the Project). Lessee’s obligations shall include, but not be limited to, the effects of any contamination or injury to person, property or the environment created or suffered by Lessee, and the cost of investigation, removal, remediation, restoration and/or abatement, and shall survive the expiration or termination of this Lease. No termination, cancellation or release agreement entered into by Lessor and Lessee shall release Lessee from its obligations under this Lease with respect to Hazardous Substances, unless specifically so agreed by Lessor in writing at the time of such agreement.

(e) **Lessor Indemnification**. Lessor and its successors and assigns shall indemnify, defend, reimburse and hold Lessee, its employees and lenders, harmless from and against any and all environmental damages, including the cost of remediation, which existed as a result of Hazardous Substances on the Premises prior to the Start Date or after the start date which were not caused by the acts of Lessee, its agents or employees or which are caused by the gross negligence or willful misconduct of Lessor, its agents or employees. Lessor’s obligations, as and when required by the Applicable Requirements, shall include, but not be limited to, the cost of investigation, removal, remediation, restoration and/or abatement, and shall survive the expiration or termination of this Lease.

(f) **Investigations and Remediation**. Lessor shall retain the responsibility and pay for any investigations or remediation measures required by governmental entities having jurisdiction with respect to the existence of Hazardous Substances on the Premises prior to the Start Date, unless such remediation measure is required as a result of Lessee’s use (including “Alterations”, as defined in paragraph 7.3(a) below) of the Premises, in which event Lessee shall be responsible for such payment. Lessee shall cooperate fully in any such activities at the request of Lessor, including allowing Lessor and Lessor’s agents to have reasonable access to the Premises at reasonable times in order to carry out Lessor’s investigative and remedial responsibilities.

(g) **Lessor Termination Option**. If a Hazardous Substance Condition (see Paragraph 9.1(e) occurs during the term of this Lease, unless Lessee is legally responsible therefor (in which case Lessee shall make the Investigation and remediation thereof required by the Applicable Requirements and this Lease shall continue In full force and effect, but subject to Lessor’s rights under Paragraph 6.2(d) and Paragraph 13), Lessor may, at Lessor’s option, either (i) Investigate and remediate such Hazardous Substance Condition, if required, as soon as reasonably possible at Lessor’s expense, in which event this Lease shall continue in full force and effect, or (ii) If the estimated cost to remediate such condition exceeds 12 times the then monthly Base Rent or $100,000, whichever is greater, give written notice to Lessee, within 30 days after receipt by Lessor of knowledge of the occurrence of such Hazardous Substance Condition, of Lessor’s desire to terminate this Lease as of the date 60 days following the date of such notice. In the event Lessor elects to give a termination notice, Lessee may, within 10 days thereafter, give written notice to Lessor of Lessee’s commitment to pay the amount by which the cost of the remediation of such Hazardous Substance Condition exceeds an amount equal to 12 times the then monthly Base Rent or $100,000, whichever is greater. Lessee shall provide Lessor with said funds or satisfactory assurance thereof within 30 days following such commitment. In such event, this Lease shall continue in full force and effect, and Lessor shall proceed to make such remediation as soon as reasonably possible after the required funds are available. If Lessee does not give such notice and provide the required funds or assurance thereof within the time provided, this Lease shall terminate as of the date specified in Lessor’s notice of termination.

6.3 **Lessee’s Compliance with Applicable Requirements**. Except as otherwise provided in this Lease, Lessee shall, at Lessee’s sole expense, fully, diligently and in a timely manner, materially comply with all Applicable Requirements, the requirements of any applicable fire insurance underwriter or rating bureau, and the recommendations of Lessor’s engineers and/or consultants which relate in any manner to the Premises, without regard to whether said requirements are now in effect or become effective after the Start Date. Lessee shall, within 10 days after receipt of Lessor’s written request, provide Lessor with copies of all permits and other documents, and other Information evidencing Lessee’s compliance with any Applicable Requirements specified by Lessor, and shall immediately upon receipt, notify Lessor in writing (with copies of any documents involved) of any threatened or actual claim, notice, citation, warning, complaint or report pertaining to or Involving the failure of Lessee or the Premises to comply with any Applicable Requirements.

6.4 **Inspection; Compliance**. Lessor and Lessor’s “Lender” (as defined in Paragraph 30) and consultants shall have the right to enter into Premises at any time, in the case of an emergency, and otherwise at reasonable times, for the purpose of inspecting the condition of the Premises and for verifying compliance by Lessee with this Lease. The cost of any such inspections shall be paid by Lessor, unless a violation of Applicable Requirements, or a contamination is found to exist or be imminent, or the inspection is requested or ordered by a governmental authority. In such case, Lessee shall upon request reimburse Lessor for the cost of such inspection, so long as such inspection is reasonably related to the violation or contamination.

7. **Maintenance; Repairs; Utility Installations; Trade Fixtures and Alterations**. See also Paragraph 54.

7.1 **Lessee’s Obligations**.

(a) **In General**. Subject to the provisions of Paragraph 2.2 (Condition), 2.3 (Compliance), 6.3 (Lessee’s Compliance with Applicable Requirements), 7.2 (Lessor’s Obligations), 9 (Damage or Destruction), and 14 (Condemnation), Lessee shall, at Lessee’s sole expense, keep the Premises, Utility Installations (intended for Lessee’s exclusive use, no matter where located), and Alterations in good order, condition and repair (whether or not the portion of the Premises requiring repairs, or the means of repairing the same, are reasonably or readily accessible to Lessee, and whether or not the need for such repairs occurs as a result of Lessee’s use, any prior use, the elements or the age of such portion of the Premises), including, but not limited to, all equipment or facilities, such as plumbing, HVAC equipment, electrical, lighting facilities, boilers, pressure vessels, fixtures, interior walls, interior surfaces of exterior walls, ceilings, floors, windows, doors, plate glass, and skylights but excluding any Items which are the responsibility of Lessor pursuant to Paragraph 7.2. Lessee in keeping the Premises in good order, condition and repair, shall exercise and perform good maintenance practices, specifically including the procurement and maintenance of the service contracts required by Paragraph 7.1 (b) below. Lessee’s obligations shall Include restorations, replacements or renewals when necessary to keep the Premises and all improvements thereon or a part thereof in good order, condition and state of repair.

(b) **Service Contracts**. ~~Lessee~~ Lessor shall, at Lessee’s sole expense, procure and maintain contracts~~, with copies to Lesser~~, in customary form and substance for, and with contractors specializing and experienced in the maintenance of the following equipment and improvements, if any, if and when installed on the Premises: (i) HVAC equipment, (ii) boiler and pressure vessels, (iii) clarifiers, and (iv) any other equipment, if reasonably required by Lessor. ~~However, Lessor reserves the right, upon notice to Lessee, to procure and maintain any or all of such service contracts, and if Lesser so elects~~, Lessee shall reimburse Lessor, upon demand, for the cost thereof.

(c) **Failure to Perform**. If Lessee fails to perform Lessee’s obligations under this Paragraph 7.1, Lessor may enter upon the Premises after 10 days’ prior written notice to Lessee (except in the case of an emergency, in which case no notice shall be required), perform such obligations on Lessee’s behalf, and put the Premises in good order, condition and repair, and Lessee shall promptly reimburse Lessor for the cost thereof.

(d) **Replacement**. Subject to Lessee’s indemnification of Lessor as set forth in Paragraph 8.7 below, and without relieving Lessee of liability resulting from Lessee’s failure to exercise and perform good maintenance practices, if an item described in Paragraph 7.1(b) cannot be repaired other than at a cost which is in excess of 50% of the cost of replacing such item, then such item shall be replaced by Lessor, and the cost thereof shall be prorated between the Parties and Lessee shall only be obligated to pay,

each month during the remanider of the term of this Lease, on the date on which Base Rent is due, an amount equal to the product of multiplying the cost of such replacement by a fraction, the numerator of which is one, and the denominator of which is 144 (ie. 1/144th of the cost per month). Lessee shall pay interest on the unamortized balance at a rate that is commercially reasonable in the judgement of Lessor's accountants. Lessee may, however, prepay its obligation at any time.

7.2 **Lessor's Obligations.** Subject to the provision of paragraphs 2.2 (Condition), 2.3 (Compliance), 4.2 (Common Area Operating Expenses), 6 (Use), 7.1 (Lessee's Obligations), 9 (Damage or Destruction) and 14 (Condemnation), Lessor, subject to reimbursement pursuant to paragraph 4.2. shall keep in good order, condition and repair the foundations, exterior walls, structural condition of interior bearing walls, exterior roof, fire sprinkler system, Common Area fire alarm and/or smoke detection systems, fire hydrants, parking lots, walkways, parkways, dreiveways, landscaping, tences, signs and ability systems serving the Common Areas and all parts therof, as well as providing the services for which there is a Common Area Operating Expense pursuant to Paragraph 4.2. Lessor shall not be obligated to paint the exterior or interior surfaces of exterior walls nor shall Lessor be obligated to maintain, repairs or replace windows, doors or plate glass of the Premises except for improvements pursuant to Exhibit "B" of this Lease. Lessee expressly waives the benefit of any statute now or hereafter in effect to the extent it is inconsistent with the terms of this Lease.

7.3 **Utility installations; Trade Fixture; Alterations.**

(a) **Definitions.** The term "Utility Installations" refers to all floor and window coverings, air lines, power panels, electrical distribution, security and fire protection systems, communication systems, lighting fixtures, HVAC equipment, plumbing, and fencing in or on the Premises. The term **"Trade Fixtures"** shall mean Lessee's machinery and equipment that can be removed without doing material damage to the Premises. The term **"Alterations"** shall mean any modification of the improvements, other than Utility Installations or Trade Fixtures, whether by addition or deletion. **"Lessee Owned Alterations and/or Utility Installations"** are defined as Alterations and/or Utility Installations made by Lessee that are not yet owned by Lessor pursuant to Paragraph 7.4(a).

(b) **Consent.** Lessee shall not make any Alterations or Utility Installations to the Premises without Lessor's prior written consent. Lessee may, however, make non-structural Utility Installations to the interior of the Premises (excluding the roof) without such consent but upon notice to Lessor, as long as they are not visible from the outside, do not involve puncturing, relocating or removing the roof or any existing walls, and the cumulative cost thereof during this Lease as extended does not exceed a sum equal to 3 month's Base Rent in the aggregate or a sum equal to one month's Base Rent in any one year. Notwithstanding the foregoing, Lessee shall not make or permit any roof penetrations and/or install anything on the roof without the prior written approval of Lessor. Lessor may, as a precondition to granting such approval, require Lessee to utilize a contractor chosen and/or approved by Lessor. Any Alterations or Utility Installations that Lessee shall desire to make and which require the consent of the Lessor shall be presented to Lessor in written form with detailed plans. Consent shall be deemed conditioned upon Lessee's: (i) acquiring all applicable governmental permits, (ii) furnishing Lessor with copies of both the permits and the plans and specifications prior to commencement of the work, and (iii) compliance with all conditions of said permits and other Applicable Requirements in a prompt and expeditious manner. Any Alterations or Utility Installations shall be performed in a workmanlike manner with good and sufficient materials. Lessee shall promptly upon completion furnish Lessor with as-built plans and specifications. For work which costs an amount in excess of one month's Base Rent, Lessor may condition its consent upon Lessee providing a lien and completion bond in an amount equal to 150% of the estimated cost of such Alteration or Utility Installation and/or upon Lessee's posting an additional Security Deposit with Lessor.

(c) **Indemnification.** Lessee shall pay, when due, all claims for labor or materials furnished or alleged to have been furnished to or for Lessee at or for use on the Premises, which claims are or may be secured by any mechanic's or materialmen's lien against the Premises or any interest therein. Lessee shall give Lessor not less than 10 days notice prior to the commencement of any work in, on or about the Premises, and Lessor shall have the right to post notices of non-responsibility. If Lessee shall contest the validity of any such lien, claim or demand, then Lessee shall, at its sole expense defend and protect itself, Lessor and the Premises against the same and shall pay and satisfy any such adverse Judgment that may be rendered thereon before the enforcement thereof. If Lessor shall require, Lessee shall furnish a surety bond in an amount equal to 150% of the amount of such contested lien, claim or demand, indemnifying Lessor against liability for the same. If Lessor elects to participate in any such action, Lessee shall pay Lessor's attorneys' fees and costs.

7.4 **Ownership; Removal; Surrender; and Restoration.**

(a) **Ownership.** Subject to Lessor's right to require removal or elect ownership as hereinafter provided, all Alterations and Utility Installations made by Lessee shall be the property of Lessee, but considered a part of the Premises. Lessor may, at any time, elect in writing to be the owner of all or any specified part of the Lessee Owned Alterations and Utility Installations. Unless otherwise instructed per paragraph 7.4(b) hereof, all Lessee Owned Alterations and Utility Installations shall, at the expiration or termination of this Lease, become the property of Lessor and be surrendered by Lessee with the Premises.

(b) **Removal.** By delivery to Lessee of written notice from Lessor not less than three (3) months~~earlier than 00 and not later than 30 days~~ prior to the end of the term of this Lease, Lessor may require that any or all Lessee Owned Alterations or Utility Installations be removed by the expiration or termination of this Lease. Lessor may require the removal at any time of all or any part of any Lessee Owned Alterations or Utility Installations made without the required consent.

(c) **Surrender; Restoration.** Lessee shall surrender the Premises by the Expiration Date or any earlier termination date, with all of the improvements, parts and surfaces thereof broom clean and free of debris, and in good operating order, condition and state of repair, ordinary wear and tear excepted. "Ordinary wear and tear" shall not include any damage or deterioration that would have been prevented by good maintenance practice. Notwithstanding the foregoing, if this Lease is for 12 months or less, then Lessee shall surrender the Premises in the same condition as delivered to Lessee on the Start Date with NO allowance for ordinary wear and tear. Lessee shall repair any damage occasioned by the installation, maintenance or removal of Trade Fixtures, Lessee owned Alterations and/or Utility Installations, furnishings, and equipment as well as the removal of any storage tank installed by or for Lessee. Lessee shall also completely remove from the Premises any and all Hazardous Substances brought onto the Premises by or for Lessee, or any third party (except Hazardous Substances which were deposited via underground migration from areas outside of the Project) even if such removal would require Lessee to perform or pay for work that exceeds statutory requirements. Trade Fixtures shall remain the property of Lessee and shall be removed by Lessee. The failure by Lessee to timely vacate the Premises pursuant to this Paragraph 7.4(c) without the express written consent of Lessor shall constitute a holdover under the provisions of Paragraph 26 below.

8. **Insurance; Indemnity.**

8.1 **Payment of Premium Increases.** See also Paragraph 60.

(a) As used herein, the term **"Insurance Cost Increase"** is defined as any increase in the actual cost of the insurance applicable to the Building and/or the Project and required to be carried by Lessor, pursuant to Paragraphs 8.2(b), 8.3(a) and 8.3(b), ("Required Insurance"), over and above the Base Premium, as hereinafter defined, calculated on an annual basis. Insurance Cost increase shall include, but not be limited to, requirements of the holder of a mortgage or deed of trust covering the Premises, Building and/or Project, increased valuation of the Premises, Building and/or Project, and/or a general premium rate increase. The term Insurance Cost increase shall not, however, include any premium increases resulting from the nature of the occupancy of any other tenant of the Building. If the parties insert a dollar amount in Paragraph 1.9, such amount shall be considered the **"Base Premium."** The Base Premium shall be the annual premium applicable to the 12 month period immediately preceding the Start Date. If, however, the Project was not insured for the entirety of such 12 month period, then the Base Premium shall be the lowest annual premium reasonably obtainable for the Required Insurance as of the Start Date, assuming the most nominal use possible of the Building. In no event, however, shall Lessee be responsible for any portion of the premium cost attributable to liability insurance coverage in excess of $2,000,000 procured under Paragraph 8.2(b).

(b) Lessee shall pay any Insurance Cost increase to Lessor pursuant to Paragraph 4.2. Premiums for policy periods commencing prior to, or extending beyond, the term of this Lease shall be prorated to coincide with the corresponding Start Date or Expiration Date.

8.2 **Liability Insurance.**

(a) **Carried by Lessee.** Lessee shall obtain and keep in force a Commercial General Liability policy of insurance protecting Lessee and Lessor as an additional insured against claims for bodily injury, personal injury and property damage based upon or arising out of the ownership, use, occupancy or maintenance of the Premises and all areas appurtenant thereto. Such insurance shall be on an occurrence basis providing single limit coverage in an amount not less than $1,000,000 per occurrence with an annual aggregate of not less than $2,000,000, an "Additional Insured-Managers or Lessors of Premises Endorsement" and contain the "Amendment of the Pollution Exclusion Endorsement" for damage caused by heat, smoke or fumes from a hostile fire. The policy shall not contain any intra-insured exclusions as between insured persons or organizations, but shall include coverage for liability assumed under this Lease as an **"Insured contract"** for the performance of Lessee's indemnity obligations under this Lease. The limits of said insurance shall not, however, limit the liability of Lessee nor relieve Lessee of any obligation hereunder. All insurance carried by Lessee shall be primary to and not contributory with any similar insurance carried by Lessor, whose insurance shall be considered excess insurance only.

(b) **Carried by Lessor.** Lessor shall maintain liability insurance as described in Paragraph 8.2(a), in addition to, and not in lieu of, the insurance required to be maintained by Lessee. Lessee shall not be named as an additional insured therein.

8.3 **Property Insurance — Building, Improvements and Rental Value.**

(a) **Building and Improvements.** Lessor shall obtain and keep in force a policy or policies of insurance in the name of Lessor, with loss payable to Lessor, any ground-lessor, and to any Lender insuring loss or damage to the Premises. The amount of such insurance shall be equal to the full replacement cost of the Premises, as the same shall exist from time to time, or the amount required by any Lender, but in no event more than the commercially reasonable and available insurable value thereof. Lessee Owned Alterations and Utility Installations, Trade Fixtures, and Lessee's personal property shall be insured by Lessee under Paragraph 8.4. If the coverage is available and commercially appropriate, such policy or policies shall insure against all risks of direct physical loss or damage (except the perils of flood and/or earthquake unless required by a Lender), including coverage for debris removal and the enforcement of any Applicable Requirements requiring the upgrading, demolition, reconstruction or replacement of any portion of the Premises as the result of a covered loss. Said policy or policies shall also contain an agreed valuation provision in lieu of any coinsurance clause, wavier

of subrogation, and inflation guard protection causing an increase in the annual property insurance coverage amount by a factor of not less than the adjusted U.S. Department of Labor Consumer Price Index for All Urban Consumers of the city nearest to where the Premises are located. If such insurance coverage has a deductible clause, the deductible amount shall not exceed $1,000 per occurrence.

(b) **Rental Value.** Lessor shall also obtain and keep in force a policy or policies in the name of Lessor with loss payable to Lessor and any Lender, insuring the loss of the full Rent for one year with an extended period of indemnity for an additional 180 days ("**Rental Value Insurance**"). Said insurance shall contain an agreed valuation provision in lieu of any coinsurance clause, and the amount of coverage shall be adjusted annually to reflect the projected Rent otherwise payable by Lessee, for the next 12 month period.

(c) **Adjacent Premises.** Lessee shall pay for any increase in the premiums for the property insurance of the Building and for the Common Areas or other buildings in the Project if said increases is caused by Lessee's acts, omissions, use or occupancy of the Premises.

(d) **Lessee's Improvements.** Since Lessor is the Insuring Party, Lessor shall not be required to insure Lessee Owned Alterations and Utility Installations unless the item in question has become the property of Lessor under the terms of this Lease.

8.4 **Lessee's Property; Business Interruption Insurance.**

(a) **Property Damage.** Lessee shall obtain and maintain insurance coverage on all of Lessee's personal property, Trade Fixtures, and

Lessee Owned Alterations and Utility Installations. Such Insurance shall be full replacement cost coverage with a deductible of not to exceed $1,000 per occurrence. The proceeds from any such insurance shall be used by Lessee for the replacement of personal property, Trade Fixtures and Lessee Owned Alterations and Utility Installations. Lessee shall provide Lessor with written evidence that such insurance is in force.

(b) **Business Interruption.** Lessee shall obtain and maintain loss of income and extra expense insurance in amounts as will reimburse Lessee for direct or indirect loss of earnings attributable to all perils commonly insured against by prudent lessees in the business of Lessee or attributable to prevention of access to the Premises as a result of such perils.

(c) **No Representation of Adequate Coverage.** Lessor makes no representation that the limits or forms of coverage of insurance specified herein are adequate to cover Lessee's property, business operations or obligations under this Lease.

8.5 **Insurance Policies.** Insurance required herein shall be by companies duly licensed or admitted to transact business in the state where the Premises are located, and maintaining during the policy term a "General Policyholders Rating" of at least B+, V, as set forth in the most current Issue of "Best Insurance Guide", or such other rating as may be required by a Lender. Lessee shall not do or permit to be done anything which invalidates the required insurance policies. Lessee shall, prior to the Start Date, deliver to Lessor certified copies of policies of such Insurance or certificates evidencing the existence and amounts of the required insurance. No such policy shall be cancelable or subject to modification except after 30 days prior written notice to Lessor. Lessee shall, at least 30 days prior to the expiration of such policies, furnish Lessor with evidence of renewals or "insurance binders" evidencing renewal thereof, or Lessor may order such insurance and charge the cost thereof to Lessee, which amount shall be payable by Lessee to Lessor upon demand. Such policies shall be for a term of at least one year, or the length of the remaining term of this Lease, whichever is less. If either Party shall fail to procure and maintain the insurance required to be carried by it, the other Party may, but shall not be required to, procure and maintain the same.

8.6 **Waiver of Subrogation.** Without affecting any other rights or remedies, Lessee and Lessor each hereby release and relieve the other, and waive their entire right to recover damages against the other, for loss of or damage to its property arising out of or incident to the perils required to be insured against herein. The effect of such releases and waivers is not limited by the amount of insurance carried or required, or by any deductibles applicable hereto. The Parties agree to have their respective property damage insurance carriers waive any right to subrogation that such companies may have against Lessor or Lessee, as the case may be, so long as the insurance is not invalidated thereby.

8.7 **Indemnity**. Except for Lessor's gross negligence or willful misconduct, Lessee shall Indemnify, protect, defend and hold harmless the Premises, Lessor and its agents, Lessor's master or ground lessor, partners and Lenders, from and against any and all claims, loss of rents and/or damages, liens, judgments, penalties, attorneys' and consultants' fees, expenses and/or liabilities arising out of, involving, or in connection with, the use and/or occupancy of the Premises by Lessee. If any action or proceeding is brought against Lessor by reason of any of the foregoing matters, Lessee shall upon notice defend the same at Lessee's expense by counsel reasonably satisfactory to Lessor and Lessor shall cooperate with Lessee in such defense. Lessor need not have first paid any such claim in order to be defended or Indemnified.

8.8 **Exemption of Lessor from Liability.** Except for that caused by Lessor's willful negligence or misconduct, Lessor shall not be liable for injury or damage to the person or goods, wares, merchandise or other property of Lessee, Lessee's employees, contractors, invitees, customers, or any other person in or about the Premises, whether such damage or injury is caused by or results from fire, steam, electricity, gas, water or rain, or from the breakage, leakage, obstruction or other defects of pipes, fire sprinklers, wires, appliances, plumbing, HVAC or lighting fixtures, or from any other cause, whether the said injury or damage results from conditions arising upon the Premises or upon other portions of the Building, or from other sources or places. Lessor shall not be liable for any damages arising from any act or neglect of any other tenant of Lessor nor from the failure of Lessor to enforce the provisions of any other lease in the Project. Notwithstanding Lessor's negligence or breach of this Lease, Lessor shall under no circumstances be liable for injury to Lessee's business or for any loss of income or profit therefrom.

9. **Damage or Destruction.**

9.1 **Definitions.**

(a) **"Premises Partial Damage"** shall mean damage or destruction to the improvements on the Premises, other than Lessee Owned Alterations and Utility Installations, which can reasonably be repaired in 3 months or less from the date of the damage or destruction, and the cost thereof does not exceed a sum equal to 6 month's Base Rent. Lessor shall notify Lessee in writing within 30 days from the date of the damage or destruction as to whether or not the damage is Partial or Total.

(b) **"Premises Total Destruction"** shall mean damage or destruction to the improvements on the Premises, other than Lessee Owned Alterations and Utility Installations and Trade Fixtures, which cannot reasonably be repaired in 3 months or less from the date of the damage or destruction and/or the cost thereof exceeds a sum equal to 6 month's Base Rent. Lessor shall notify Lessee in writing within 30 days from the date of the damage or destruction as to whether or not the damage is Partial or Total.

(c) **"Insured Loss**" shall mean damage or destruction to improvements on the Premises, other than Lessee Owned Alterations and Utility Installations and Trade Fixtures, which was caused by an event required to be covered by the Insurance described in Paragraph 8.3(a), irrespective of any deductible amounts or coverage limits involved.

(d) **"Replacement Cost**" shall mean the cost to repair or rebuild the improvements owned by Lessor at the time of the occurrence to their condition existing immediately prior thereto, including demolition, debris removal and upgrading required by the operation of Applicable Requirements, and without deduction for depreciation.

(e) **"Hazardous Substance Condition"** shall mean the occurrence or discovery of a condition involving the presence of, or a contamination by, a Hazardous Substance as defined in Paragraph 6.2(a), in, on, or under the Premises.

9.2 **Partial Damage — Insured Loss** If a Premises Partial Damage that is an Insured Loss occurs, then Lessor shall, at Lessor's expense, repair such damage (but not Lessee's Trade Fixtures or Lessee Owned Alterations and Utility Installations) as soon as reasonably possible and this Lease shall continue in full force and effect; provided, however, that Lessee shall, at Lessor's election, make the repair of any damage or destruction the total cost to repair of which is $5,000 or less, and, in such event, Lessor shall make any applicable insurance proceeds available to Lessee on a reasonable basis for that purpose. Notwithstanding the foregoing, if the required insurance was not in force or the insurance proceeds are not sufficient to effect such repair, the Insuring Party shall promptly contribute the shortage in proceeds as and when required to complete said repairs. In the event, however, such shortage was due to the fact that, by reason of the unique nature of the Improvements, full replacement cost insurance coverage was not commercially reasonable and available, Lessor shall have no obligation to pay for the shortage in insurance proceeds or to fully restore the unique aspects of the Premises unless Lessee provides Lessor with the funds to cover same, or adequate assurance thereof, within 10 days following receipt of written notice of such shortage and request therefor. If Lessor receives said funds or adequate assurance thereof within said 10 day period, the party responsible for making the repairs shall complete them as soon as reasonably possible and this Lease shall remain in full force and effect. If such funds or assurance are not received, Lessor may nevertheless elect by written notice to Lessee within 10 days thereafter to: (i) make such restoration and repair as is commercially reasonable with Lessor paying any shortage in proceeds, in which case this Lease shall remain in full force and effect, or (ii) have this Lease terminate 30 days thereafter. Lessee shall not be entitled to reimbursement of any funds contributed by Lessee to repair any such damage or destruction. Premises Partial Damage due to flood or earthquake shall be subject to Paragraph 9.3, notwithstanding that there may be some insurance coverage, but the net proceeds of any such insurance shall be made available for the repairs if made by either Party. See also Par. 61.

9.3 **Partial Damage — Uninsured Loss** If a Premises Partial Damage that is not an insured Loss occurs, unless caused by a negligent or willful act of Lessee (in which event Lessee shall make the repairs at Lessees expense), Lessor may either (i) repair such damage as soon as reasonably possible at Lessor's expense, in which event this Lease shall continue in full force and effect, or (ii) terminate this Lease by giving written notice to Lessee within 30 days after receipt by Lessor of knowledge of the occurrence of such damage. Such termination shall be effective 60 days following the date of such notice In the event Lessor elects to terminate this Lease, Lessee shall have the right within 10 days after receipt of the termination notice to give written notice to Lessor of Lessee's commitment to pay for the repair of such damage without reimbursement from Lessor. Lessee shall provide Lessor with said funds or satisfactory assurance thereof within 30 days after making such commitment. In such event this Lease shall continue in full force and effect, and Lessor shall proceed to make such repairs as soon as reasonably possible after the required funds are available. If Lessee does not make the required commitment, this Lease shall terminate as of the date specified in the termination notice.

9.4 **Total Destruction**. Notwithstanding any other provision hereof, if a Premises Total Destruction occurs, this Lease shall terminate 60 days following such Destruction. If the damage or destruction was caused by the gross negligence or willful misconduct of Lessee, Lessor shall have the right to recover Lessor's damages from Lessee, except

as provided In Paragraph 8.6.

9.5 **Damage Near End of Term.** If at any time during the last 6 months of this Lease there is damage for which the cost to repair exceeds one month's Base Rent, whether or not an Insured Loss, Lessor may terminate this Lease effective 60 days following the date of occurrence of such damage by giving a written termination notice to Lessee within 30 days after the date of occurrence of such damage. Notwithstanding the foregoing, if Lessee at that time has an exercisable option to extend this Lease or to purchase the Premises, then Lessee may preserve this Lease by, (a) exercising such option and (b) providing Lessor with any shortage in insurance proceeds (or adequate assurance thereof) needed to make the repairs an or before the earlier of (i) the date which is 10 days after Lessee's receipt of Lessor's written notice purporting to terminate this Lease, or (ii) the day prior to the date upon which such option expires. If Lessee duly exercises such option during such period and provides Lessor with funds (or adequate assurance thereof) to cover any shortage in insurance proceeds, Lesssor shall, at Lessor's commercially reasonable expense, repair such damage as soon as reasonably possible and this Lease shall continue in full force and effect. If Lessee falls to exercise such option and provide such funds or assurance during such period, then this Lease shall terminate on the date specified in the termination notice and Lessee's option shall be extinguished.

9.6 **Abatement of Rent; Lessee's Remedies.**

(a) **Abatement.** In the event of Premises Partial Damage or Premises Total Destruction or a Hazardous Substance Condition for which Lessee is not responsible under this Lease, the Rent payable by Lessee for the period required for the repair, remediation or restoration of such damage shall be abated in proportion to the degree to which Lessee's use of the Premises is impaired, but not to exceed the proceeds received from the Rental Value insurance. All other obligations of Lessee hereunder shall be performed by Lessee, and Lessor shall have no liability for any such damage, destruction,

remediation, repair or restoration except as provided herein.

(b) **Remedies**. If Lessor shall be obligated to repair or restore the Premises and does not commence in a substantial and meaningful way, such repair or restoration within 90 days after such obligation shall accrue, Lessee may, at any time prior to the commencement of such repair or restoration, give written notice to lessor and to any Lenders of which Lessee has actual notice of Lesses's election to terminate this Lease on a date not less than 60 days following the giving of such notice. If Lessee gives such notice and such repair or restoration is not commenced within 30 days thereafter, this Lease shall terminate as of the date specified in said notice. If the repair or restoration is commenced within such 30 days, this Lease shall continue in full force and effect. "Commence" shall mean either the unconditional authorization of the preparation of the required plans, or the beginning of the actual work on the Premises, whichever first occurs.

9.7 **Termination; Advance Payments.** Upon termination of this Lease pursuant to Paragraph 6.2(g) or Paragraph 9, an equitable adjustment shall be made concerning advance Base Rent and any other advance payments made by Lessee to Lessor. Lessor shall, in addition return to Lessee so much of Lessee's Security Deposit as has not been, or is not then required to be, used by Lessor.

9.8 **Waive Statutes.** Lessor and Lessee agree that the terms of this Lease shall govern the effect of any damage to or destruction of the Premises with respect to the termination of this Lease and hereby waive the provisions of any present or future statute to the extent inconsistent herewith.

10. **Real Property Taxes.**

10.1 **Definitions.** See Paragraph 60.

(a) **"Real Property Taxes."** As used herein, the term **"Real Property Taxes"** shall include any form of assessment; real estate, general, special, ordinary or extraordinary, or rental levy or tax (other than inheritance, personal income or estate taxes); improvement bond; and/or license fee imposed upon or levied against any legal or equitable interest of Lessor in the Project, Lessor's right to other income therefrom, and/or Lessor's business of leasing, by any authority having the direct or indirect power to tax and where the funds are generated with reference to the Project address and where the proceeds so generated are to be applied by the city, county or other local taxing authority of a jurisdiction within which the Project is located. The term "Real Property Taxes" shall also include any tax, fee, levy, assessment or charge, or any increase therein, imposed by reason of events occurring during the term of this Lease, including but not limited to, a change in the ownership of the Project or any portion thereof or a change in the improvements thereon.

(b) **"Base Real Property Taxes."** As used herein, the term **"Base Real Property Taxes"** shall be the amount of Real Property Taxes, which are assessed against the Premises, Building, Project or Common Areas in the calendar year during which the Lease is executed. In calculating Real Property Taxes for any calendar year, the Real Property Taxes for any real estate tax year shall be included in the calculation of Real Property Taxes for such calendar year based upon the number of days which such calendar year and tax year have in common.

10.2 **Payment of Taxes.** Lessor shall pay the Real Property Taxes applicable to the Project, and except as otherwise provided in Paragraph 10.3, any increases in such amounts over the Base Real Property Taxes shall be included in the calculation of Common Area Operating Expenses in accordance with the provisions of Paragraph 4.2.

10.3 **Additional Improvements.** Common Area Operating Expenses shall not include Real Property Taxes specified in the tax assessor's records and work sheets as being caused by additional improvements placed upon the Project by other lessees or by Lessor for the exclusive enjoyment of such other lessees. Notwithstanding Paragraph 10.2 hereof, Lessee shall, however, pay to Lessor at the time Common Area Operating Expenses are payable under Paragraph 4.2, the entirety of any increase in Real Property Taxes if assessed solely by reason of Alterations, Trade Fixtures or Utility Installations placed upon the Premises by Lessee or at Lessee's request.

10.4 **Joint Assessment.** If the Building is not separately assessed, Real Property Taxes allocated to the Building shall be an equitable proportion of the Real Property Taxes for all of the land and improvements included within the tax parcel assessed, such proportion to be determined by Lessor from the respective valuations assigned in the assessor's work sheets or such other information as may be reasonably available. Lessor's reasonable determination thereof, in good faith, shall be conclusive.

10.5 **Personal Property Taxes.** Lessee shall pay prior to delinquency all taxes assessed against and levied upon Lessee Owned Alterations and Utility Installations, Trade Fixtures, furnishings, equipment and all personal property of Lessee contained in the Premises. When possible, Lessee shall cause its Lessee Owned Alterations and Utility Installations, Trade Fixtures, furnishings, equipment and all other personal property to be assessed and billed separately from the real property of Lessor. If any of Lessee's said property shall be assessed with Lessor's real property, Lessee shall pay Lessor the taxes attributable to Lessee's property within 10 days after receipt of a written statement setting forth the taxes applicable to Lessee's property.

11. **Utilities.** Lessee shall pay for all water, gas, heat, light, power, telephone, trash disposal and other utilities and services supplied to the Premises, together with any taxes thereon. Notwithstanding the provisions of Paragraph 4.2, if at any time in Lessor's sole judgment, Lessor determines that Lessee is using a disproportionate amount of water, electricity or other commonly metered utilities, or that Lessee is generating such a large volume of trash as to require an increase in the size of the dumpster and/or an increase in the number of times per month that the dumpster is emptied, then Lessor may increase Lessee's Base Rent by an amount equal to such increased costs. See also Paragraph 55

12. **Assignment and Subletting**.

12.1 **Lessor's Consent Required**.

(a) Lessee shall not voluntarily or by operation of law assign, transfer, mortgage or encumber (collectively, **"assign or assignment"**) or sublet all or any part of Lessee's interest in this Lease or in the Premises without Lessor's prior written consent which consent shall not be unreasonably witheld.

(b) A change in the control of Lessee shall constitute an assignment requiring consent. The transfer, on a cumulative basis, of 25% or more of the voting control of Lessee shall constitute a change in control for this purpose.

(c) The involvement of Lessee or its assets in any transaction, or series of transactions (by way of merger, sale, acquisition, financing, transfer, leveraged buy-out or otherwise), whether or not a formal assignment or hypothecation of this Lease or Lessee's assets occurs, which results or will result in a reduction of the Net Worth of Lessee by an amount greater than 25% of such Net Worth as it was represented at the time of the execution of this Lease or at the time of the most recent assignment to which Lessor has consented, or as it exists immediately prior to said transaction or transactions constituting such reduction, whichever was or is greater, shall be considered an assignment of this Lease to which Lessor may withhold its consent. **"Net Worth of Lessee"** shall mean the net worth of Lessee (excluding any guarantors) established under generally accepted accounting principles.

(d) An assignment or subletting without consent shall, at Lessor's option, be a Default curable after notice per Paragraph 13.1(c), or a noncurable Breach without the necessity of any notice and grace period. If Lessor elects to treat such unapproved assignment or subletting as a noncurable Breach, Lessor may either: (i) terminate this Lease, or (ii) upon 30 days written notice, increase the monthly Base Rent to 110% of the Base Rent then in effect Further, in the event of such Breach and rental adjustment, (i) the purchase price of any option to purchase the Premises held by Lessee shall be subject to similar adjustment to 110% of the price previously in effect, and (ii) all fixed and non-fixed rental adjustments scheduled during the remainder of the Lease term shall be increased to 110% of the scheduled adjusted rent.

(e) Lessee's remedy for any breach of Paragraph 12.1 by Lessor shall be limited to compensatory damages and/or injunctive relief.

12.2 **Terms and Conditions Applicable to Assignment and Subletting.**

(a) Regardless of Lessor's consent, any assignment or subletting shall not: (i) be effective without the express written assumption by such assignee or sublessee of the obligations of Lessee under this Lease, (ii) release Lessee of any obligations hereunder, or (iii) alter the primary liability of Lessee for the payment of Rent or for the performance of any other obligations to be performed by Lessee.

(b) Lessor may accept Rent or performance of Lessee's obligations from any person other than Lessee pending approval or disapproval of an assignment. Neither a delay in the approval or disapproval of such assignment nor the acceptance of Rent or performance shall constitute a waiver or estoppel of Lessor's right to exercise its remedies for Lessee's Default or Breach.

(c) Lessor's consent to any assignment or subletting shall not constitute a consent to any subsequent assignment or subletting.

(d) In the event of any Default or Breach by Lessee, Lessor may proceed directly against Lessee, any Guarantors or anyone else responsible for the performance of Lessee's obligations under this Lease, including any assignee or sublessee, without first exhausting Lessor's remedies against any other person or entity responsible therefore to Lessor, or any security held by Lessor.

(e) Each request for consent to an assignment or subletting shall be in writing, accompanied by information relevant to Lessor's determination as to the financial and operational responsibility and appropriateness of the proposed assignee or sublessee, including but not limited to the intended use and/or required modification of the Premises. If any, ~~together with a fee of $1,000 or 10% of the current monthly Base Rent applicable to the portion of the Premises which is the subject of the proposed assignment or sublease, whichever is greater as consideration for Lesser's considering and processing said request.~~ Lessee agrees to provide Lessor with such other or additional Information and/or documentation as may be reasonably requested.

(f) Any assignee of, or sublessee under, this Lease shall, by reason of accepting such assignment or entering into such sublease, be deemed to have assumed and agreed to conform and comply with each and every term, covenant, condition and obligation herein to be observed or performed by Lessee during the term of said assignment or sublease, other than such obligations as are contrary to or inconsistent with provisions of an assignment or sublease to which Lessor has specifically consented to in writing.

12.3 **Additional Terms and Conditions Applicable to Subletting**. The following terms and conditions shall apply to any subletting by Lessee of all or any part of the Premises and shall be deemed included in all subleases under this Lease whether or not expressly incorporated therein:

(a) Lessee hereby assigns and transfers to Lessor all of Lessee's interest in all Rent payable on any sublease, and Lessor may collect such Rent and apply same toward Lessee's obligations under this Lease; provided, however, that until a Breach shall occur in the performance of Lessee's obligations. Lessee may collect said Rent. Lessor shall not, by reason of the foregoing or any assignment of such sublease, nor by reason of the collection of Rent, be deemed liable to the sublessee for any failure of Lessee to perform and comply with any of Lessee's obligations to such sublessee. Lessee hereby irrevocably authorizes and directs any such sublessee, upon receipt of a written notice from Lessor stating that a Breach exists in the performance of

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Lessee's obligations under this Lease, to pay to Lessor all Rent due and to become due under the sublease. Sublessee shall rely upon any such notice from Lessor and shall pay all Rents to Lessor without any obligation or right to inquire as to whether such Breach exists, notwithstanding any claim from Lessee to the contrary.

(b) In the event of a Breach of Lessee, Lessor may, at its option, require sublessee to atom to Lessor, in which event Lessor shall undertake the obligations of the Sublessor under such sublease from the time of the exercise of said option to the expiration of such sublease; provided, however, Lessor shall not be liable for any prepaid rents or security deposit paid by such sublessor to such sublessor or for any prior Defaults or Breaches of such sublessor.

(c) Any matter requiring the consent of the sublessor under a sublease shall also require the consent of Lessor.

(d) No sublessee shall further assign or sublet all or any part of the Premises without Lessor's prior written consent.

(e) Lessor shall deliver a copy of any notice of Default or Breach by Lessee to the sublessee, who shall have the right to cure the Default of Lessee within the grace period, if any, specified in such notice. The sublessee shall have a right of reimbursement and offset from and against Lessee for any such Defaults cured by the sublessee.

13. **Default; Breach; Remedies.**

13.1 Default; Breach. A "**Default**" Is defined as a failure by the Lessee to comply with or perform any of the terms, covenants, conditions or Rules and Regulations under this Lease. A "Breach" is defined as the occurrence of one or more of the following Defaults, and the failure of Lessee to cure such Default within any applicable grace period:

(a) The abandonment of the Premises; or the vacating of the Premises without providing a commercially reasonable level of security, or where the coverage of the property insurance described in Paragraph 8.3 is jeopardized as a result thereof, or without providing reasonable assurances to minimize potential vandalism.

(b) The failure of Lessee to make any payment of Rent or any Security Deposit required to be made by Lessee hereunder, whether to Lessor or to a third party, when due, to provide reasonable evidence of insurance or surety bond, or to fulfill any obligation under this Lease which endangers or threatens life or property, where such failure continues for a period of 3 business days following written notice to Lessee.

(c) The failure by Lessee to provide (i) reasonable written evidence of compliance with Applicable Requirements, (ii) the service contracts, (iii) the rescission of an unauthorized assignment or subletting, (iv) an Estoppel Certificate, (v) a requested subordination, (vi) evidence concerning any guaranty and/or Guarantor, (vii) any document requested under Paragraph 41 (easements), or (viii) any other documentation or information which Lessor may reasonably require of Lessee under the terms of this Lease, where any such failure continues for a period of 10 days following written notice to Lessee.

(d) A Default by Lessee as to the terms, covenants, conditions or provisions of this Lease, or of the rules adopted under Paragraph 2.9 hereof, other than those described in subparagraphs 13.1 (a), (b) or (c), above, where such Default continues for a period of 30 days after written notice; provided, however, that if the nature of Lessee's Default is such that more than 30 days are reasonably required for its cure, then it shall not be deemed to be a Breach if Lessee commences such cure within said 30 day period and thereafter diligently prosecutes such cure to completion.

(e) The occurrence of any of the following events: (i) the making of any general arrangement or assignment for the benefit of creditors; (ii) becoming a "**debtor**" as defined in 11 U.S.C. § 101 or any successor statute thereto (unless, in the case of a petition filed against Lessee, the same is dismissed within 60 days); (iii) the appointment of a trustee or receiver to take possession of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where possession is not restored to Lessee within 30 days; or (iv) the attachment, execution or other judicial seizure of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where such seizure is not discharged within 30 days; provided, however, in the event that any provision of this subparagraph (e) is contrary to any applicable law, such provision shall be of no force or effect, and not affect the validity of the remaining provisions.

(f) The discovery that any financial statement of Lessee or of any Guarantor given to Lessor was materially false.

(g) If the performance of Lessee's obligations under this Lease is guaranteed: (i) the death of a Guarantor, (ii) the termination of a Guarantor's liability with respect to this Lease other than in accordance with the terms of such guaranty, (iii) a Guarantor's becoming insolvent or the subject of a bankruptcy filing, (iv) a Guarantor's refusal to honor the guaranty, or (v) a Guarantor's breach of its guaranty obligation on an anticipatory basis, and Lessee's failure, within 60 days following written notice of any such event, to provide written alternative assurance or security, which, when coupled with the then existing resources of Lessee, equals or exceeds the combined financial resources of Lessee and the Guarantors that existed at the time of execution of this Lease.

13.2 **Remedies.** If Lessee fails to perform any of its affirmative duties or obligations, within 10 days after written notice (or in case of an emergency, without notice), Lessor may, at its option, perform such duty or obligation on Lessee's behalf, including but not limited to the obtaining of reasonably required bonds, insurance policies, or governmental licenses, permits or approvals. The costs and expenses of any such performance by Lessor shall be due and payable by Lessee upon receipt of Invoice therefor. If any check given to Lessor by Lessee shall not be honored by the bank upon which it is drawn, Lessor, at its option, may require all future payments to be made by Lessee to be by cashier's check. In the event of a Breach, Lessor may, with or without further notice or demand, and without limiting Lessor in the exercise of any right or remedy which Lessor may have by reason of such Breach:

(a) Terminate Lessee's right to possession of the Premises by any lawful means, in which case this Lease shall terminate and Lessee shall immediately surrender possession to Lessor. In such event Lessor shall be entitled to recover from Lessee: (i) the unpaid Rent which had been earned at the time of termination; (ii) the worth at the time of award of the amount by which the unpaid rent which would have been earned after termination until the time of award exceeds the amount of such rental loss that the Lessee proves could have been reasonably avoided; (iii) the worth at the time of award of the amount by which the unpaid rent for the balance of the term after the time of award exceeds the amount of such rental loss that the Lessee proves could be reasonably avoided; and (iv) any other amount necessary to compensate Lessor for all the detriment proximately caused by the Lessee's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result there from, including but not limited to the cost of recovering possession of the Premises, expenses of reletting, including necessary renovation and alteration of the Premises, reasonable attorneys' fees, and that portion of any leasing commission paid by Lessor in connection with this Lease applicable to the unexpired term of this Lease. The worth at the time of award of the amount referred to in provision (iii) of the immediately preceding sentence shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of the District within which the Premises are located at the time of award plus one percent. Efforts by Lessor to mitigate damages caused by Lessee's Breach of this Lease shall not waive Lessor's right to recover damages under Paragraph 12. If termination of this Lease is obtained through the provisional remedy of unlawful detainer, Lessor shall have the right to recover in such proceeding any unpaid Rent and damages as are recoverable therein, or Lessor may reserve the right to recover all or any part thereof in a separate suit. If a notice and grace period required under Paragraph 13.1 was not previously given, a notice to pay rent or quit, or to perform or quit given to Lessee under the unlawful detainer statute shall also constitute the notice required by Paragraph 13.1. In such case, the applicable grace period required by Paragraph 13.1 and the unlawful detainer statute shall run concurrently, and the failure of Lessee to cure the Default within the greater of the two such grace periods shall constitute both an unlawful detainer and a Breach of this Lease entitling Lessor to the remedies provided for in this Lease and/or by said statute.

(b) Continue the Lease and Lessee's right to possession and recover the Rent as it becomes due, in which event Lessee may sublet or assign, subject only to reasonable limitations. Acts of maintenance, efforts to relet, and/or the appointment of a receiver to protect the Lessor's interests, shall not constitute a termination of the Lessee's right to possession

(c) Pursue any other remedy now or hereafter available under the laws or judicial decisions of the state wherein the Premises are located. The expiration or termination of this Lease and/or the termination of Lessee's right to possession shall not relieve Lessee from liability under any indemnity provisions of this Lease as to matters occurring or accruing during the term hereof or by reason of Lessee's occupancy of the Premises.

13.3 **Inducement Recapture**. Any agreement for free or abated rent or other charges, or for the giving or paying by Lessor to or for Lessee of any cash or other bonus, Inducement or consideration for Lessee's entering into this Lease, all of which concessions are hereinafter referred to as "**Inducement Provisions**", shall be deemed conditioned upon Lessee's full and faithful performance of all of the terms, covenants and conditions of this Lease. Upon Breach of this Lease by Lessee, any such Inducement Provision shall automatically be deemed deleted from this Lease and of no further force or effect and any rent, other charge, bonus, Inducement or consideration theretofore abated, given or paid by Lessor under such an Inducement Provision shall be immediately due and payable by Lessee to Lessor, notwithstanding any subsequent cure of said Breach by Lessee. The acceptance by Lessor of rent or the cure of the Breach which initiated the operation of this paragraph shall not be deemed a waiver by Lessor of the provisions of this paragraph unless specifically so stated in writing by Lessor at the time of such acceptance.

13.4 **Late Charges**. Lessee hereby acknowledges that late payment by Lessee of Rent will cause Lessor to incur costs not contemplated by this Lease, the exact amount of which will be extremely difficult to ascertain. Such costs include, but are not limited to, processing and accounting charges, and late charges which may be imposed upon Lessor by any Lender. Accordingly, if any Rent shall not be received by Lessor within 5 days after such amount shall be due, then, without any requirement for notice to Lessee, Lessee shall pay to Lessor a one-time late charge equal to 10% of each such overdue amount or $100, whichever is greater. The parties hereby agree that such late charge represents a fair and reasonable estimate of the costs Lessor will incur by reason of such late payment. Acceptance of such late charge by Lessor shall in no event constitute a waiver of Lessee's Default or Breach with respect to such overdue amount, nor prevent the exercise of any of the other rights and remedies granted hereunder. In the event that a late charge is payable hereunder, whether or not collected, for 3 consecutive installments of Base Rent, then notwithstanding any provision of this Lease to the contrary, Base Rent shall, at Lessor's option, become due and payable quarterly in advance. See also Par. 53.

13.5 **Interest**. Any monetary payment due Lessor hereunder, other than late charges, not received by Lessor, when due as to scheduled payments (such as Base Rent) or within 30 days following the date on which it was due for non-scheduled payment, shall bear interest from the date when due, as to scheduled payments, or the 31st day after it was due as to non-scheduled payments. The interest **("Interest")** charged shall be equal to the prime rate reported in the Wall Street Journal as published closest prior to the date when due plus 4%, but shall not exceed the maximum rate allowed by law. Interest is payable in addition to the potential late charge provided for in Paragraph 13.4.

13.6 **Breach by Lessor.**

(a) **Notice of Breach.** Lessor shall not be deemed in breach of this Lease unless Lessor fails within a reasonable time to perform an obligation required to be performed by Lessor. For purposes of this Paragraph, a reasonable time shall in no event be less than 30 days after receipt by Lessor, and any Lender whose name and address shall have been furnished Lessee in writing for such purpose, of written notice specifying wherein such obligation of Lessor has not been performed; provided, however, that if the nature of Lessor's obligation is such that more than 30 days are reasonably required for its performance, then Lessor shall not be in breach if performance is commenced within such 30 day period and thereafter diligently pursued to completion.

(b) Performance by Lessee on Behalf of Lessor. In the event that neither Lessor nor Lender cures said breach within 30 days after receipt of said notice, or if having commenced said cure they do not diligently pursue it to completion, then Lessee may elect to cure said breach at Lessee's expense and offset from Rent an amount equal to the greater of one month's Base Rent or the Security Deposit, and to pay an excess of such expense under protest, reserving Lessee's right to reimbursement from Lessor. Lessee shall document the cost of said cure and supply said documentation to Lessor.

14. **Condemnation.** If the Premises or any portion thereof are taken under the power of eminent domain or sold under the threat of the exercise of said power (collectively **"Condemnation"**), this Lease shall terminate as to the part taken as of the date the condemning authority takes title or possession, whichever first occurs. If more than 10% of the floor area of the Unit, or more than 25% of Lessee's Reserved Parking Spaces, is taken by Condemnation, Lessee may, at Lessee's option, to be exercised in writing within 10 days after Lessor shall have given Lessee written notice of such taking (or in the absence of such notice, within 10 days after the condemning authority shall have taken possession) terminate this Lease as of the date the condemning authority takes such possession. If Lessee does not terminate this Lease in accordance with the foregoing, this Lease shall remain in full force and effect as to the portion of the Premises remaining, except that the Base Rent shall be reduced in proportion to the reduction in utility of the Premises caused by such Condemnation. ~~Condemnation awards and/or payments shall be the property of Lessor, whether such award shall be made as compensation for diminution in value of the leasehold, the value of the part taken, or for severance damages; provided, however, that Lessee shall be entitled to any compensation for Lessee's relocation expenses, loss of business goodwill and/or Trade Fixtures,without regard to whether or not this Lease is terminated pursuant to the provisions of this Paragraph. All Alteration and Utility Installation made to the Premises by Lessee, for purpose of Condemnation only, shall be considered the property of the Lessee and Lessee shall be untitled to any and all compensation which is payable therefor~~. In the event that this Lease is not terminated by reason of the Condemnation, Lessor shall repair any damage to the Premises caused by such Condemnation. See also Par. 57.

15. **Brokerage Fees.** See Paragraph 56.

15.1 **Additional Commission.** In addition to the payments owed pursuant to Paragraph 1.10 above, and unless Lessor and the Brokers otherwise agree in writing, Lessor agrees that: (a) if Lessee exercises any Option, (b) if Lessee acquires from Lessor any rights to the Premises or other premises owned by Lessor and located within the Project, (c) If Lessee remains in possession of the Premises, with the consent of Lessor, after the expiration of this Lease, or (d) if Base Rent is increased, whether by agreement or operation of an escalation clause herein, then, Lessor shall pay Brokers a fee in accordance with the schedule of the Brokers in effect at the time of the execution of this Lease.

~~15.2 **Assumption of Obligations.** Any buyer or transferee of Lessor's interest in this Lease shall be deemed to have assumed Lesser's obligation hereunder. Brokers shall be third party beneficiaries of the provision of Paragraphs 1.10, 15, 22 and 31. If Lessor fail to pay to Brokers any amounts due as and for brokerage fees pertoining to the Lease when due, then such amounts shall accrue interest. In addition, If Lesser fails to pay any amounts to Lessee's Broker when due, Lessee's Broker may send written notice to Lesser and Lessee of such failure and if Lesser fails to pay such amounts within 10 days after said notice, Lessee shall pay said monies to its Broker and offset such amounts against Rent. In addition, Lessee's Broker shall be doomed to be a third party beneficiary of any commission agreement entered into by and/or between Lesser and Lesser's Broker for the limited purpose of collecting any brokerage fee owed.~~

15.3 **Representations and Indemnities of Broker Relationships.** Lessee and Lessor each represent and warrant to the other that it has had no dealings with any person, firm, broker or finder (other than the Brokers, if any) in connection with this Lease, and that no one other than said named Brokers is entitled to any commission or finder's fee in connection herewith. Lessee and Lessor do each hereby agree to indemnify, protect, defend and hold the other harmless from and against liability for compensation or charges which may be claimed by any such unnamed broker, finder or other similar party by reason of any dealings or actions of the indemnifying Party, including any costs, expenses, attorneys' fees reasonably incurred with respect thereto.

16. **Estoppel Certificates.**

(a) Each Party (as **"Responding Party"**) shall within 10 days after written notice from the other Party (the **"Requesting Party"**) execute, acknowledge and deliver to the Requesting Party a statement in writing in form similar to the then most current **"Estoppels Certificate"** form published by the American industrial Real Estate Association, plus such additional information, confirmation and/or statements as may be reasonably requested by the Requesting Party.

(b) If the Responding Party shall fail to execute or deliver the Estoppel Certificate within such 10 day period, the Requesting Party may execute an Estoppel Certificate stating that: (i) the Lease is in full force and effect without modification except as may be represented by the Requesting Party, (ii) there are no uncured defaults in the Requesting Party's performance, and (iii) if Lessor is the Requesting Party, not more than one month's rent has been paid in advance. Prospective purchasers and encumbrances may rely upon the Requesting Party's Estoppel Certificate, and the Responding Party shall be stopped from denying the truth of the facts contained in said Certificate.

(c) If Lessor desires to finance, refinance, or sell the Premises, or any part thereof, Lessee and all Guarantors shall deliver to any potential lender or purchaser designated by Lessor such financial statements as may be reasonably required by such lender or purchaser, including but not limited to Lessee's financial statements for the past 3 years. All such financial statements shall be received by Lessor and such lender or purchaser in confidence and shall be used only for the purposes herein set forth.

17. **Definition of Lessor** The term **"Lessor"** as used herein shall mean the owner or owners at the time in question of the fee title to the Premises, or' if this is a sublease, of the Lessee's interest in the prior lease. In the event of a transfer of Lessor's title or Interest in the Premises or this Lease, Lessor shall deliver to the transferee or assignee (in cash or by credit) any unused Security Deposit held by Lessor. Except as provided in Paragraph 15, upon such transfer or assignment and delivery of the Security Deposit, as aforesaid, the prior Lessor shall be relieved of all liability with respect to the obligations and/or covenants under this Lease thereafter to be performed by the Lessor. Subject to the foregoing, the obligations and/or covenants in this Lease to be performed by the Lessor shall be binding only upon the Lessor as hereinabove defined. Notwithstanding the above, and subject to the provisions or Paragraph 20 below, the original Lessor under this Lease, and all subsequent holders of the Lessor's interest in this Lease shall remain liable and responsible with regard to the potential duties and liabilities of Lessor pertaining to Hazardous Substances as outlined in Paragraph 6.2 above.

18. **Severability.** The invalidity of any provision of this Lease, as determined by a court of competent jurisdiction, shall in no way affect the validity of any other provision hereof.

19. **Days.** Unless otherwise specifically indicated to the contrary, the word "days" as used in this Lease shall mean and refer to calendar days.

20 **Limitation on Liability.** Subject to the provisions of Paragraph 17 above, the obligations of Lessor under this Lease shall not constitute personal obligations of Lessor, the individual partners of Lessor or its or their individual partners, directors, officers or shareholders and Lessee shall look to he Premises and to no other assets of Lessor, for the satisfaction of any liability of Lessor with respect to this Lease, and shall not seek recourse against the individual partners of Lessor, or its or their individual partners, directors, officers or shareholders, or any of their personal assets for such satisfaction.

21. **Time of Essence.** Time is of the essence with respect to the performance of all obligations to be performed or observed by the Parties under this Lease.

22. **No Prior or Other Agreements; Broker Disclaimer.** This Lease contains all agreements between the Parties with respect to any matter mentioned herein, and no other prior or contemporaneous agreement or understanding shall be effective. Lessor and Lessee each represents and warrants to the Brokers that it has made, and is relying solely upon, its own investigation as to the nature, quality, character and financial responsibility of the other Party to this Lease and as to the use, nature, quality and character of the Premises. Brokers have no responsibility with respect thereto or with respect to any default or breach hereof by either Party. The liability (including court costs and attorneys' fees), of any Broker with respect to negotiation, execution, delivery or performance by either Lessor or Lessee under this Lease or any amendment or modification hereto shall be limited to an amount up to the fee received by such Broker pursuant to this Lease; provided, however, that the foregoing limitation on each Broker's liability shall not be applicable to any gross negligence or willful misconduct of such Broker.

23. **Notices.**

23.1 **Notice Requirements.** All notices required or permitted by this Lease or applicable law shall be in writing and may be delivered in person (by hand or by courier) or

may be sent by regular, certified or registered mail or U.S. Postal Service Express Mail, with postage prepaid, or by facsimile transmisson, and shall be deemed sufficiently given if served in a manner specified in this Paragraph 23. The addresses noted adjacent to a Party's signature on this Lease shall be that Party's address for delivery or mailing of notices. Either Party may by written notice to the other specify a different address for notice, except that upon Lessee's taking possession of the Premises, the Premises shall constitute Lessee's address for notice. A copy of all notices to Lessor shall be concurrently transmitted to such party or parties at such adresses as Lessor may from time to time hereafter designate in

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writing.

23.2 **Date of Notice.** Any notice sent by registered or certified mail, return receipt requested, shall be deemed given on the date of delivery shown on the receipt card, or if no delivery date is shown, the postmark thereon. If sent by regular mail the notice shall be deemed given 48 hours after the same is addressed as required herein and mailed with postage prepaid. Notices delivered by United States Express Mail or overnight courier that guarantee next day delivery shall be deemed given 24 hours after delivery of the same to the Postal Service or courier. Notices transmitted by facsimile transmission or similar means shall be deemed delivered upon telephone confirmation of receipt (confirmation report from fax machine is sufficient), provided a copy is also delivered via delivery or mail. If notice is received on a Saturday, Sunday or legal holiday, it shall be deemed received on the next business day.

24. **Waivers**. No waiver by Lessor of the Default or Breach of any term, covenant or condition hereof by Lessee, shall be deemed a waiver of any other term, covenant or condition hereof, or of any subsequent Default or Breach by Lessee of the same or of any other term, covenant or condition hereof. Lessor's consent to, or approval of, any act shall not be deemed to render unnecessary the obtaining of Lessor's consent to, or approval of, any subsequent or similar act by Lessee, or be construed as the basis of an estoppel to enforce the provision or provisions of this Lease requiring such consent. The acceptance of Rent by Lessor shall not be a waiver of any Default or Breach by Lessee. Any payment by Lessee may be accepted by Lessor on account of monies or damages due Lessor, notwithstanding any qualifying statements or conditions made by Lessee in connection therewith, which such statements and/or conditions shall be of no force or effect whatsoever unless specifically agreed to in writing by Lessor at or before the time of deposit of such payment.

25. **Disclosures Regarding The Nature of a Real Estate Agency Relationship**.

(a) When entering into a discussion with a real estate agent regarding a real estate transaction, a Lessor or Lessee should from the outset understand what type of agency relationship or representation it has with the agent or agents in the transaction. Lessor and Lessee acknowledge being advised by the Brokers in this transaction, as follows:

(i) Lessor's Agent. A Lessor's agent under a listing agreement with the Lessor acts as the agent for the Lessor only. A Lessor's agent or subagent has the following affirmative obligations: To the Lessor: A fiduciary duty of utmost care, integrity, honesty, and loyalty in dealings with the Lessor.To the Lessee and the Lessor: a. Diligent exercise of reasonable skills and care in performance of the agent's duties. b. A duty of honest and fair dealing and good faith. c. A duty to disclose all facts known to the agent materially affecting the value or desirability of the property that are not known to, or within the diligent attention and observation of, the Parties. An agent is not obligated to reveal to either Party any confidential information obtained from the other Party which does not involve the affirmative duties set forth above.

(ii) Lessee's Agent. An agent can agree to act as agent for the Lessee only. In these situations, the agent is not the Lessor's agent, even if by agreement the agent may receive compensation for services rendered, either in full or in part from the Lessor. An agent acting only for a Lessee has the fallowing affirmative obligations. To the Lessee: A fiduciary duty of utmost care, integrity, honesty, and loyalty in dealings with the Lessee. To the Lessee and the Lessor: a. Diligent exercise of reasonable skills and care in performance of the agent's duties. b. A duty of honest and fair dealing and good faith. c. A duty to disclose all facts known to the agent materially affecting the value or desirability of the property that are not known to, or within the diligent attention and observation of, the Parties. An agent is not obligated to reveal to either Party any confidential information obtained from the other Party which does not involve the affirmative duties set forth above.

(iii) Agent Representing Both Lessor and Lessee. A real estate agent, either acting directly or through one or more associate licenses, can legally be the agent of both the Lessor and the Lessee in a transaction, but only with the knowledge and consent of both the Lessor and the Lessee. In a dual agency situation, the agent has the following affirmative obligations to both the Lessor and the Lessee: a. A fiduciary duty of utmost care, integrity, honesty and loyalty in the dealings with either Lessor or the Lessee. b. Other duties to the Lessor and the Lessee as stated above in subparagraphs (i) or (ii). In representing both Lessor and Lessee, the agent may not without the express permission of the respective Party, disclose to the other Party that the Lessor will accept rent in an amount less than that indicated in the listing or that the Lessee is willing to pay a higher rent than that offered. The above duties of the agent in a real estate transaction do not relieve a Lessor or Lessee from the responsibility to protect their own interests. Lessor and Lessee should carefully read all agreements to assure that they adequately express their understanding of the transaction. A real estate agent is a person qualified to advise about real estate. If legal or tax advice is desired, consult a competent professional.

(b) Brokers have no responsibility with respect to any default or breach hereof by either Party. The liability (including court costs and attorneys' fees), of any Broker with respect to any breach of duty, error or omission relating to this Lease shall not exceed the fee received by such Broker pursuant to this Lease; provided, however, that the foregoing limitation on each Broker's liability shall not be applicable to any gross negligence or willful misconduct of such Broker.

(c) Buyer and Seller agree to identify to Brokers as "Confidential" any communication or information given Brokers that is considered by such Party to be confidential.

26. **No Right To Holdover**. Lessee has no right to retain possession of the Premises or any part thereof beyond the expiration or termination of this Lease. In the event that Lessee holds over, then the Base Rent shall be increased to 150% of the Base Rent applicable immediately preceding the expiration or termination. Nothing contained herein shall be construed as consent by Lessor to any holding over by Lessee.

27. **Cumulative Remedies**. No remedy or election hereunder shall be deemed exclusive but shall, wherever possible, be cumulative with all other remedies at law or in equity.

28. **Covenants and Conditions; Construction of Agreement**. All provisions of this Lease to be observed or performed by Lessee are both covenants and conditions. In construing this Lease, all headings and titles are for the convenience of the Parties only and shall not be considered a part of this Lease. Whenever required by the context, the singular shall include the plural and vice versa. This Lease shall not be construed as if prepared by one of the Parties, but rather according to its fair meaning as a whole, as if both Parties had prepared it.

29. **Binding Effect; Choice of Law.** This Lease shall be binding upon the Parties, their personal representatives, successors and assigns and be governed by the laws of the State in which the Premises are located. Any litigation between the Parties hereto concerning this Lease shall be initiated in the county in which the Premises are located.

30. **Subordination; Attornment; Non-Disturbance.**

30.1 **Subordination.** This Lease and any Option granted hereby shall be subject and subordinate to any ground lease, mortgage, deed of trust, or other hypothecation or security device (collectively, **"Security Device")**, now or hereafter placed upon the Premises, to any and all advances made on the security thereof, and to all renewals, modifications, and extensions thereof. Lessee agrees that the holders of any such Security Devices (in this Lease together referred to as **"Lender")** shall have no liability or obligation to perform any of the obligations of Lessor under this Lease. Any Lender may elect to have this Lease and/or any Option granted hereby superior to the lien of its Security Device by giving written notice thereof to Lessee, whereupon this Lease and such Options shall be deemed prior to such Security Device, notwithstanding the relative dates of the documentation or recordation thereof.

30.2 **Attornment.** Subject to the non-disturbance provisions of Paragraph 30.3, Lessee agrees to attorn to a Lender or any other party who acquires ownership of the Premises by reason of a foreclosure of a Security Device, and that in the event of such foreclosure, such new owner shall not: (a) be liable for any act or omission of any prior lessor or with respect to events occuring prior to acquisition of ownership; (b) be subject to any offsets or defenses which Lessee might have against any prior lessor, (c) be bound by prepayment of more than one month's rent, or (d) be liable for the return of any security deposit paid to any prior lessor.

30.3 **Non-Disturbance.** With respect to Security Devices entered into by Lessor after the execution of this Lease, Lessee's subordination of this Lease shall be subject to receiving a commercially reasonable non-disturbance agreement (a **"Non-Disturbance Agreement")** from the Lender which Non-Disturbance Agreement provides that Lessee's possession of the Premises, and this Lease, including any options to extend the term hereof, will not be disturbed so long as Lessee is not in Breach hereof and attorns to the record owner of the Premises. Further, within 60 days after the execution of this Lease, Lessor shall use its commercially reasonable efforts to obtain a Non-Disturbance Agreement from the holder of any pre-existing Security Device which is secured by the Premises. In the event that Lessor is unable to provide the Non-Disturbance Agreement within said 60 days, then Lessee may, at Lessee's option, directly contact Lender and attempt to negotiate for the execution and delivery of a Non-Disturbance Agreement.

30.4 **Self-Executing.** The agreements contained in this Paragraph 30 shall be effective without the execution of any further documents; provided, however, that, upon written request from Lessor or a Lender in connection with a sale, financing or refinancing of the Premises, Lessee and Lessor shall execute such further writings as may be reasonably required to separately document any subordination, attornment and/or Non-Disturbance Agreement provided for herein.

31. **Attorneys' Fees.** If any Party or Broker brings an action or proceeding involving the Premises whether founded in tort, contract or equity, or to declare rights hereunder, the Prevailing Party (as hereafter defined) in any such proceeding, action, or appeal thereon, shall be entitled to reasonable attorneys' fees. Such fees may be awarded in the same suit or recovered in a separate suit, whether or not such action or proceeding is pursued to decision or judgment. The term, **"Prevailing Party"** shall include, without limitation, a Party or Broker who substantially obtains or defeats the relief sought, as the case may be, whether by compromise, settlement, judgment, or the abandonment by the other Party or Broker of its claim or defense. The attorneys' fees award shall not be computed in accordance with any court fee schedule, but shall be such as to fully reimburse all attorneys' fees reasonably incurred. In addition, Lessor shall be entitled to attorneys' fees, costs and expenses incurred in the preparation and service of notices of Default and consultations in connection therewith, whether or not a legal action is subsequently commenced in connection with such Default or resulting Breach ($200 is a reasonable minimum per

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FORM MTG-2-11/98E
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occurrence for such services and consultation).

32. **Lessor's Access; Showing Premises; Repairs**. Lessor and Lessor's agents shall have the right to enter the Premises at any time, in the case of an emergency, and otherwise at reasonable times for the purpose of showing the same to prospective purchasers, lenders, or tenants, and making such alterations repairs, improvements or additions to the Premises as Lessor may deem necessary. All such activities shall be without abatement of rent or liability to Lessee. Lessor may at any time place on the Premises any ordinary **"For Sale"** signs and Lessor may during the last 6 months of the term hereof place on the Premises any ordinary**"For Lease"** signs. Lessee may at any time place on the Premises any ordinary **"For Sublease"** sign.

33. **Auctions**. Lessee shall not conduct, nor permit to be conducted, any auction upon the Premises without Lessor's prior written consent. Lessor shall not be obligated to exercise any standard of reasonableness in determining whether to permit an auction.

34. **Signs**. Except for ordinary "For Sublease" signs which may be placed only on the Premises, Lessee shall not place any sign upon the Project without Lessor's prior written consent which consent shall not be unreasonably witheld. All signs must comply with all Applicable Requirements.

35. **Termination; Merger**. Unless specifically stated otherwise in writing by Lessor, the voluntary or other surrender of this Lease by Lessee, the mutual termination or cancellation hereof, or a termination hereof by Lessor for Breach by Lessee, shall automatically terminate any sublease or lesser estate in the Premises; provided, however, that Lessor may elect to continue any one or all existing subtenancies. Lessor's failure within 10 days following any such event to elect to the contrary by written notice to the holder of any such lesser interest, shall constitute Lessor's election to have such event constitute the termination of such interest.

36. **Consents**. Except as otherwise provided herein, wherever in this Lease the consent of a Party is required to an act by or for the other Party, such consent shall not be unreasonably withheld or delayed. Lessor's actual reasonable costs and expenses (including but not limited to architects', attorneys', engineers' and other consultants' fees) incurred in the consideration of, or response to, a request by Lessee for any Lessor consent, including but not limited to consents to an assignment, a subletting or the presence or use of a Hazardous Substance, shall be paid by Lessee upon receipt of an invoice and supporting documentation therefor. Lessor's consent to any act, assignment or subletting shall not constitute an acknowledgment that no Default or Breach by Lessee of this Lease exists, nor shall such consent be deemed a waiver of any then existing Default or Breach, except as may be otherwise specifically stated in writing by Lessor at the time of such consent. The failure to specify herein any particular condition to Lessor's consent shall not preclude the imposition by Lessor at the time of consent of such further or other conditions as are then reasonable with reference to the particular matter for which consent is being given. In the event that either Party disagrees with any determination made by the other hereunder and reasonably requests the reasons for such determination, the determining party shall furnish its reasons in writing and in reasonable detail within 10 business days following such request.

37. **Guarantor**.

37.1 **Execution**. The Guarantors, if any, shall each execute a guaranty in the form most recently published by the American Industrial Real Estate Association, and each such Guarantor shall have the same obligations as Lessee under this Lease.

37.2 **Default**. It shall constitute a Default of the Lessee if any Guarantor fails or refuses, upon request to provide: (a) evidence of the execution of the guaranty, including the authority of the party signing on Guarantor's behalf to obligate Guarantor, and in the case of a corporate Guarantor, a certified copy of a resolution of its board of directors authorizing the making of such guaranty, (b) current financial statements, (c) an Estoppel Certificate, or (d) written confirmation that the guaranty is still in effect.

38. **Quiet Possession**. Subject to payment by Lessee of the Rent and performance of all of the covenants, conditions and provisions on Lessee's part to be observed and performed under this Lease, Lessee shall have quiet possession and quiet enjoyment of the Premises during the term hereof.

39. **Options**. If Lessee is granted an option, as defined below, then the following provisions shall apply.

39.1 **Definition**. **"Option"** shall mean: (a) the right to extend the term of or renew this Lease or to extend or renew any lease that Lessee has on other property of Lessor; (b) the right of first refusal or first offer to lease either the Premises or other property of Lessor; (c) the right to purchase or the right of first refusal to purchase the Premises or other property of Lessor.

39.2 **Options Personal To Original Lessee**. Any Option granted to Lessee in this Lease is personal to the original Lessee, and cannot be assigned or exercised by anyone other than said original Lessee and only while the original Lessee is in full possession of the Premises and, if requested by Lessor, with Lessee certifying that Lessee has no intention of thereafter assigning or subletting.

39.3 **Multiple Options**. In the event that Lessee has any multiple Options to extend or renew this Lease, a later Option cannot be exercised unless the prior Options have been validly exercised.

39.4 **Effect of Default on Options**.

(a) Lessee shall have no right to exercise an Option: (i) during the period commencing with the giving of any notice of Default and continuing until said Default is cured, (ii) during the period of time any Rent is unpaid (without regard to whether notice thereof is given Lessee), (iii) during the time Lessee is in Breach of this Lease, or (iv) in the event that Lessee has been given 3 or more notices of separate Default, whether or not the Defaults are cured, during the 12 month period immediately preceding the exercise of the Option.

(b) The period of time within which an Option may be exercised shall not be extended or enlarged by reason of Lessee's inability to exercise an Option because of the provisions of Paragraph 39.4(a).

(c) An Option shall terminate and be of no further force or effect, notwithstanding Lessee's due and timely exercise of the Option, if, after such exercise and prior to the commencement of the extended term, (i) Lessee fails to pay Rent for a period of 30 days after such Rent becomes due (without any necessity of Lessor to give notice thereof), (ii) Lessor gives to Lessee 3 or more notices of separate Default during any 12 month period, whether or not the Defaults are cured, or (iii) If Lessee commits a Breach of this Lease.

40. **Security Measures.** Lessee hereby acknowledges that the Rent payable to Lessor hereunder does not include the cost of guard service or other security measures, and that Lessor shall have no obligation whatsoever to provide same. Lessee assumes all responsibility for the protection of the Premises, Lessee, its agents and invitees and their property from the acts of third parties.

41. **Reservations.** Lessor reserves the right: (i) to grant, without the consent or joinder of Lessee, such easements, rights and dedications that Lessor deems necessary, (ii) to cause the recordation of parcel maps and restrictions, and (iii) to create and/or install new utility raceways, so long as such easements, rights, dedications, maps, restrictions, and utility raceways do not unreasonably interfere with the use of the Premises by Lessee. Lessee agrees to sign any documents reasonably requested by Lessor to effectuate such rights.

42. **Performance Under Protest.** If at any time a dispute shall arise as to any amount or sum of money to be paid by one Party to the other under the provisions hereof, the Party against whom the obligation to pay the money is asserted shall have the right to make payment "under protest" and such payment shall not be regarded as a voluntary payment and there shall survive the right on the part of said Party to institute suit for recovery of such sum. If it shall be adjudged that there was no legal obligation on the part of said Party to pay such sum or any part thereof, said Party shall be entitled to recover such sum or so much thereof as it was not legally required to pay.

43. **Authority.** If either Party hereto is a corporation, trust, limited liability company, partnership, or similar entity, each individual executing this Lease on behalf of such entity represents and warrants that he or she is duly authorized to execute and deliver this Lease on its behalf. Each party shall, within 30 days after request, deliver to the other party satisfactory evidence of such authority.

44. **Conflict.** Any conflict between the printed provisions of this Lease and the typewritten or handwritten provisions shall be controlled by the typewritten or handwritten provisions.

45. **Offer.** Preparation of this Lease by either party or their agent and submission of same to the other Party shall not be deemed an offer to lease to the other Party. This Lease is not intended to be binding until executed and delivered by all Parties hereto.

46. **Amendments.** This Lease may be modified only in writing, signed by the Parties in interest at the time of the modification. As long as they do not materially change Lessee's obligations hereunder, Lessee agrees to make such reasonable non-monetary modifications to that Lease as may be reasonably required by a Lender in connection with the obtaining of normal financing or refinancing of the Premises.

47. **Multiple Parties.** If more than one person or entity is named herein as either Lessor or Lessee, such multiple Parties shall have joint and several responsibility to comply with the terms of this Lease.

48. **Waiver of Jury Trial.** The Parties hereby waive their respective rights to trial by jury in any action or proceeding Involving the Property or arising out of this Agreement.

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FORM MTG-2-11/98E
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49. **Mediation and Arbitration of Disputes**. An Addendum requiring the Mediation and/or the Arbitration of all disputes between the Parties and/or Brokers arising out of this Lease ☐ is ☐ is not attached to this Lease.

LESSOR AND LESSEE HAVE CAREFULLY READ AND REVIEWED THIS LEASE AND EACH TERM AND PROVISION CONTAINED HEREIN, AND BY THE EXECUTION OF THIS LEASE SHOW THEIR INFORMED AND VOLUNTARY CONSENT THERETO. THE PARTIES HEREBY AGREE THAT, AT THE TIME THIS LEASE IS EXECUTED, THE TERMS OF THIS LEASE ARE COMMERCIALLY REASONABLE AND EFFECTUATE THE INTENT AND PURPOSE OF LESSOR AND LESSEE WITH RESPECT TO THE PREMISES.

ATTENTION: NO REPRESENTATION OR RECOMMENDATION IS MADE BY THE AMERICAN INDUSTRIAL REAL ESTATE ASSOCIATION OR BY ANY BROKER AS TO THE LEGAL SUFFICIENCY, LEGAL EFFECT, OR TAX CONSEQUENCES OF THIS LEASE OR THE TRANSACTION TO WHICH IT RELATES. THE PARTIES ARE URGED TO:

1. SEEK ADVICE OF COUNSEL AS TO THE LEGAL AND TAX CONSEQUENCES OF THIS LEASE.

2. RETAIN APPROPRIATE CONSULTANTS TO REVIEW AND INVESTIGATE THE CONDITION OF THE PREMISES. SAID INVESTIGATION SHOULD INCLUDE BUT NOT BE LIMITED TO: THE POSSIBLE PRESENCE OF HAZARDOUS SUBSTANCES, THE ZONING OF THE PREMISES, THE STRUCTURAL INTEGRITY, THE CONDITION OF THE ROOF AND OPERATING SYSTEMS, COMPLIANCE WITH THE AMERICANS WITH DISABILITIES ACT AND THE SUITABILITY OF THE PREMISES FOR LESSEE'S INTENDED USE.

WARNING: IF THE PREMISES ARE LOCATED IN A STATE OTHER THAN CALIFORNIA, CERTAIN PROVISIONS OF THE LEASE MAY NEED TO BE REVISED TO COMPLY WITH THE LAWS OF THE STATE IN WHICH THE PREMISES ARE LOCATED.

The parties hereto have executed this Lease at the place and on the dates specified above their respective signatures.

Executed at: San Leandro, CA	Executed at: San Leandro, CA
on: 3/2/05	on: 1 March 2005
By LESSOR:	By LESSEE:
2101 Williams Associates, LLC	Energy Recovery, Inc.
By: /s/ Donald L. Jones	By: /s/ G. G. PIQUE
Name Printed: Donald L. Jones	Name Printed: G. G. PIQUE
Title: Managing Member	Title: PRESIDENT / CEO
By:	By:
Name Printed:	Name Printed:
Title:	Title:
Address: 2081 Adams Ave San Leandro, CA 94577	Address: 1908 DOOLITTLE DR SAN LEANDRO, CA 94577
Telephone: (__) 510-562-2580	Telephone: (510) 483-7370
Facsimile: (__) 510-562-9978	Facsimile: (510) 483-7371
Federal ID No.	Federal ID No.

These forms are often modified to meet changing requirements of law and needs of the Industry. Always write or call to make sure you are utilizing the most current form: American Industrial Real Estate Association, 700 South Flower Street, Suite 600, Los Angeles, CA 90017. (213) 687-8777.

ADDENDUM TO STANDARD INDUSTRIAL LEASE DATED FEBRUARY 28, 2005, BY AND BETWEEN 2101 WILLIAMS ASSOCIATES, LLC, AS LESSOR, AND ENERGY RECOVERY, INC. (ERI), AS LESSEE.

50. Leased Premises. The subject Premises include that certain 9,559 square feet of plant and offices, commonly known as 1908 Doolittle Drive and leased by Lessee pursuant to that certain Lease dated July 25, 2000 ("Original Lease" and "Original Premises"), which is herein being expanded to include ("Expansion Areas"):

(i) that certain 5,154 square feet of offices commonly known as 2199 Williams Street

(ii) that certain 4,250 square feet of light industrial space commonly known as 2191 Williams Street

(iii) that certain 3, 219 square feet of warehouse commonly known as 2189 Williams Street

Cumulatively, the above is part of and shall be hereafter referred to as the "Premises" and "1908 Doolittle Drive," and are shown on Exhibit "A" attached hereto.

51. Renovation/Commencement of Lease/ Prior Occupancy/Early Possession of Expansion Areas.

a. Lessor agrees, at its sole cost and expense, and as soon as it can reasonably be accomplished following the execution of this Lease, to commence and prosecute to completion in a diligent and good and workmanlike manner: (1) plans and specifications, by an architect and/or engineer where required, for the renovation and improvements set forth in Exhibit "B" to this Lease; (2) the application and receipt of appropriate planning and building permits where required; and (3) the construction and delivery of said improvements and Premises to Lessee. Lessee understands that facets of the renovation and construction of improvements, especially those to the Original Premises, will cause some inconvenience to Lessee and disruption of normal operations, including the creation of dust and noise, the need for Lessee to close areas while construction is underway, and the need for Lessee to provide access to the Premises sometimes during non-business hours.

b. The parties hereto are aiming toward substantial completion and delivery of Lessee's Premises according to the approximate timeline described below, which is based on and subject to: (1) the Lessee executing this Lease by March 1, 2005; (2) the cancellation of lease provisions set forth in Paragraph 64; and (3) provided Lessor is not delayed by causes beyond its control, which shall include but not be limited to any unanticipated delays in obtaining building permits, any delays in construction due to fires, unusually severe weather, labor problems, including strikes or slowdowns, acts of God, and other similar causes, and delays caused by the Lessee or its agents and/or sub-contractors:

April 1, 2005-	Original Premises (1908 Doolittle Drive)
May 1, 2005-	5,154 SF (formerly known as 2199 Williams)
	4 250 SF (formerly known as 2191 Williams)
	3,219 SF (formerly known as 2189 Williams) — subject to unreasonable delays due to engineering and permits
	Exterior Improvements (including new exits and modifications to existing, but excluding paving and striping)
June 1, 2005-	Paving and Striping of all or a portion of the Southwest parking lot.

Should Lessor fail to deliver the Premises by any of the above dates, then this Lease shall commence upon the date Lessor does substantially complete the above work and delivers possession to Lessee. If the actual commencement date of this Lease is other than that set forth in Paragraph 1.3 above, then Lessor and Lessee shall prepare and execute an Amendment to Lease setting forth the revised commencement and termination dates of the Lease term, but failure to execute such an amendment shall not affect the actual commencement date.

"Substantial completion" or "Substantially completing" shall be the date as agreed between Lessor and Lessee, or, if the parties cannot so agree, then it shall be upon execution of a certification from the architect or engineer supervising the construction of the Premises that all of the improvements hereto above described have been on the date specified in said certification substantially completed in accordance with the plans and specifications to the extent that Lessee can reasonably and conveniently use and occupy the building and appurtenances for the conduct of its ordinary business and, if required, the issuance of a certificate, or temporary certificate, of occupancy for the Premises. It is understood that Lessee may commence setting up its operations and performing tenant related improvements within the Premises before Lessor substantially completes its construction; however, Lessee agrees that its work shall not interfere with or delay Lessor's construction, including the date of substantial completion. Nor shall substantial

/s/ Illegible _____ /s/ _____

completion be delayed due to Lessee's delay or failure to perform its tasks or complete any improvements it undertakes.

c. Prior Occupancy. Lessee is granted prior occupancy of the demised Premises for the purposes of setting up its operations and performing tenant related improvements, including bringing in data and telephone cabling, provided that said prior occupancy and work shall not delay or interfere with the conduct of Lessor's work or performance, or cause labor difficulties. Any such prior occupancy shall be upon all of the terms and conditions of this Lease, including indemnifying Lessor and carrying liability and property damage insurance and reimbursing Lessor for any utilities or services used, except that the Lessee shall not be responsible for paying rent until the commencement date or early possession hereof of the particular expansion space being improved.

d. Early Possession of Expansion Areas. Lessee is granted early possession for its operations (i.e. prior to the formal commencement of the Lease on May 1, 2005) upon substantial completion of each Expansion Area. Any early possession shall be upon all of the terms and conditions of this Lease and Lessee shall pay additional rent for each Expansion Area as set forth in Paragraph 52.

52. Rental Schedule.

a. Early Possession Rent Schedule. Prior to the termination of the Original Lease provided herein, Lessee shall continue to pay its current base monthly rent for the Original Premises and other expenses due as set forth in the Original Lease. Base monthly rent for the Expansion Areas shall be as follows and shall commence upon substantial completion of each Expansion Area:

2189 Williams Street	$1,930.00
2199 Williams Street	$4,640.00
2191 Williams Street	$2,975.00

b. The monthly base rent, as set forth in Paragraph 1.5 of the Lease, shall be adjusted pursuant to this paragraph on the 31st month of the Lease term (the "adjustment date") and the rent as so adjusted shall be payable each succeeding month until the expiration of the primary term of the Lease. The adjusted monthly base rent shall be $18,190.00.

53. Security Deposit. Lessor shall apply the six thousand, six hundred and ninety dollars and no/100 ($6,690.00) security deposit paid by Lessee in August 2000 and held by Lessor towards the security deposit due per Paragraph 1.7c of this Lease, provided that Lessee is not in default in its performance of any material term or condition of the Lease, dated July 25, 2000, by and between 2101 Williams Associates, LLC, as Lessor, and Energy Recovery, Inc., as Lessee, for the Premises commonly known as 1908 Doolittle Drive, San Leandro, California, 94577.

Notwithstanding the above paragraph or the provisions of paragraphs 1.7.c. and 5 of the Lease, Lessee shall, to further secure its obligations under this Lease, establish an Escrow Account at a conventional financial institution in the initial base amount of Sixty-Nine Thousand Two Hundred dollars ($69,200.00) to function as follows:

If rent and other monies due under the Lease shall not be received by Lessor within ten (10) days after such amount is due then, without any requirement for notice to Lessee, Lessor shall have the right to withdraw said amount due from the Escrow Account. In that event, Lessee shall within ten (10) days of written request from Lessor therefore deposit monies sufficient to restore said Escrow Account to its full amount required by this clause. Lessee's failure to do so shall constitute a material default under this Lease.

Lessee's obligation to maintain said Escrow Account shall cease upon the last day of the thirty-sixth (36th) month of this Lease provided that Lessee has fulfilled its material obligations under this Lease in a timely manner, is still in possession of the subject Premises, and has provided Lessor with financial statements evidencing Lessee's continued financial security and ability to fulfill its remaining obligations under this Lease.

All interest accrued on said Escrow Account shall remain in said account and add to the $69,200.00 base amount; provided, however, that if the need for said Escrow Account shall cease as provided for above, then any such accrued interest shall be paid to Lessee and become a part of the total amount so withdrawn.

/s/ Illegible _____ /s/ _____

54. Repairs. Notwithstanding the provisions of paragraph 7.1 of this Lease, the Lessee shall not be responsible, either in whole or in part and except as provided below, for the following type repairs: structural repairs; utilities which are "external" to the Premises and which serve the overall project or building of which the demised Premises are a part; repairs of a "capital" nature such as the major repair or replacement of paving, air conditioning, heating, plumbing, electrical or similar type equipment or improvements caused by old age or extended use, it being the intent to this Lease that the Lessee should not be responsible for excessive wear and tear of such equipment or improvements which occurred prior to Lessee's occupancy of the Premises; repairs due to design or structural defects, latent or patent; repairs which are covered by warranty; and costs caused by the act or neglect of the Lessor, or other tenants or third parties which are known to be the cause of the additional costs and for which reimbursement can be obtained through the best efforts of the Lessor or its agents.

    The Lessee shall be responsible, however, for its prorata share of regular and periodic maintenance and repairs of all such equipment and improvements listed above; for replacement of light bulbs and tubes; for its real or accrued prorata share of repairs and replacements resulting from the use and depreciation of such equipment and improvements during Lessee's occupancy; for any repair, replacement or maintenance required because of the fault or negligence of the Lessee (or of any other tenant, agent, invitee of the Project where cause cannot be found or assigned through the best efforts of the Lessor); for minor plumbing repairs or stoppages within the demised Premises; and for the general upkeep, maintenance, and repair of Lessee's exclusive premises except as provided herein. Part of the above responsibilities are covered by the common area expense allocations established in paragraph 4.2 of the Lease.

55. Utilities. Notwithstanding the standard Utility Clause contained in the Lease, it is understood that portions of the water, electricity, and in some instances gas serving the Premises will be or are currently being supplied under one meter for the entire building and project of which the demised Premises are a part. Lessee agrees upon demand and as additional rental hereunder to pay its prorata share of said utilities, to be determined as follows:

    a. Electrical: Lessor will install house meters to help measure Lessee's primary electrical usage. Lessee will be responsible only for its own electrical usage and will cooperate with Lessor in determining same.

    b. Water, excluding fire sprinkler system standby charges: In reference to restroom, lunchroom and similar type uses, Lessee shall pay its prorata share of water usage and sewer service charges, based generally on the ratio that Lessee's total rentable area and/or number of employees, if that is a more accurate method of measuring usage, bears to the total occupied area and/or number of employees in the project. In reference to Lessee's manufacturing or painting processes, any requirement for above normal water supply and usage shall be measured by a house meter installed by Lessee.

    c. Fire sprinkler system standby charges: Lessee shall pay its prorata share based on the percentage that Lessee's total rentable area bears to the total rentable area within the building or buildings of which the demised Premises are a part and which are metered as one.

    d. Gas. (Separately metered by PG&E if required.)

    e. Common Area Expenses: Lessee's prorata share will be generally determined based on Lessee's percentage occupancy, and use, of the total rentable area within the applicable portion of the Project; provided, however, that Lessee shall also be responsible for nay additional or special costs caused or incurred because of Lessee's unique use or operation.

    All such formulas and calculations will be based on sound and reasonable accounting practices for projects similar to the subject development.

56. Brokers. Each party represents that it has not had dealings with any real estate broker, agent, finder or other person with respect to this Lease in any manner, except for Donald L. Jones Company. Each party shall hold harmless the other party from all damages resulting from any claims that may be asserted against the other party by any broker, agent, finder, or other person with whom such indemnifying party has or purportedly has dealt. Lessor shall be liable for any commission or fee payable to Donald L. Jones Company.

57. Condemnation. Notwithstanding the provisions of paragraph 14 above, in the event of condemnation, as in paragraph 14 defined, Lessee shall participate in any award to the extant of its unamortized costs for those leasehold improvements title to which passed to or, upon the expiration of this Lease, may pass to Lessor, and for monetary damages related to the bonus value of its lease, fixtures, moving expenses and business interruption, and to any other portion of the

/s/ Illegible _____ /s/ _____

award which by statute compensates the Lessee for the termination of Lessee's leasehold estate, for which as to either or all of the above the condemning authorities make a specific allocation in their award provided that said allocation does not reduce the award made to the Lessor.

58. Limit on Liability. Lessor herein is a an LLC, and it is understood and agreed that any claims by Lessee against Lessor shall be limited to the assets of the partnership or LLC, and furthermore, Lessee expressly waives any and all rights to proceed against the individual partners or the officers, directors or shareholders of any corporate partner, except to the extent of their interest in said partnership.

59. Parking. Assigned parking and the use of outside area within the complex shall be equitably prorated between the tenants; provided, however, that all parties understand and agree that the number of available spaces as well as the tenant mix within the project can change from time to time.

As of the date of this Lease, Lessee is allocated _____ spaces as shown marked on the attached exhibit (to be inserted upon completion of the Site Plan by Lessor's architects).

60. Property Tax & Insurance Base Year and Increase Calculations

a. Property Tax. The base year for calculating property tax shall be the annual amount of property taxes assessed on the Project for the year 2004/2005 adjusted to include any increase in assessment from improvements to be made to the property by the Lessor, in general conformance with Exhibit "B" of this Lease. Notwithstanding the provisions of Paragraph 10 of this Lease, Lessee shall not be responsible for any increase in real property taxes attributable to renovation work and improvements made to the project either by or on behalf of the Lessor or other tenants; provided, however, that Lessee shall be responsible for its prorata share of any subsequent increase in taxes attributable to inflationary increases in valuation or rate change of any such improvements. Except for the improvements to be made by Lessor pursuant to this Lease, Lessee shall be responsible for increases to real property taxes attributable to improvements made by or on behalf of Lessee. Lessee shall not be responsible for any income, excess profits, estate, inheritance or franchise taxes (except taxes imposed in either direct or indirect substitution for real property taxes) or taxes or assessments or other charges or operating expenses otherwise paid by Lessee or by other tenants of the building or project.

b. Insurance. The base year for calculating insurance increases shall be the annual amount of premiums paid on the Property for the year 2004/2005 adjusted to reflect any increase in value for all initial improvements to be made to the property by the Lessor in general conformance with Exhibit "B" of this Lease. Notwithstanding the provisions of Paragraph 8 above, Lessee shall not be responsible for any initial increase in valuation attributable to the renovation work and improvements made to the project or by future capital type improvements made to the Project either by the Lessor or by other tenants, except for capital improvements made for the benefit of Lessee either in part or in whole (exclusive of those improvements made pursuant to Exhibit "B" to this Lease). Lessee shall, however, be responsible for any subsequent inflationary increase in valuation of said improvements. Lessee's potential liability for insurance increases assumes that Lessor uses its best efforts to secure said insurance at competitive rates.

61. Damage or Destruction. Notwithstanding anything to the contrary contained in paragraph 9 of the Lease, it is agreed that:

a. Lessor shall be required to provide to Lessee within thirty (30) days following the occurrence of the damage or destruction, specific notice on whether the Lessor will have the Premises rebuilt within six (6) months from the date of the casualty. Lessee shall have the right to immediately terminate the Lease in the event:

(1) Lessor fails to provide such notice to Lessee within such thirty (30) day period;

(2) Lessor states in said notice that it shall not have the Premises rebuilt within such six (6) month period; or

(3) If Lessor notifies Lessee that it will rebuild the Premises within such six (6) month period, but fails to diligently begin the process of repairing the same no later than sixty (60) days from the date of the casualty.

b. Under no circumstances shall Lessor have the right to terminate this Lease unless it is electing not to rebuild the Premises within said approximately 6 month period.

/s/ Illegible _____ /s/ _____

c. Partial Damage is defined as that in which the cost of restoration is less than twenty-five (25%) percent of the then replacement value of the Premises.

62. Option to Renew. Lessor grants to Lessee an option to renew this Lease for one (1) additional five(5) year period on the same terms, conditions, covenants, agreements or amendments, if any, then if force pursuant to this Lease except for the amount of the rental rate which shall be determined as set for below.

Lessee shall exercise this option by serving written notice upon Lessor of its intent to exercise the above options at least six (6) months prior to the expiration of the initial five year term of the lease. Lessee shall have the right to exercise this option only in the event that Lessee is not in default in its performance of any material term or condition of the Lease.

Said rent for the renewal term shall be determined either by agreement between the parties or by arbitration based on 95% of the fair market rent value of the Premises. For the purposes of this clause, fair market rent shall be defined as the probable industrial gross rent that the Premises should bring in a competitive and open market at the time that this option is exercised, with the Lessor and a "highest and best use" tenant acting prudently and knowledgeably, based on the "as is" condition of the Premises at that time and upon lease terms and conditions consistent with those that govern this Lease extension.

If Lessor and Lessee are unable to agree upon said fair market rent value within thirty (30) days from notice of exercise of the option herein granted, then it will be set either by a qualified MAI appraiser chosen by the parties, or by arbitration as follows:

a. Within five (5) days after written notice by either party to the other requesting arbitration, one arbitrator shall be appointed by each party. Notice in writing of such appointment, when made, shall be given by each party to the other. The two arbitrators so named shall meet promptly and seek to reach a conclusion as to the fair market rent value of the Premises, and their decision rendered in writing and delivered to the parties hereto shall be final and binding on the parties.

b. If said two (2) arbitrators shall fail to reach a decision within fifteen (15) days after appointment of the second arbitrator, then the two arbitrators shall forthwith choose a third arbitrator within five (5) days to act with them. If they fail to select a third arbitrator within said five (5) days, the third arbitrator shall be promptly appointed by the Presiding Judge of the Superior Court, State of California, County of Alameda. The party making such application to said Judge shall give the other party hereto five (5) days written notice thereof.

c. The arbitration shall proceed with due dispatch. The third arbitrator shall select the value submitted by one of the initial two arbitrators that is closest to the value determined by the third arbitrator. The decision of third arbitrator, reached accordingly, shall be binding, final and conclusive on the parties hereto. Such decision shall be in writing and delivered to the parties.

d. If either party fails to appoint an arbitrator as herein provided, then the arbitrator that has been appointed shall be the sole arbitrator.

e. The expense of any such arbitration shall be borne equally between the parties hereto, except that the cost of any attorney's fees incurred by the parties are their own respective responsibilities.

f. The arbitration shall be conducted in accordance with the applicable statutes of the State of California then in effect.

63. Right of First Refusal.

During the term of this Lease and at such time as Lessor is aware that the space commonly known as 2181 Williams is under the control of Landlord or will be available for lease, Lessor shall notify Lessee in writing of such availability. Thereafter, Lessee shall have the right for a period of fifteen (15) days to exercise its right in writing to lease said available space at the then paying escalated per square foot rate for the initial Premises herein leased. All other terms shall be the same, including the expiration date which shall be coterminous with the initial Premises and the base year for property taxes and insurance. See Exhibit "C"

64. Contingency and Cancellation Provisions. Portions of this Lease and the approximate timeline for delivery of portions of Lessee's premises is subject to and contingent upon the existing tenants in the spaces commonly known as 2191 and 2199 Williams Street vacating their premises in a timely fashion upon Lessor's 30 Day Notice to Vacate. Lessor's 30 Day Notice to Vacate to such existing tenants shall be given upon execution of this Lease.

/s/ Illegible _____ /s/ _____

Additionally, this Lease is subject to the full execution and consummation of that Agreement for Lease Termination, dated February 22, 2005, between 2101 Williams Associates and Energy Recovery, Inc. of the Original Lease.

65. Cost Overruns. Should the total cost of the improvements paid or incurred by Lessor exceed the total budgeted amount set forth in Exhibit "B" to this Lease, then Lessee at its option shall either (1) pay the difference to Lessor in cash within thirty (30) days after Lessor completes the construction and delivers the improved premises to the Lessee; or (2) amortize the difference as additional rental over the extended term at a 10% annualized interest rate.

Lessor will endeavor, in good faith, to provide Lessee with realistic budget estimates, and to timely advise Lessee when said costs have or are expected to change.

Exhibit "A"

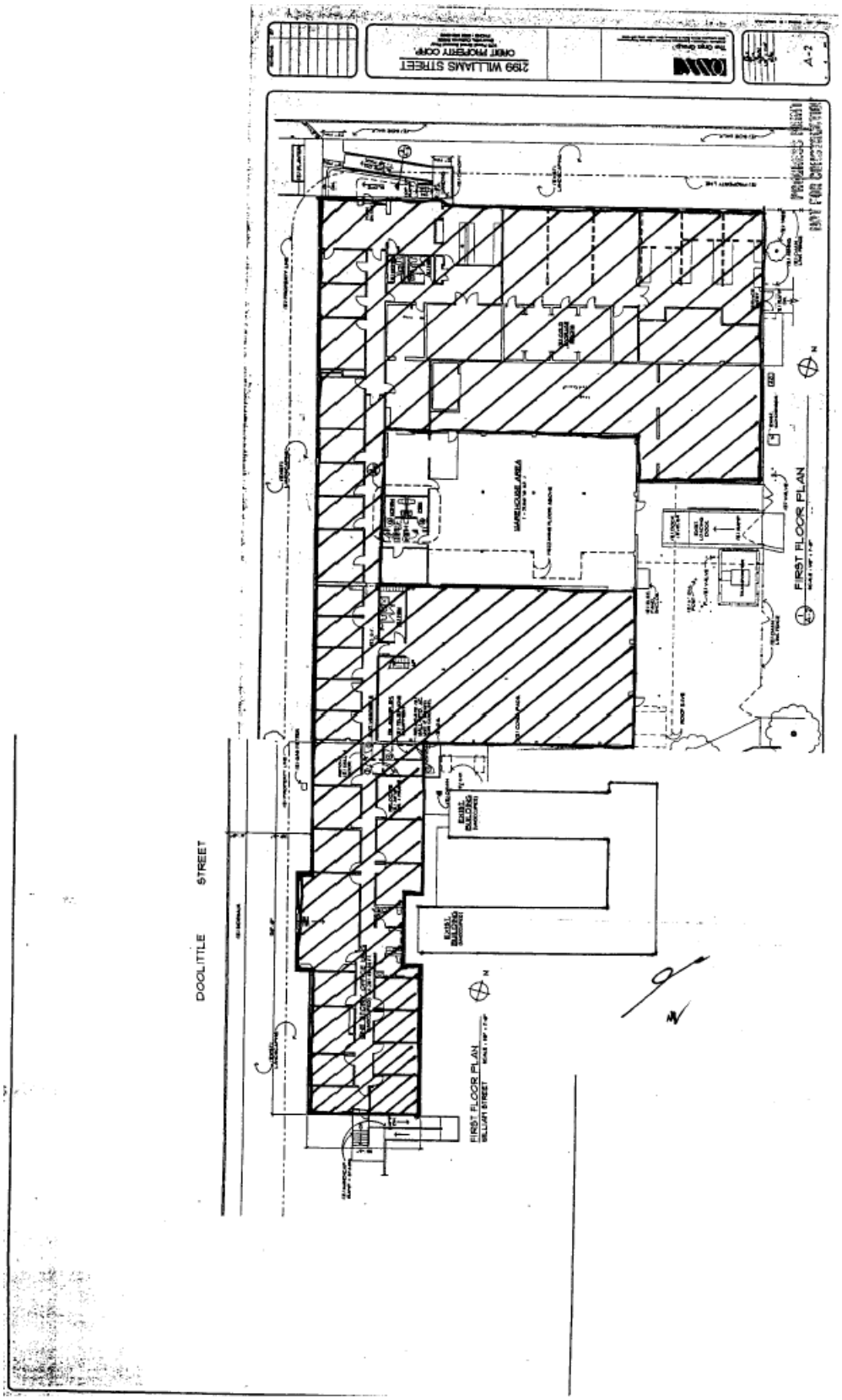

2199 WILLIAMS STREET
OWNER PROPERTY CORP.
A-2
FIRST FLOOR PLAN
DOOLITTLE STREET
FIRST FLOOR PLAN

EXHIBIT "B"
To Standard Industrial Lease, dated February 28, 2005, by and between 2101 Williams, LLC, as Lessor, and Energy Recovery, Inc. (ERI), as Lessee

RENOVATION AND IMPROVEMENTS

	BUDGET
Original Premises (1908 Doolittle Drive)	
• Remove (2) damaged window screens at south front entry	$ 500
• Repair room partition wall in conference room so that it functions properly	$ 1,000
• Move water heater and/or install individual hot water units under sinks (5) total in office and warehouse	$ 2,500
• Re-paint walls and offices as necessary and requested by Lessee	$ 1,500
• Replace water stained or broken ceiling titles throughout offices	$ 500
• Insure lighting fixture ballasts are working throughout offices	$ 1,000
• Remove door and door frame between office hallway into Inspection room, frame, sheetrock and paint opening as shown on Exhibit "D".	$ 300
• Remove door, door frame and a portion of the walls in Southeast corner of the Inspection room as shown on Exhibit "D"	$ 300
• Remove door and door frame to Electrical Room. Enclose telecom and server equipment — an approximately 6' x 7' are — with framed, sheetrocked and painted walls to height of suspended ceiling. Install 3' x 7' solid wood door with deadbolt into enclosed Telecom/Server room. Floor inside remains "as is". See Exhibit "D"	$ 2,000
• Remove existing air conditioning wall unit and install window in same wall to approximately match existing windows in size. Patch and paint exterior wall as necessary.	$ 2,500
• Carpet floor are in electrical room around the enclosed Telecom/Server room	$ 500

	BUDGET
2189 Williams (3,219 sq ft)	
• Install approximately 8’ x 7’ wide opening with double doors between 2189 Williams and 2199 Williams, as shown on Exhibit “D”	$ 1,500
• Install 120/208 volt, 225 amp electrical panel including house meter.	Landlord
• Re-feed all existing electrical through new panel and house meter.	Incl.
• Provide 3-way switching (switch at exterior entrance and at door between warehouse and 2199 Williams	Incl.
• Replace or repair existing metal roof including rotary roof vents to code	Landlord
• Provide tenant $2,500 towards its cost of supplementing ventilation	$ 2,500
• Patch, repair and paint walls as required	$ 3,000
• Install new 3’ x 7’ storefront door, ADA ramp and landscaping to left of existing truck door as shown on Exhibit “D”	Landlord
• Repair or replace existing warehouse light fixtures	Landlord
2199 Williams (5,154 sq ft)	
• Reopen former doorway in wall between 1908 Doolittle and 2199 Williams and widen as structurally feasible, as shown on Exhibit “D”	$ 300
• Remove existing walls and doorways as shown on Exhibit “D”	$ 2,000
• Remove existing carpet and paint floors in areas marked “1” on Exhibit “D.” Paint or seal floors as practical to convert area for more dry-manufacturing type use	$ 3,000
• Remove existing carpet and replace with VCT in areas marked “2” on Exhibit “D”.	$ 2,000
• Replace existing carpet, re-paint walls, and install new suspended ceiling as Required throughout offices	Landlord
• Replace water stained or broken ceiling tiles throughout office	$ 500
• Install coffee counter and sink with running water, including individual hot	$ 3,000

	BUDGET
water unit in area marked “2” on Exhibit “D”	
• Supplement existing HVAC to provide typical heat and air conditioning to offices	$ 8,000
2191 Williams (warehouse) (4,250 sq ft)	
• Install 3’ x 7’ opening and door between 2191 Williams and 2199 Williams as shown on Exhibit “D”	$ 2,500
• Install 8’ wide opening for forklift between 2191 Williams and 2189 Williams as shown on Exhibit “D”	$ 1,500
• Construct two, approximately 8’ high, sheetrocked and painted walls in open area as shown on Exhibit “D”	$ 2,000
• Add insulation, as practical, in wall between 2191 Williams and 2199 Williams to improve acoustics in offices	$ 1,500
• Clear existing three (3) floor drains and insure proper drainage.	$ 1,500
• Allow ERI to install burm for water tank, to be removed by tenant upon Vacating premises or termination of Lease	
Exterior	
• Up to a maximum allowance of $50,000;	$50,000
i. Replace two (2) exterior windows on South-facing side of 1908 Doolittle entrance	
ii. Replace six (6) exterior windows on West-facing side of 1908 Doolittle office wing (up to metal siding)	
iii. Replace window film and/or panes as necessary in remaining exterior windows along entire west-facing Doolittle frontage and north-facing Williams frontage	
• ERI to approve all window designs and pay for upgrades as deemed necessary beyond minimum allowance	

	BUDGET
• Repave and stripe all or portion of parking area in front of 1908 Doolittle to eliminate low spots and potholes.	
• Install appropriate “No parking — tow away “signs in Doolittle parkinglot	
• Allow for larger signage to be attached to building or placed in front landscape area of 1908 Doolittle per local zoning restrictions.	
• Allow ERI to install a removable chain link barrier on rear loading dock between ERI and 88 Linen. New barrier to be coordinated with and approved by 88 Linen.	
• Re-paint as necessary non-beige, painted exterior portions of the Project to match as closely as possible existing beige color	$ 20,000
• Add emergency exit from 1908 Doolittle offices, with 3’ x 7’ metal door with Panic bar hardware and ADA ramp from electrical room. Tenant to modify fence it installed to accommodate new emergency exit	Landlord
• Provide ADA ramp to existing 2199 Williams Street exit	Landlord

Additional Requirements

• Insure that all existing doors, electrical, mechanical (including HVAC) and plumbing systems serving all leased Premises are in good working order, and maintain the roofing in good, water tight condition.	
• Allow ERI, Inc. to choose and pay for carpeting and interior painting upgrades beyond minimum allowance for all building.	
TOTAL	$117,400

Exhibit "C"

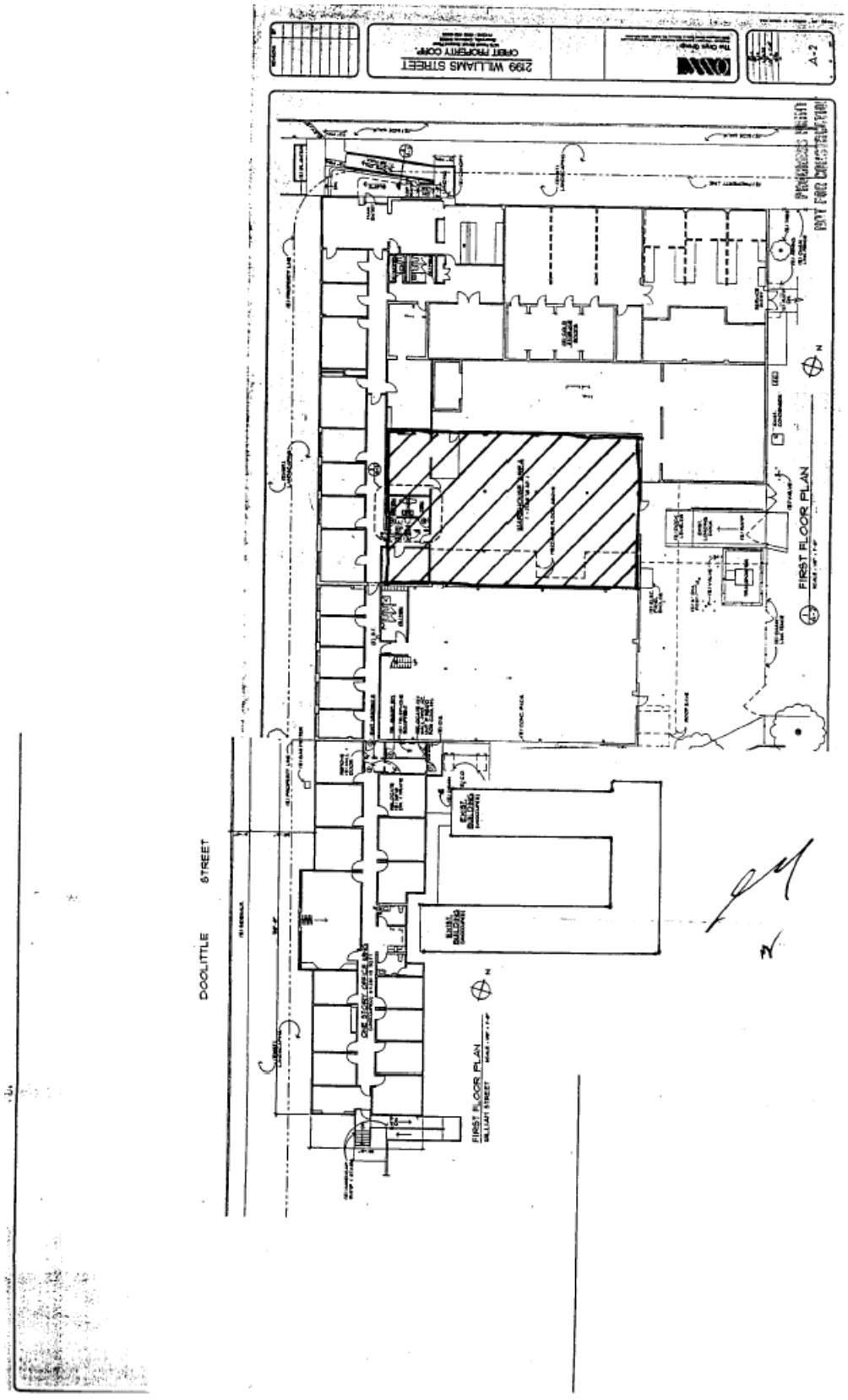

2199 WILLIAMS STREET
FIRST FLOOR PLAN
DOOLITTLE STREET
FIRST FLOOR PLAN

Exhibit "D"

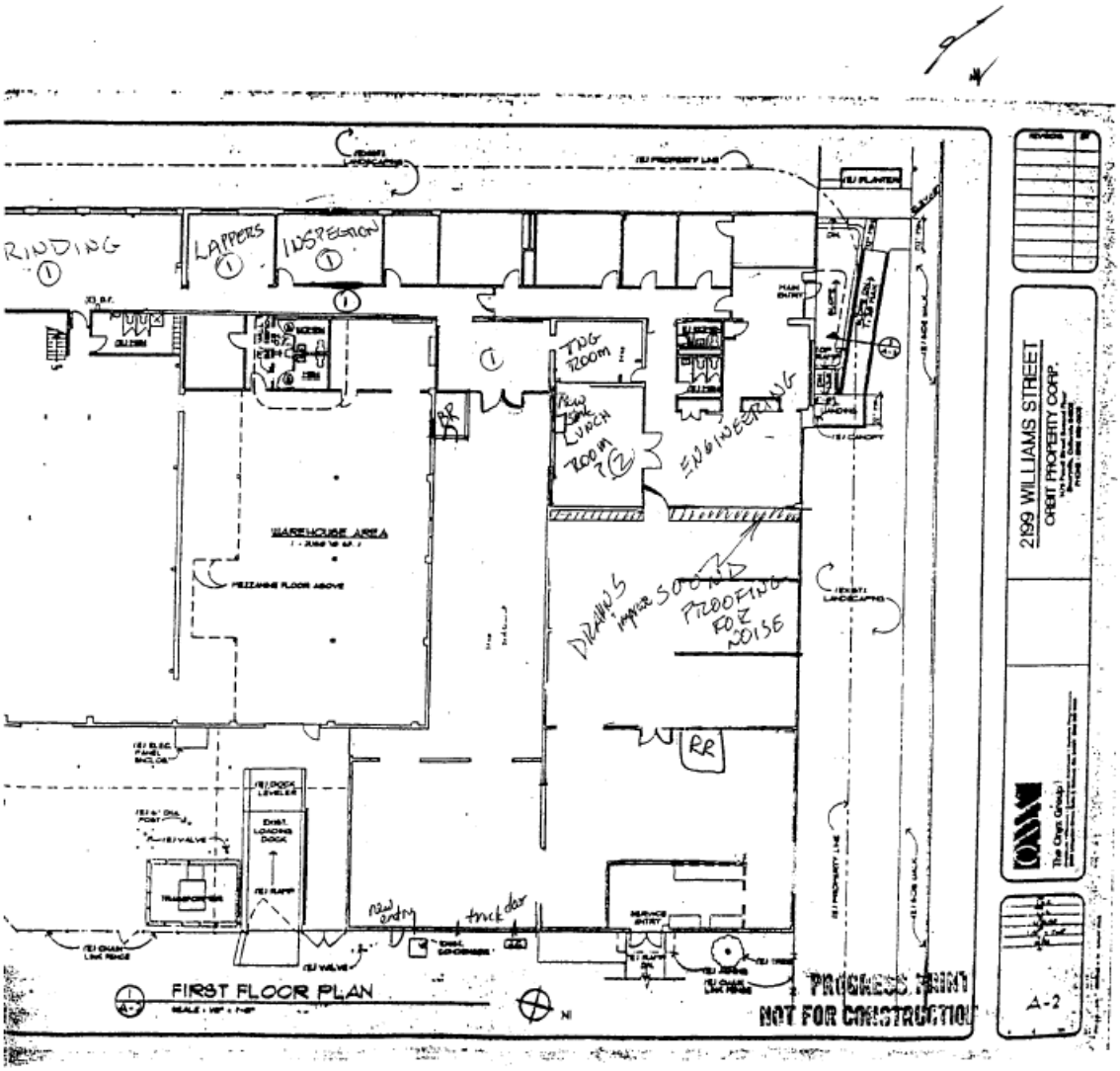
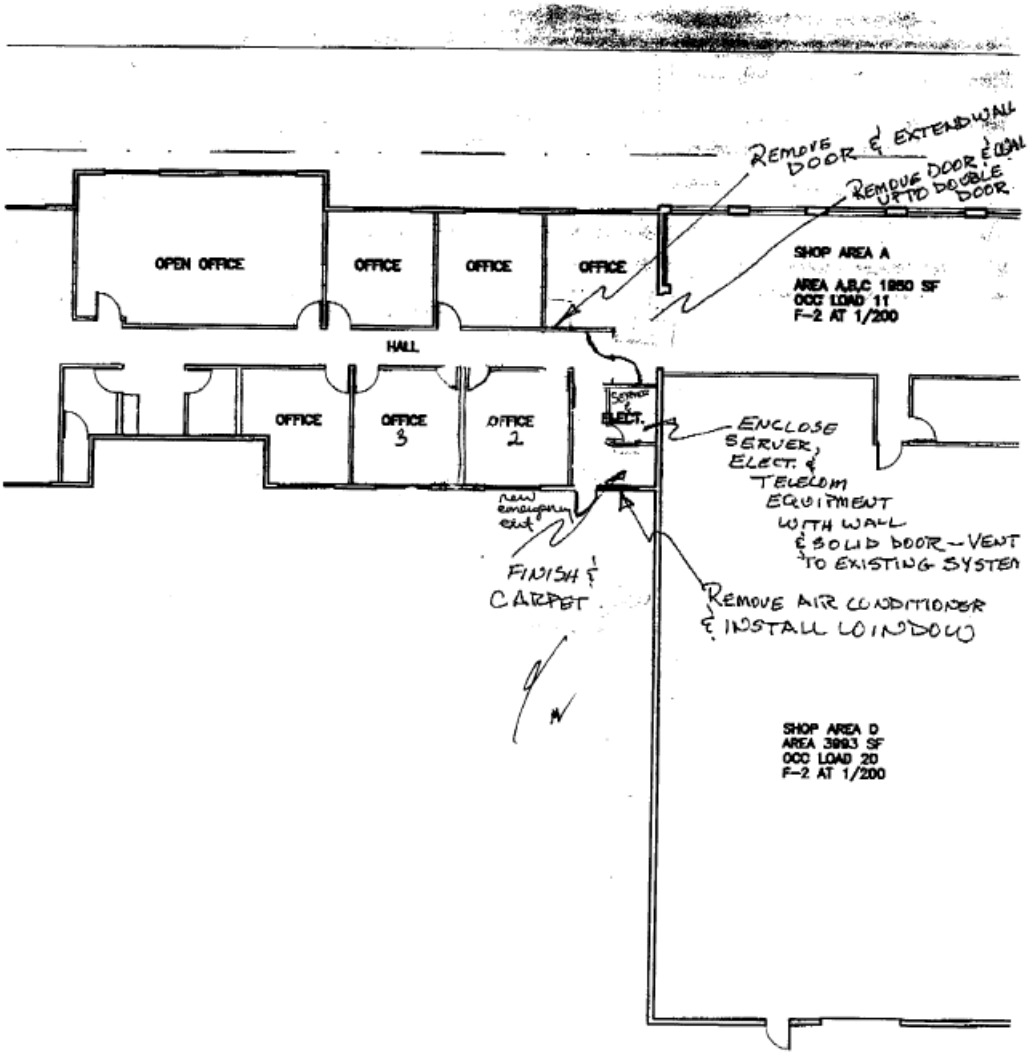

RINDING
LAPPERS
INSPECTION
WAREHOUSE AREA
MEZZANINE FLOOR ABOVE
RR
2199 WILLIAMS STREET
ORBIT PROPERTY CORP.
A-2
FIRST FLOOR PLAN
NOT FOR CONSTRUCTION

Exhibit "D"


REMOVE DOOR & EXTEND WALL
REMOVE DOOR & INFILL UPTO DOUBLE DOOR
OPEN OFFICE
OFFICE
OFFICE
OFFICE
SHOP AREA A
AREA A,B,C 1950 SF
OCC LOAD 11
F-2 AT 1/200
HALL
OFFICE
OFFICE 3
OFFICE 2
SERVER & ELECT.
ENCLOSE SERVER, ELECT. & TELECOM EQUIPMENT WITH WALL & SOLID DOOR - VENT TO EXISTING SYSTEM
new emergency exit
FINISH & CARPET
REMOVE AIR CONDITIONER & INSTALL WINDOW
N
SHOP AREA D
AREA 3993 SF
OCC LOAD 20
F-2 AT 1/200

AMENDMENT TO LEASE

THIS AMENDMENT TO LEASE, being entered into this 3rd day of October, 2005, between 2101 Williams Associates, LLC, a California limited liability company, hereinafter called Lessor, and Energy Recovery, Inc., a Delaware corporation (ERI), hereinafter called Lessee, covering the premises commonly referred to as 1908 Doolittle Drive, San Leandro, California.

Lessor and Lessee hereby amend that certain Lease between them dated February 28, 2005 as follows:

1. The term of the Lease shall be changed to commence on June 15, 2005, and end on June 14, 2010. The rent increase shall be effective on December 15, 2007.

2. The premises as defined in paragraph 1.2a of the Lease are hereby expanded to include that certain approximately 4,072 SF of warehouse and office commonly known as 2181 Williams Street (Expansion Area) and outlined in green on Exhibit "A" attached hereto.

   Lessee's total revised square footage, including the Expansion Area referenced above, has herein been increased to approximately 26,254 square feet, including 8,847 SF of office and 17,407 SF of warehouse and manufacturing space.

3. Lessor agrees at its sole cost and expense and as soon as it can reasonably be accomplished following the execution of this Amendment, to commence and prosecute to completion in a diligent and good and workmanlike manner the construction and delivery of the improvements to the Expansion Area as set forth in Exhibit "C." Lessee understands that facets of the renovation and construction of said improvements will cause some inconvenience to Lessee and disruption of normal operations, including but not limited to the creation of dust and noise.

4. The parties hereto are aiming toward substantial completion and delivery of the Expansion Area to the Lessee on October 15, 2005; provided that Lessor is not delayed by causes beyond its control, which shall include but not be limited to any unanticipated delays due to obtaining any necessary building permits, any delays in construction due to fires, unusually severe weather, labor problems including strikes or slowdowns, acts of God, and other similar causes, and delays caused by the Lessee or its agents and/or subcontractors. The Expansion Area lease term shall end coterminous with the initial Premises on June 14, 2010.

   Should Lessor fail to deliver the Expansion Area by the above date, then the Expansion Area Lease term shall commence upon the date Lessor does substantially complete the above work and delivers possession to Lessee. If the actual lease commencement date of the Expansion Area is other than that set forth above, then Lessor and Lessee shall prepare and execute a Second Amendment to Lease setting forth the revised commencement and termination dates of the Expansion Area Lease term, but failure to execute such an amendment shall not affect the actual commencement date.

   "Substantial completion" or "substantially completing" shall be the date as agreed between Lessor and Lessee, or, if the parties cannot so agree, then it shall be upon execution of a certification from the architect or engineer supervising the construction of the Premises that all of the improvements hereto above described have been on the date specified in said certification substantially completed in accordance with the plans and specifications to the extent that Lessee can reasonably and conveniently use and occupy the building and appurtenances for the conduct of its ordinary business and, if required, the issuance of a certificate, or temporary certificate, of occupancy for the Premises. It is understood that Lessee may commence setting up its operations and performing its separate tenant related improvements within the Expansion Area before Lessor substantially completes its construction; however, Lessee agrees that its

work shall not interfere with or delay Lessor's construction, including the date of substantial completion. Nor shall substantial completion be delayed due to Lessee's delay or failure to perform its tasks or complete any improvements it undertakes.

5. The base monthly rent for the Expansion Area, subject to existing and future increases over base year taxes and insurance and other expenses as set forth in the subject Lease, shall be as follows:

10/15/2005 — 12/14/2007	—	$3,828.00/month I.G.
12/15/2007 — 06/14/2010	—	$3,990.00/month I.G.

The total base monthly rent for all of Lessee's premises shall be $21,128.00 ($0.80/SF), and shall increase on December 15, 2007 to $22,180.00 ($0.84/SF).

6. Should the total cost of the improvements to the Expansion Area paid or incurred by Lessor exceed the total budgeted amount set forth in Exhibit "C" to this Lease, then Lessee at its option shall either (1) pay the difference to Lessor in cash within thirty (30) days after Lessor completes the construction and delivers the improved Expansion Area to the Lessee; or (2) amortize the difference as additional rental over the term for the Expansion Area at a 10% annualized interest rate. Lessor will endeavor, in good faith, to provide Lessee with realistic budget estimates, and to timely advise Lessee when said costs have or are expected to change.

7. Lessee shall pay all common area expenses and all utility and service charges for the entire building. Should Lessor lease the vacant premises commonly known as 1906 Doolittle Drive, then Lessee's share of common area expenses and utilities shall be reduced to its prorata share to be determined as set forth in Paragraph 55 of the Lease.

8. The Security Deposit paid and Escrow Account established pursuant to the Lease shall remain in effect and cover the Expansion Area. At such time that the Escrow Account closes, Lessee shall deposit with Lessor $2,600 as security for 2181 Williams Street.

9. Lessee's option to renew for one (1) additional five (5) year period at market rents, with six (6) moths prior written notice will apply to the Expansion Area as well.

10. Except as herein specified, all of the other terms and conditions of the subject Lease shall remain in full force and effect.

IN WITNESS WHEREOF, Lessor and Lessee have executed this Amendment To Lease the day and year first written above.

LESSOR

2101 Williams Associates, LLC

By: /s/ Donald L. Jones
Donald L. Jones, Manager

LESSEE

Energy Recovery, Inc.

By: /s/ G.G. Pique
G.G. Pique, President/CEO

EXHIBIT "C"

to Amendment To Lease, dated September 8, 2005, by and between 2101 Williams, LLC, as Lessor, and Energy Recovery, Inc. (ERI) as Lessee

RENOVATION AND IMPROVEMENTS FOR 2181 WILLIAMS STREET (4,072 SF)

	BUDGET
ELECTRICAL	$ 9,800
• Replace existing three (3) exterior light fixtures around loading dock with four (4) existing fixtures in Office 1 — one at 1908 Doolittle truck door, one at 2181 Williams truck door, and two along side of truck dock (existing fixture above main electrical panel will not be replaced)	
• Repair and relamp all lighting fixtures	
• Remove all unused conduit and approximately 6 panels on north wall in warehouse (Lessee responsible for meeting with electrician directly if any electrical improvements should stay)	
• Connect two (2) new exhaust fans (fans should be 208V)	
• Remove one (1) unused electrical transformers — from northeast corner of warehouse	
• Check telephone system in Office 1 and remove if obsolete	
• Add new lights to new drop ceiling in Office 1	
• Remove obsolete panel on east wall of Office I	
• Replace existing quadplexes with 2 duplexes per wall on the east, south and west walls of Office I — new duplexes should be closer to floor and recessed to make flush with new 5/8 sheetrock to be added	
CARPENTRY	$ 18,000
• Create 10' x 12' opening in wall between 2181 and 2189 Williams in approximate location of previously filled opening.	

	BUDGET
• Remove wall cabinets and metal poster cabinet in Office 1. Save metal poster cabinet for ERI	
• Repair sliding doors and/or replace tracks in Office 1	
• Install new drop ceiling (2' x 4' grid) in Office 1	
• Install door closer on door to warehouse in Office 1	
• Sheetrock, tape and texture walls in Office 1 (painting by others)	
• Patch hole in hallway at ceiling in front of restroom	
• Create 4' x 7' opening in wall between 2181 Williams and 2199 Williams mfg area	
• Drop sprinkler heads for new suspended ceiling	
PLUMBING	$ 1,500
• Remove unused gas piping on north wall in warehouse	
• Remove floor to roof pipe/vent near mezzanine structure	
• 2" water line with meter to remain on north wall in warehouse	
• Remove gas pipe and bib on west wall in Office 1 to above suspended ceiling height	
• Hydro jet sanitary sewer lines from trench drains	
HVAC	
• Install two (2) new (each 12,000 CFM) exhaust fans (208V) Similar to those installed in 1908 Doolittle and 2189 Williams Air handling will match or exceed capacity of 3 existing fans in 1908 Doolittle	$ 8,200
• Run HVAC to Office 1, Office 2, and hallway in front of Office 2 and restrooms	$ 15,955
DOCK & DOOR EQUIPMENT	landlord
• Insure loading dock platform is in working order	
• Insure roll up door between 2181 Williams and 1908 Doolittle is in working order	
• Insure front roll up door to 2181 Williams is in working order	
PAINTING	
• Blow down dust and lint from warehouse ceiling	landlord
• Paint exterior wall on south side of roll up door, roll up door and touch up	landlord

	BUDGET
North wall along recessed truck dock.	
• Paint Office 1, Office 2, and hallway in front of Office 2 and restrooms	landlord
MISCELLANEOUS	
• Remove largest hoist from track (located closest to east wall)	$ 0
• Fill secondary trench drains with concrete from in front of new passageway into 2189 Williams to northeast corner of warehouse.	landlord
• Grind down steel studs and remainder of concrete equipment pads on north side of warehouse floor. Then clean warehouse floor	$ 4380
• Seal warehouse floor	$ 3206
• Clean and hose out trench drains.	landlord
• Clean carpet in Office 2	landlord
• Strip and clean existing VCT in Office 1	landlord
Contingency	$ 1,000
TOTAL	$ 62,041

Exhibit 10.13.2

SECOND AMENDMENT TO LEASE

THIS SECOND AMENDMENT TO LEASE, being entered into this 4th day of January, 2006, between 2101 Williams Associates, LLC, a California limited liability company, hereinafter called Lessor, and Energy Recovery, Inc., a Delaware corporation (ERI), hereinafter called Lessee, covering the premises commonly referred to as 1908 Doolittle Drive, San Leandro, California.

Lessor and Lessee hereby amend that certain Lease between them dated February 28, 2005, and previously amended October 3, 2005, as follows:

1. The actual lease commencement date for the Expansion Area (defined in the Amendment to Lease as 2181 Williams Street, San Leandro, CA) shall be December 1, 2005. The rent adjustment, per Paragraph 5 in the Amendment to Lease, shall remain effective on December 15, 2007.

2. The Expansion Area lease term shall still end coterminous with the initial Premises on June 14, 2010.

3. Except as herein specified, all of the other terms and conditions of the subject Lease shall remain in full force and effect.

IN WITNESS WHEREOF, Lessor and Lessee have executed this Amendment To Lease the day and year first written above.

LESSOR	LESSEE
2101 Williams Associates, LLC	Energy Recovery, Inc.
By: /s/ Donald L. Jones	By: /s/ G.G. Pique
Donald L. Jones, Manager	G.G. Pique. President/CEO

Exhibit 10.13.3

THIRD AMENDMENT TO LEASE

THIS THIRD AMENDMENT TO LEASE, being entered into this 26th day of September, 2006, between 2101 Williams Associates, LLC, a California limited liability company, hereinafter called Lessor, and Energy Recovery, Inc., a Delaware corporation (ERI), hereinafter called Lessee, covering the premises commonly referred to as 1908 Doolittle Drive, San Leandro, California.

Lessor and Lessee hereby further amend that certain Lease between them dated February 28, 2005, and previously amended October 3, 2005 and January 4, 2006, as follows:

1. The premises as defined in paragraph l.2a of the Lease are hereby expanded to include that certain approximately 2,483 SF of office and storage space commonly known as 1906 Doolittle Drive (1906 Doolittle Expansion Area) and outlined in purple on Exhibit "A" attached hereto.

   Lessee's total revised square footage, including the 1906 Doolittle Expansion Area referenced above, has herein been increased to approximately 28,737 square feet, including 11,267 SF of office and 17,470 SF of warehouse and manufacturing space.

2. The lease commencement date for the 1906 Doolittle Expansion Area shall be November 15, 2006 and shall end coterminous with the initial Premises on June 14, 2010.

3. Lessor agrees at its sole cost and expense and as soon as it can reasonably be accomplished following the execution of this Third Amendment to Lease, to commence and prosecute to completion in a diligent and good and workmanlike manner the construction and delivery of the improvements to the 1906 Doolittle Expansion Area as set forth in Exhibit "D."

   The parties hereto are aiming toward substantial completion and delivery of the 1906 Doolittle Expansion Area to the Lessee on November 15, 2006; provided that Lessor is not delayed by causes beyond its control, which shall include but not be limited to any unanticipated delays due to obtaining any necessary building permits, any delays in construction due to fires, unusually severe weather, labor problems including strikes or slowdowns, acts of God, and other similar causes, and delays caused by the Lessee or its agents and/or subcontractors.

   Should Lessor fail to deliver the 1906 Doolittle Expansion Area by the above date, then the 1906 Doolittle Expansion Area Lease term shall commence upon the date Lessor does substantially complete the above work and delivers possession to Lessee. If the actual lease commencement date of the 1906 Doolittle Expansion Area is other than that set forth above, then Lessor and Lessee shall prepare and execute a Fourth Amendment to Lease setting forth the revised commencement date of the 1906 Doolittle Expansion Area Lease term, but failure to execute such an amendment shall not affect the actual commencement date.

   "Substantial completion" or "substantially completing" shall be the date as agreed between Lessor and Lessee, or, if the parties cannot so agree, then it shall be upon execution of a certification from the architect or engineer supervising the construction of the Premises that all of the improvements hereto above described have been on the date specified in said certification substantially completed in accordance with the plans and specifications to the extent that Lessee can reasonably and conveniently use and occupy the building and appurtenances for the conduct of its ordinary business and, if required, the issuance of a certificate, or temporary certificate, of occupancy for the Premises. Substantial completion shall not be delayed due to Lessee's delay or failure to perform its tasks or complete any improvements it undertakes.

4. The base monthly rent for the 1906 Doolittle Expansion Area, subject to existing and future increases over base year taxes and insurance and other expenses as set forth in the subject Lease, shall be as follows:

    11/15/2006 — 06/14/2010 - $2,350.00/month I.G.

    The total base monthly rent for all of Lessee's premises shall be $23,478.00, and shall increase on December 15, 2007 to $24,530.00.

5. Lessee, as the sole occupant of the property, shall pay all common area expenses and all utility and service charges for the entire building. Lessee shall pay its prorata share for the 1906 Doolittle Expansion Area of increases in real estate taxes and insurance above a Base Year. The Base Year for the 1906 Doolittle Expansion Area shall be 2006/2007.

6. Lessee shall deposit with Lessor $5,400 as security for the 2181 Williams Expansion Area and the 1906 Doolittle Expansion Area. Total security deposit paid by Lessee for entire Premises shall equal $40,000. Upon execution of this Third Amendment to Lease, Lessor authorizes Lessee to close the Escrow Account that was established per the terms of the Lease.

7. Lessee's option to renew for one (1) additional five (5) year period at market rents, with six (6) months prior written notice will apply to the 1906 Doolittle Expansion Area as well.

8. Lessee shall be provided with a Right of First Refusal to lease all or part of new building construction on the property. Rental terms shall be negotiated between Lessor and Lessee, including early termination of this Third Amendment to Lease for the 1906 Doolittle Expansion Area. Upon notice of interest by Lessee, the Lessor shall research the feasibility of new building construction on the property, and upon commencement of lease negotiations, Lessor shall work with Lessee on design of new building.

9. Except as herein specified, all of the other terms and conditions of the subject Lease shall remain in full force and effect.

IN WITNESS WHEREOF, Lessor and Lessee have executed this Third Amendment To Lease the day and year first written above.

LESSOR	LESSEE
2101 Williams Associates, LLC	Energy Recovery, Inc.
By: /s/ Donald L. Jones	By: /s/ G.G. Pique
Donald L. Jones, Manager	G.G. Pique, President/CEO

Exhibit "A"

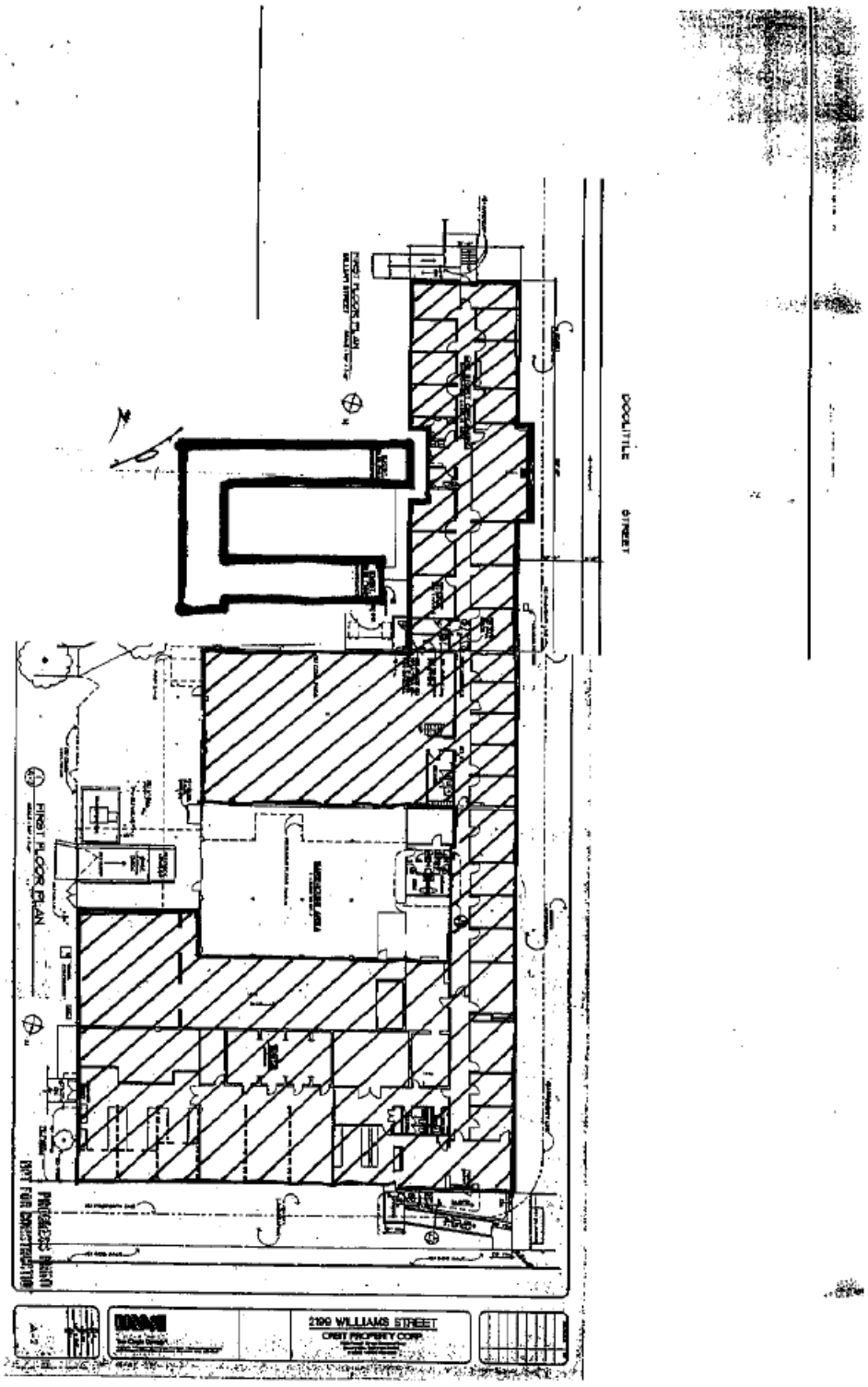

DOOLITTLE STREET
FIRST FLOOR PLAN
2199 WILLIAMS STREET
CREIT PROPERTY CORP

EXHIBIT "D"
To Third Amendment to Lease, dated September 26, 2006, by and between 2101 Williams, LLC, as Lessor, and Energy Recovery, Inc., as Lessee

RENOVATION OF 1906 DOOLITTLE DRIVE EXPANSION AREA

STORAGE AREA

- Frame and sheetrock wall to close off storage area at corner of restroom. Include one (1) 3' x 7' man door. New wall and door painted on both sides.
- Demo sink, wall cabinetry and space heater.
- Replace exterior 3' x 7' man door with 8' x 8' opening and double doors of similar type to existing.
- Pour new concrete landing level with enlarged doorway and build concrete ramp to connect to existing handicap ramp from 1908 Doolittle (demo portion of curb on existing handicap ramp).
- Paint walls and ceiling a neutral color of tenant's choice (maximum of one color and two coats for each surface).
- Lighting remains as is.
- Electrical outlets remain as is.

RESTROOM

- Paint walls and ceiling (maximum of one color and one coat for each surface)
- Install new exhaust fan
- Clean and repair as necessary
- Replace accessories and lighting as necessary

KITCHEN

- Install prefabricated, lower cabinet and a counter with sink. Cabinetry to accommodate a small fridge.
- Install/or move one duplex outlet at counter height for coffee maker and microwave, and install/or move one duplex outlet in lower cabinet for small fridge.
- Paint walls and ceiling a color of tenant's choice (maximum of two colors and two coats for each surface).
- Install sheet vinyl of tenant's choice (standard spec) on floor and coved at walls.
- Install new surface mounted, fluorescent light fixture.
- Install new exhaust fan.

OLD KITCHEN/OFFICE 1

- Demo old kitchen appliances, cabinetry, phone cabinet, wall between old kitchen and Office 1 and closet in Office 1.
- Frame and sheetrock a wall to close off office. New wall to be flush with existing wall and door to office.
- Install one duplex outlet in new wall and make existing outlets and electrical switches flush with wall if physically and economically feasible.
- Paint walls, ceiling, window trim, electrical conduit and sprinkler pipe a color of tenant's choice. Window trim and ceiling may be painted a different color than walls. (maximum of two coats per surface)
- New carpet installed on floor and 4" rubber base installed on walls.
- Add new surface mounted, fluorescent light fixture(s) as necessary to match existing fixtures.
- Repair window hardware as necessary so operable windows open and close.
- Area conditioned by HVAC system

FRONT ENTRY AREA

- Remove wood from covered windows. Replace window trim as necessary.

- Paint walls, ceiling, window trim, conduit and pipes (maximum of two colors and two coats for each surface)
- Install carpet on floor throughout area, and 4" rubber base on walls. At tenant's option, install approximately 3' x 4' area of VCT (standard spec) at entry door.
- Add new surface mounted, fluorescent light fixture(s) as necessary to match existing fixtures.
- Demo slatted walls next to front entry door at tenant's option.
- Repair window hardware as necessary so operable windows open and close.
- Area conditioned by HVAC system.

OFFICE 2/CONFERENCE ROOM

- Demo cabinet and counter.
- Add and move light fixtures as necessary to match existing surface mounted, fluorescent light fixture(s)
- Install new door at opening to office.
- Paint walls, ceiling, window trim, conduit and piping (maximum of two colors and two coats for each surface)
- Install new carpet on floor and 4" rubber base on walls.
- Repair window hardware as necessary so operable windows open and close.
- Area conditioned by HVAC system.

LONG OPEN OFFICE AREA

- Frame and sheetrock wall to close off Long, Open Office area. Wall should include 3' x 7' door and approximately 2' x 7' sidelight. This will create a hallway between Entry Area, Office 2/Conference Room and Long Open Office Area.
- Demo cabinetry, sink and heater.
- Remove old thermostat, close up small opening in exterior wall covered by sheet metal (and close up any other similar type openings throughout space), make electrical outlets and switches flush with wall if physically and economically feasible.
- Install new surface mounted, fluorescent light fixtures throughout to match fixtures used in other areas.
- Paint walls, ceiling, window trim and any exposed piping in Hallway and Long, Open Office Area (maximum of two colors and two coats for each surface)
- Install new carpet on floors and 4" base on walls in Hallway and Long, Open Office Area.
- Repair window hardware as necessary so operable windows open and close.
- Long Open Office Area conditioned by HVAC system.

HVAC

- Install new HVAC system for Office 1, Front Entry Area, Office 2/Conference Room, and Long, Open Office Area.
- Build soffit around duct work where physically and economically feasible.
- Build two, new, approximately 3' x 3', closets for parts of HVAC system. One located in storage area and the other in the NE corner of the Long Open Office Area.

EXTERIOR

- Build new bench near entry of similar style to existing bench that broke.
- Tenant responsible for signage changes
- Paint Front Entry Door and repair and rekey locks on all exterior doors.
- Remove ivy in courtyard. Replace with compacted crushed granite with some planting pots or small landscaping areas (Landlord's choice based on feasibility and cost).

STANDARD MULTI-TENANT OFFICE LEASE — GROSS
AIR COMMERCIAL REAL ESTATE ASSOCIATION

1. **Basic Provisions ("Basic Provisions").**

1.1 **Parties:** This Lease **("Lease")**, dated for reference purposes only February 15, 2008, is made by and between Beretta Investment Group, a general partnership **("Lessor")** and Energy Recovery, Inc., a Delaware Corporation (**"Lessee"**), (collectively the **"Parties"**, or individually a **"Party"**).

1.2(a) **Premises:** That certain portion of the Project (as defined below), known as Suite Numbers(s) 220, 2nd floor(s), consisting of approximately 5,713 rentable square feet and approximately 5,713 useable square feet (**"Premises"**). The Premises are located at: 433 Hegenberger Road, in the City of Oakland, County of Alameda, State of California, with zip code 94621. In addition to Lessee's rights to use and occupy the Premises as hereinafter specified, Lessee shall have non-exclusive rights to the Common Areas (as defined in Paragraph 2.7 below) as hereinafter specified, but shall not have any rights to the roof, the exterior walls, the area above the dropped ceilings, or the utility raceways of the building containing the Premises (**"Building"**) or to any other buildings in the Project. The Premises, the Building, the Common Areas, the land upon which they are located, along with all other buildings and improvements thereon, are herein collectively referred to as the **"Project."** The Project consists of approximately 44,470 rentable square feet. (See also Paragraph 2)

1.2(b) **Parking:** 3/1000 unreserved and -0- reserved vehicle parking spaces at a monthly cost of $0.00 per unreserved space and $N/A per reserved space. (See Paragraph 2.6)

1.3 **Term:** 2 years and 0 months (**"Original Term"**) commencing April 1, 2008 **("Commencement Date")** and ending March 31, 2010 **("Expiration Date")**. (See also Paragraph 3)

1.4 **Early Possession:** Upon Completion of Interior Improvements ("**Early Possession Date"**). (See also Paragraphs 3.2 and 3.3)

1.5 **Base Rent:** $9,140.00 per month (**"Base Rent**)", payable on the first day of each month commencing April 1, 2008. (See also Paragraph 4)

☑ If this box is checked, there are provisions in this Lease for the Base Rent to be adjusted.

1.6 **Lessee's Share of Operating Expense Increase:** based upon 5,713 rsf ~~percent (_____%) (**"Lessee's Share"**)~~. Lessee's Share has been calculated by dividing the approximate rentable square footage of the Premises by the total approximate square footage of the rentable space contained in the Project and shall not be subject to revision except in connection with an actual change in the size of the Premises or a change in the space available for lease in the Project.

1.7 **Base Rent and Other Monies Paid Upon Execution:**

(a) **Base Rent:** $9,140.00 for the period 4/01/08 — 4/31/08.

(b) **Security Deposit:** $9000.00 (**"Security Deposit"**). (See also Paragraph 5)

(c) **Parking:** $Not applicable for the period Not applicable.

(d) **Other:** $_____ for _____.

(e) **Total Due Upon Execution of this Lease:** $18,140.00.

1.8 **Agreed Use:** General office use (non-medical/dental; no retail). (See also Paragraph 6)

1.9 **Base Year; Insuring Party**. The Base Year is 2008. Lessor is the **"Insuring Party"**. (See also Paragraphs 4.2 and 8)

1.10 **Real Estate Brokers:** (See also Paragraph 15)

(a) **Representation:** The following real estate brokers (the **"Brokers"**) and brokerage relationships exist in this transaction (check applicable boxes):

☑ Colliers International represents Lessor exclusively (**"Lessor's Broker"**);

☑ Lee & Associates represents Lessee exclusively (**"Lessee's Broker"**); or

☐ _____ represents both Lessor and Lessee (**"Dual Agency"**).

(b) **Payment to Brokers:** Upon execution and delivery of this Lease by both Parties, Lessor shall pay to the Brokers the brokerage fee agreed to in a separate written agreement ~~(or if there is no such agreement, the sum of _____ or _____% of the total Base Rent for the brokerage services rendered by the Brokers)~~.

1.11 **Guarantor.** The obligations of the Lessee under this Lease shall be guaranteed by None **("Guarantor").** (See also Paragraph 37)

1.12 **Business Hours for the Building:** 7:00 a.m. to 7:00 p.m., Mondays through Fridays (except Building Holidays) and None a.m. to None p.m. on Saturdays (except Building Holidays) **"Building Holidays"** shall mean the dates of observation of New Year's Day, President's Day, Memorial Day, Independence Day, Labor Day, Thanksgiving Day, Christmas Day, and

_____ /s/ TW
INITIALS **INITIALS**

FORM OFG-1-9/99E
/s/

as determined by Lessor.

1.13 **Lessor Supplied Services.** Notwithstanding the provisions of Paragraph 11.1, Lessor is NOT obligated to provide the following:

☑ Janitorial services

☐ Electricity

☐ Other (specify): _____

1.14 **Attachments.** Attached hereto are the following, all of which constitute a part of this Lease:

☑ an Addendum consisting of Paragraphs 1 through 2;

☑ a plot plan depicting the Premises;

☑ a current set of the Rules and Regulations;

☐ a Work Letter;

☐ a janitorial schedule;

☐ other (specify): _____
_____.

2. **Premises**.

2.1 **Letting**. Lessor hereby leases to Lessee, and Lessee hereby leases from Lessor, the Premises, for the term, at the rental, and upon all of the terms, covenants and conditions set forth in this Lease. Unless otherwise provided herein, any statement of size set forth in this Lease, or that may have been used in calculating Rent, is an approximation which the Parties agree is reasonable and any payments based thereon are not subject to revision whether or not the actual size is more or less. **Note: Lessee is advised to verify the actual size prior to executing this Lease**

2.2 **Condition**. Lessor shall deliver the Premises to Lessee in a clean condition on the Commencement Date or the Early Possession Date, whichever first occurs (**"Start Date"**), and warrants that the existing electrical, plumbing, fire sprinkler, lighting, heating, ventilating and air conditioning systems (**"HVAC"**), and all other items which the Lessor is obligated to construct pursuant to the Work Letter attached hereto, if any, other than those constructed by Lessee, shall be in good operating condition on said date.

2.3 **Compliance**. ~~Lessor warrants that~~ The ~~the~~ improvements comprising the Premises and the Common Areas comply with the building codes that were in effect at the time that each such improvement, or portion thereof, was constructed, and also with all applicable laws, covenants or restrictions of record, regulations, and ordinances (**"Applicable Requirements"**) ~~in effect on the Start Date~~. Said warranty does not apply to the use to which Lessee will put the Premises, modifications which may be required by the Americans with Disabilities Act or any similar laws as a result of Lessee's use (see Paragraph 50), or to any Alterations or Utility Installations (as defined in Paragraph 7.3(a)) made or to be made by Lessee. **NOTE: Lessee is responsible for determining whether or not the zoning and other Applicable Requirements are appropriate for Lessee's intended use, and acknowledges that past uses of the Premises may no longer be allowed**. ~~If the Premises do not comply with said warranty, Lessor shall, except as otherwise provided, promptly after receipt of written notice from Lessee setting forth with specificity the nature and extend of such non compliance, rectify the same. If the Applicable Requirements are hereafter changed so as to require during the term of this Lease the construction of an addition to or an alteration of the Premises, the remediation of any Hazardous Substance, or the reinforcement or other physical modification of the Premises (**"Capital Expenditure"**). Lessor and Lessee shall allocate the cost of such work as follows:~~

~~(a) Subject to Paragraph 2.3(c) below, if such Capital Expenditures are required as a result of the specific and unique use of the Premises by Lessee as compared with uses by tenants in general, Lessee shall be fully responsible for the cost thereof, provided, however that if such Capital Expenditure is required during the last 2 years of this Lease and the cost thereof exceeds 6 months' Base Rent, Lessee may instead terminate this Lease unless Lessor notifies Lessee, in writing, within 10 days after receipt of Lessee's termination notice that Lessor has elected to pay the difference between the actual cost thereof and the amount equal to 6 months' Base Rent. If Lessee elects termination, Lessee shall immediately cease the use of the Premises which requires such Capital Expenditure and deliver to Lessor written notice specifying a termination date at least 90 days thereafter. Such termination date shall, however, in no event be earlier than the last day that Lessee could legally utilize the Premises without commencing such Capital Expenditure.~~

~~(b) If such Capital Expenditure is not the result of the specific and unique use of the Premises by Lessee (such as, governmentally mandated seismic modifications), then Lessor and Lessee shall allocate the cost of such Capital Expenditure as follows: Lessor shall advance the funds necessary for such Capital Expenditure but Lessee shall be obligated to pay, each month during the remainder of the term of this Lease, on the date on which Base Rent is due, an amount equal to the product of multiplying Lessee's share of the cost of such Capital Expenditure (the percentage specified in Paragraph 1.6 by a fraction, the numerator of which is one, and the denominators of which is 144 (i.e. 1/144th of the cost per month). Lessee shall pay interest on the unamortized balance Lessee's share at a rate that is commercially reasonable in the judgement of Lessor's accountants. Lesssee may, however, prepay its obligation at any time. Provided, however, that if such Capital Expenditure is required during the last 2 years of this Lease or if Lessor reasonably determines that it is not economically feasible to pay its share therof, Lessor shall have the option to terminate this Lease upon 90 days prior written notice to Lesssee unless Lessee notifies Lessor, in writing, within 10 days after receipt of Lessor's termination notice that Lessee will pay for such Capital Expenditure. If Lessor does not elect to terminate, and fails to tender its share of any such Capital Expenditure, Lessee may advance such funds and deduct same, with Interest, from Rent until Lessor's share of such costs have been fully paid. If Lessee is unable to finance Lessor's share, or if the balance of the Rent due and payable for the reminder of this Lease is not sufficient to fully reimburse Lessee on an offset basis, Lessee shall have the right to terminate this Lease upon 30 days written notice to Lessor.~~

~~(c) Notwithstanding the above, the provisions concerning Capital Expenditures are intended to apply only to nonvoluntary, unexpected, and new Applicable Requirements. If the Capital Expenditures are instead triggered by Lessee as a result of an actual or proposed change in use, change in intensity of use, or modification to the Premises then, and in that event, Lessee shall be fully responsible for the cost thereof, and Lessee shall not have any right to terminate this Lease.~~

2.4 **Acknowledgements**. Lessee acknowledges that: (a) Lessee has been advised by Lessor and/or Brokers to satisfy itself with respect to the condition of the Premises (including but not limited to the electrical, HVAC and fire sprinkler systems, security, environmental aspects, and compliance with Applicable Requirements), and their suitability for Lessee's intended use, (b) Lessee has made such investigation as it deems necessary with reference to such matters and assumes all responsibility therefor as the same relate to its occupancy of the Premises, and (c) neither Lessor, Lessor's agents, nor Brokers have made any oral or written representations or warranties with respect to said matters other than as set forth in this Lease. In addition, Lessor acknowledges that: (i) Brokers have made no representations, promises or warranties concerning Lessee's ability to honor the Lease or suitability to occupy the Premises, and (ii) it is Lessor's sole responsibility to investigate the financial capability and/or suitability of all proposed tenants.

2.5 **Lessee as Prior Owner/Occupant**. The warranties made by Lessor in Paragraph 2 shall be of no force or effect if immediately prior to the Start Date, Lessee was the owner or occupant of the Premises. In such event, Lessee shall be responsible for any necessary corrective work.

2.6 **Vehicle Parking**. So long as Lessee is not in default, and subject to the Rules and Regulations attached hereto, and as established by Lessor from time to time, Lessee shall be entitled to rent and use the number of parking spaces specified in Paragraph 1.2(b) at the rental rate applicable from time to time for monthly parking as set by Lessor and/or its licensee.

(a) If Lessee commits, permits or allows any of the prohibited activities described in the Lease or the rules then in effect, then Lessor shall have the right, without notice, in addition to such other rights and remedies that it may have, to remove or tow away the vehicle involved and charge the cost to Lessee, which cost shall be immediately payable upon demand by Lessor.

(b) The monthly rent per parking space specified in Paragraph 1.2(b) is subject to change upon 30 days prior written notice to Lessee. The rent for the parking is payable one month in advance prior to the first day of each calendar month.

2.7 **Common Areas — Definition**. The term **"Common Areas"** is defined as all areas and facilities outside the Premises and within the exterior boundary line of the Project and interior utility raceways and installations within the Premises that are provided and designated by the Lessor from time to time for the general nonexclusive use of Lessor, Lessee and other tenants of the Project and their respective employees, suppliers, shippers, customers, contractors and invitees, including, but not limited to, common entrances, lobbies, corridors, stairwells, public restrooms, elevators, parking areas, loading and unloading areas, trash areas, roadways, walkways, driveways and landscaped areas.

2.8 **Common Areas — Lessee's Rights**. Lessor grants to Lessee, for the benefit of Lessee and its employees, suppliers, shippers, contractors, customers and invitees, during the term of this Lease, the nonexclusive right to use, in common with others entitled to such use, the Common Areas as they exist from time to time, subject to any rights, powers, and privileges reserved by Lessor under the terms hereof or under the terms of any rules and regulations or restrictions governing the use of the Project. Under no circumstances shall the right herein granted to use the Common Areas be deemed to include the right to store any property, temporarily or permanently, in the Common Areas. Any such storage shall be

permitted only by the prior written consent of Lessor or Lessor's designated agent, which consent may be revoked at any time. In the event that any unauthorized storage shall occur then Lessor shall have the right, without notice, in addition to such other rights and remedies that it may have, to remove the property and charge the cost to Lessee, which cost shall be immediately payable upon demand by Lessor.

2.9 **Common Areas — Rules and Regulations**. Lessor or such other person(s) as Lessor may appoint shall have the exclusive control and management of the Common Areas and shall have the right, from time to time, to adopt, modify, amend and enforce reasonable rules and regulations **("Rules and Regulations")** for the management, safety, care, and cleanliness of the grounds, the parking and unloading of vehicles and the preservation of good order, as well as for the convenience of other occupants or tenants of the Building and the Project and their invitees. The Lessee agrees to abide by and conform to all such Rules and Regulations, and to cause its employees, suppliers, shippers, customers, contractors and invitees to so abide and conform. Lessor shall not be responsible to Lessee for the noncompliance with said Rules and Regulations by other tenants of the Project.

2.10 **Common Areas — Changes**. Lessor shall have the right, in Lessor's sole discretion, from time to time:

(a) To make changes to the Common Areas, including, without limitation, changes in the location, size, shape and number of the lobbies, windows, stairways, air shafts, elevators, escalators, restrooms, driveways, entrances, parking spaces, parking areas, loading and unloading areas, ingress, egress, direction of traffic, landscaped areas, walkways and utility raceways;

(b) To close temporarily any of the Common Areas for maintenance purposes so long as reasonable access to the Premises remains available;

(c) To designate other land outside the boundaries of the Project to be a part of the Common Areas;

(d) To add additional buildings and improvements to the Common Areas;

(e) To use the Common Areas while engaged in making additional improvements, repairs or alterations to the Project, or any portion thereof; and

(f) To do and perform such other acts and make such other changes in, to or with respect to the Common Areas and Project as Lessor may, in the exercise of sound business judgment, deem to be appropriate.

3. **Term**.

3.1 **Term**. The Commencement Date, Expiration Date and Original Term of this Lease are as specified in Paragraph 1.3.

3.2 **Early Possession**. If Lessee totally or partially occupies the Premises prior to the Commencement Date, the obligation to pay Base Rent shall be abated for the period of such early possession. All other terms of this Lease (including but not limited to the obligations to pay Lessee's Share of the Operating Expense Increase) shall, however, be in effect during such period. Any such early possession shall not affect the Expiration Date.

3.3 **Delay In Possession**. Lessor agrees to use its best commercially reasonable efforts to deliver possession of the Premises to Lessee by the Commencement Date. If, despite said efforts, Lessor is unable to deliver possession by such date, Lessor shall not be subject to any liability therefor, nor shall such failure affect the validity of this Lease. Lessee shall not, however, be obligated to pay Rent or perform its other obligations until Lessor delivers possession of the Premises and any period of rent abatement that Lessee would otherwise have enjoyed shall run from the date of delivery of possession and continue for a period equal to what Lessee would otherwise have enjoyed under the terms hereof, but minus any days of delay caused by the acts or omissions of Lessee. If possession is not delivered within 60 days after the Commencement Date, as the same may be extended under the terms of any Work Letter executed by Parties, Lessee may, at its option, by notice in writing within 10 days after the end of such 60 day period, cancel this Lease, in which event the Parties shall be discharged from all obligations hereunder. If such written notice is not received by Lessor within said 10 day period, Lessee's right to cancel shall terminate. If possession of the Premises is not delivered within 120 days after the Commencement Date, this Lease shall terminate unless other agreements are reached between Lessor and Lessee, in writing.

3.4 **Lessee Compliance**. Lessor shall not be required to deliver possession of the Premises to Lessee until Lessee complies with its obligation to provide evidence of insurance (Paragraph 8.5). Pending delivery of such evidence, Lessee shall be required to perform all of its obligations under this Lease from and after the Start Date, including the payment of Rent, notwithstanding Lessor's election to withhold possession pending receipt of such evidence of insurance. Further, if Lessee is required to perform any other conditions prior to or concurrent with the Start Date, the Start Date shall occur but Lessor may elect to withhold possession until such conditions are satisfied.

4. **Rent**.

4.1. **Rent Defined**. All monetary obligations of Lessee to Lessor under the terms of this Lease (except for the Security Deposit) are deemed to be ren**("Rent").**

4.2 **Operating Expense Increase**. Lessee shall pay to Lessor during the term hereof, in addition to the Base Rent, Lessee's Share of the amount by which all Operating Expenses for each Comparison Year exceeds the amount of all Operating Expenses for the Base Year, such excess being hereinafter referred to as the **"Operating Expense Increase",** in accordance with the following provisions:

(a) **"Base Year"** is as specified in Paragraph 1.9.

(b) **"Comparison Year"** is defined as each, calendar year during the term of this Lease subsequent to the Base Year; provided, however, Lessee shall have no obligation to pay a share of the Operating Expense Increase applicable to the first 12 months of the Lease Term (other than such as are mandated by a governmental authority, as to which government mandated expenses Lessee shall pay Lessee's Share, notwithstanding they occur during the first twelve (12) months). Lessee's Share of the Operating Expense Increase for the first and last Comparison Years of the Lease Term shall be prorated according to that portion of such Comparison Year as to which Lessee is responsible for a share of such increase.

(c) **"Operating Expenses"** include all costs incurred by Lessor relating to the ownership and operation of the Project, calculated as if the Project was at least 95% occupied, including, but not limited to, the following:

(i) The operation, repair, and maintenance in neat, clean, safe, good order and condition, but not the replacement (see subparagraph (g)), of the following:

(aa) The Common Areas, including their surfaces, coverings, decorative items, carpets, drapes and window coverings, and including parking areas, loading and unloading areas, trash areas, roadways, sidewalks, walkways, stairways, parkways, driveways, landscaped areas, striping, bumpers, irrigation systems, Common Area lighting facilities, building exteriors and roofs, fences and gates;

(bb) All heating, air conditioning, plumbing, electrical systems, life safety equipment, communication systems and other equipment used in common by, or for the benefit of, lessees or occupants of the Project, including elevators and escalators, tenant directories, fire detection systems including sprinkler system maintenance and repair.

(ii) Trash disposal, janitorial and security services, pest control services, and the costs of any environmental inspections;

(iii) Any other service to be provided by Lessor that is elsewhere in this Lease stated to be an "Operating Expense";

(iv) The cost of the premiums for the insurance policies maintained by Lessor pursuant to paragraph 8 and any deductible portion of an insured loss concerning the Building or the Common Areas;

(v) The amount of the Real Property Taxes payable by Lessor pursuant to paragraph 10;

(vi) The cost of water, sewer, gas, electricity, and other publicly mandated services not separately metered;

(vii) Labor, salaries, and applicable fringe benefits and costs, materials, supplies and tools, used in maintaining and/or cleaning the Project and accounting and management fees attributable to the operation of the Project;

(viii) The cost of any Capital Expenditure to the Building or the Project not covered under the provisions of Paragraph 2.3 provided; however, that Lessor shall allocate the cost of any such Capital Expenditure over ~~a 12 year period~~ the useful life as determined by Lessor ~~and Lessee shall not be required to pay more than Lessee's Share of 1/144th of the cost of such Capital Expenditure in any given month~~;

(ix) Replacement of equipment or improvements that have a useful life for accounting purposes of 5 years or less.

(d) Any item of Operating Expense that is specifically attributable to the Premises, the Building or to any other building in the Project or to the operation, repair and maintenance thereof, shall be allocated entirely to such Premises, Building, or other building. However, any such item that is not specifically attributable to the Building or to any other building or to the operation, repair and maintenance thereof, shall be equitably allocated by Lessor to all buildings in the Project.

(e) The inclusion of the improvements, facilities and services set forth in Subparagraph 4.2(c) shall not be deemed to impose an obligation upon Lessor to either have said improvements or facilities or to provide those services unless the Project already has the same, Lessor already provides the services, or Lessor has agreed elsewhere in this Lease to provide the same or some of them.

(f) Lessee's Share of Operating Expense Increase shall be payable by Lessee within 10 days after a reasonably detailed statement of actual expenses is presented to Lessee by Lessor. At Lessor's option, however, an amount may be estimated by Lessor from time to time in advance of Lessee's Share of the Operating Expense Increase for any Comparison Year, and the same shall be payable monthly during each Comparison Year of the Lease term, on the same day as the Base Rent is due hereunder. In the event that Lessee pays Lessor's estimate of Lessee's Share of Operating Expense Increase as aforesaid, Lessor shall deliver to Lessee ~~within 60 days~~ after the expiration of each Comparison Year a reasonably detailed statement showing Lessee's Share of the actual Operating Expense Increase incurred during such year. If Lessee's payments under this paragraph (f) during said Comparison Year exceed Lessee's Share as indicated on said statement, Lessee shall be entitled to credit the amount of such overpayment against Lessee's Share of Operating Expense Increase next falling due. If Lessee's payments under this paragraph

during said Comparison Year were less than Lessee's Share as indicated on said statement, Lessee shall pay to Lessor the amount of the deficiency within 10 days after delivery by Lessor to Lessee of said statement. Lessor and Lessee shall forthwith adjust between them by cash payment any balance determined to exist with respect to that portion of the last Comparison Year for which Lessee is responsible as to Operating Expense Increases, notwithstanding that the Lease term may have terminated before the end of such Comparison Year.

(g) Operating Expenses shall ~~not~~ include the costs of replacement for equipment or capital components such as the roof, foundations, exterior walls or a Common Area capital improvement, such as the parking lot paving, elevators, fences that have a useful life for accounting purposes of 5 years or more unless it is of the type described in paragraph 4.2(c) (viii), in which case their cost shall be included as above provided.

(h) Operating Expenses shall not include any expenses paid by any tenant directly to third parties, or as to which Lessor is otherwise reimbursed by any third party, other tenant, or by insurance proceeds.

4.3 **Payment**. Lessee shall cause payment of Rent to be received by Lessor in lawful money of the United States on or before the day on which it is due, without offset or deduction (except as specifically permitted in this Lease). Rent for any period during the term hereof which is for less than one full calendar month shall be prorated based upon the actual number of days of said month. Payment of Rent shall be made to Lessor at its address stated herein or to such other persons or place as Lessor may from time to time designate in writing. Acceptance of a payment which is less than the amount then due shall not be a waiver of Lessor's rights to the balance of such Rent, regardless of Lessor's endorsement of any check so stating. In the event that any check, draft, or other instrument of payment given by Lessee to Lessor is dishonored for any reason, Lessee agrees to pay to Lessor the sum of $25 in addition to any Late Charge. Payments will be applied first to accrued late charges and attorney's fees, second to accrued interest, then to Base Rent and Operating Expense Increase, and any remaining amount to any other outstanding charges or costs.

5. **Security Deposit**. Lessee shall deposit with Lessor upon execution hereof the Security Deposit as security for Lessee's faithful performance of its obligations under this Lease. If Lessee fails to pay Rent, or otherwise Defaults under this Lease, Lessor may use, apply or retain all or any portion of said Security Deposit for the payment of any amount due Lessor or to reimburse or compensate Lessor for any liability, expense, loss or damage which Lessor may suffer or incur by reason thereof. If Lessor uses or applies all or any portion of the Security Deposit, Lessee shall within 10 days after written request therefor, deposit monies with Lessor sufficient to restore said Security Deposit to the full amount required by this Lease. If the Base Rent increases during the term of this Lease, Lessee shall, upon written request from Lessor, deposit additional moneys with Lessor so that the total amount of the Security Deposit shall at all times bear the same proportion to the increased Base Rent as the initial Security Deposit bore to the initial Base Rent. Should the Agreed Use be amended to accommodate a material change in the business of Lessee or to accommodate a sublessee or assignee, Lessor shall have the right to increase the Security Deposit to the extent necessary, in Lessor's reasonable judgment, to account for any increased wear and tear that the Premises may suffer as a result thereof. If a change in control of Lessee occurs during this Lease and following such change the financial condition of Lessee is, in Lessor's reasonable judgment, significantly reduced, Lessee shall deposit such additional monies with Lessor as shall be sufficient to cause the Security Deposit to be at a commercially reasonable level based on such change in financial condition. Lessor shall not be required to keep the Security Deposit separate from its general accounts. Within 14 days after the expiration or termination of this Lease, if Lessor elects to apply the Security Deposit only to unpaid Rent, and otherwise within 30 days after the Premises have been vacated pursuant to Paragraph 7.4(c) below, Lessor shall return that portion of the Security Deposit not used or applied by Lessor. No part of the Security Deposit shall be considered to be held in trust, to bear interest or to be prepayment for any monies to be paid by Lessee under this Lease.

6. **Use**.

6.1 **Use**. Lessee shall use and occupy the Premises only for the Agreed Use, or any other legal use which is reasonably comparable thereto, and for no other purpose. Lessee shall not use or permit the use of the Premises in a manner that is unlawful, creates damage, waste or a nuisance, or that disturbs occupants of or causes damage to neighboring premises or properties. Lessor shall not unreasonably withhold or delay its consent to any written request for a modification of the Agreed Use, so long as the same will not impair the structural integrity of the improvements of the Building, will not adversely affect the mechanical, electrical, HVAC, and other systems of the Building, and/or will not affect the exterior appearance of the Building. If Lessor elects to withhold consent, Lessor shall within 7 days after such request give written notification of same, which notice shall include an explanation of Lessor's objections to the change in the Agreed Use.

6.2 **Hazardous Substances**.

(a) **Reportable Uses Require Consent**. The term **"Hazardous Substance"** as used in this Lease shall mean any product, substance, or waste whose presence, use, manufacture, disposal, transportation, or release, either by itself or in combination with other materials expected to be on the Premises, is either: (i) potentially injurious to the public health, safety or welfare, the environment or the Premises, (ii) regulated or monitored by any governmental authority, or (iii) a basis for potential liability of Lessor to any governmental agency or third party under any applicable statute or common law theory. Hazardous Substances shall include, but not be limited to, hydrocarbons, petroleum, gasoline, and/or crude oil or any products, byproducts or fractions thereof. Lessee shall not engage in any activity in or on the Premises which constitutes a Reportable Use of Hazardous Substances without the express prior written consent of Lessor and timely compliance (at Lessee's expense) with all Applicable Requirements. **"Reportable Use"** shall mean (i) the installation or use of any above or below ground storage tank, (ii) the generation, possession, storage, use, transportation, or disposal of a Hazardous Substance that requires a permit from, or with respect to which a report, notice, registration or business plan is required to be filed with, any governmental authority, and/or (iii) the presence at the Premises of a Hazardous Substance with respect to which any Applicable Requirements requires that a notice be given to persons entering or occupying the Premises or neighboring properties. Notwithstanding the foregoing, Lessee may use any ordinary and customary materials reasonably required to be used in the normal course of the Agreed Use such as ordinary office supplies (copier toner, liquid paper, glue, etc.) and common household cleaning materials, so long as such use is in compliance with all Applicable Requirements, is not a Reportable Use, and does not expose the Premises or neighboring property to any meaningful risk of contamination or damage or expose Lessor to any liability therefor. In addition, Lessor may condition its consent to any Reportable Use upon receiving such additional assurances as Lessor reasonably deems necessary to protect itself, the public, the Premises and/or the environment against damage, contamination, injury and/or liability, including, but not limited to, the installation (and removal on or before Lease expiration or termination) of protective modifications (such as concrete encasements) and/or increasing the Security Deposit.

(b) **Duty to Inform Lessor**. If Lessee knows, or has reasonable cause to believe, that a Hazardous Substance has come to be located in, on, under or about the Premises, other than as previously consented to by Lessor, Lessee shall immediately give written notice of such fact to Lessor, and provide Lessor with a copy of any report, notice, claim or other documentation which it has concerning the presence of such Hazardous Substance.

(c) **Lessee Remediation**. Lessee shall not cause or permit any Hazardous Substance to be spilled or released in, on, under, or about the Premises (including through the plumbing or sanitary sewer system) and shall promptly, at Lessee's expense, comply with all Applicable Requirements and take all investigatory and/or remedial action reasonably recommended, whether or not formally ordered or required, for the cleanup of any contamination of, and for the maintenance, security and/or monitoring of the Premises or neighboring properties, that was caused or materially contributed to by Lessee, or pertaining to or involving any Hazardous Substance brought onto the Premises during the term of this Lease, by or for Lessee, or any third party.

(d) **Lessee Indemnification**. Lessee shall indemnify, defend and hold Lessor, its agents, employees, lenders and ground lessor, if any, harmless from and against any and all loss of rents and/or damages, liabilities, judgments, claims, expenses, penalties, and attorneys' and consultants' fees arising out of or involving any Hazardous Substance brought onto the Premises by or for Lessee, or any third party (provided, however, that Lessee shall have no liability under this Lease with respect to underground migration of any Hazardous Substance under the Premises from areas outside of the Project not caused or contributed to by Lessee). Lessee's obligations shall include, but not be limited to, the effects of any contamination or injury to person, property or the environment created or suffered by Lessee, and the cost of investigation, removal, remediation, restoration and/or abatement, and shall survive the expiration or termination of this Lease. No termination, cancellation or release agreement entered into by Lessor and Lessee shall release Lessee from its obligations under this Lease with respect to Hazardous Substances, unless specifically so agreed by Lessor in writing at the time of such agreement.

~~(e) **Lessor Indemnification**. Lessee and its successors and assigns shall indemnify, defend, reimburse and hold Lessee, its employees and lenders, harmless from and against any and all environmental damages, including the cost of remediation, which result from Hazardous Substances which existed on the Premises prior to Lessee's occupancy or which are caused by the gross negligence or willful misconduct of Lessor, its agents or employees. Lessor's obligations, as and when required by the Applicable Requirements, shall include, but not be limited to, the cost of investigation, removal, remediation, restoration and/or abatement, and shall survive the expiration or termination of this Lease.~~

(f) **Investigations and Remediations**. Lessor shall retain the responsibility and pay for any investigations or remediation measures required by governmental entities having jurisdiction with respect to the existence of Hazardous Substances on the Premises prior to Lessee's occupancy, unless such remediation measure is required as a result of Lessee's use (including "Alterations", as defined in paragraph 7.3(a) below) of the Premises, in which event Lessee shall be responsible for such payment. Lessee shall cooperate fully in any such activities at the request of Lessor, including allowing Lessor and Lessor's agents to have reasonable access to the Premises at reasonable times in order to carry out Lessor's investigative and remedial responsibilities.

(g) **Lessor Termination Option**. If a Hazardous Substance Condition (see Paragraph 9.1(e)) occurs during the term of this Lease, unless Lessee is legally responsible therefor (in which case Lessee shall make the investigation and remediation thereof required by the Applicable Requirements and this Lease shall continue in full force and effect, but subject to Lessor's rights under Paragraph 6.2(d) and Paragraph 13), Lessor

may, at Lessor's option, either (i) investigate and remediate such Hazardous Substance Condition, if required, as soon as reasonably possible at Lessor's expense, in which event this Lease shall continue in full force and effect, or (ii) if the estimated cost to remediate such condition exceeds 12 times the then monthly Base Rent or $100,000, whichever is greater, give written notice to Lessee, within 30 days after receipt by Lessor of knowledge of the occurrence of such Hazardous Substance Condition, of Lessor's desire to terminate this Lease as of the date 60 days following the date of such notice. In the event Lessor elects to give a termination notice, Lessee may, within 10 days thereafter, give written notice to Lessor of Lessee's commitment to pay the amount by which the cost of the remediation of such Hazardous Substance Condition exceeds an amount equal to 12 times the then monthly Base Rent or $100,000, whichever is greater. Lessee shall provide Lessor with said funds or satisfactory assurance thereof within 30 days following such commitment. In such event, this Lease shall continue in full force and effect, and Lessor shall proceed to make such remediation as soon as reasonably possible after the required funds are available. If Lessee does not give such notice and provide the required funds or assurance thereof within the time provided, this Lease shall terminate as of the date specified in Lessor's notice of termination.

6.3 **Lessee's Compliance with Applicable Requirements**. Except as otherwise provided in this Lease, Lessee shall, at Lessee's sole expense, fully, diligently and in a timely manner, materially comply with all Applicable Requirements, the requirements of any applicable fire insurance underwriter or rating bureau, and the recommendations of Lessor's engineers and/or consultants which relate in any manner to the Premises, without regard to whether said requirements are now in effect or become effective after the Start Date. Lessee shall, within 10 days after receipt of Lessor's written request, provide Lessor with copies of all permits and other documents, and other information evidencing Lessee's compliance with any Applicable Requirements specified by Lessor, and shall immediately upon receipt, notify Lessor in writing (with copies of any documents involved) of any threatened or actual claim, notice, citation, warning, complaint or report pertaining to or involving the failure of Lessee or the Premises to comply with any Applicable Requirements.

6.4 **Inspection; Compliance**. Lessor and Lessor's **"Lender"** (as defined in Paragraph 30) and consultants shall have the right to enter into Premises at any time, in the case of an emergency, and otherwise at reasonable times, for the purpose of inspecting the condition of the Premises and for verifying compliance by Lessee with this Lease. The cost of any such inspections shall be paid by Lessor, unless a violation of Applicable Requirements, or a Hazardous Substance Condition (see paragraph 9.1e) is found to exist or be imminent, or the inspection is requested or ordered by a governmental authority. In such case, Lessee shall upon request reimburse Lessor for the cost of such inspection, so long as such inspection is reasonably related to the violation or contamination.

7. **Maintenance; Repairs; Utility Installations; Trade Fixtures and Alterations**

7.1 **Lessee's Obligations**. Notwithstanding Lessor's obligation to keep the Premises in good condition and repair, Lessee shall be responsible for payment of the cost thereof to Lessor as additional rent for that portion of the cost of any maintenance and repair of the Premises, or any equipment (wherever located) that serves only Lessee or the Premises, to the extent such cost is attributable to causes beyond normal wear and tear. Lessee shall be responsible for the cost of painting, repairing or replacing wall coverings, and to repair or replace any improvements with the Premises. Lessor may, at its option, upon reasonable notice, elect to have Lessee perform any particular such maintenance or repairs the cost of which is otherwise Lessee's responsibility hereunder.

7.2 **Lessor's Obligations**. Subject to the provisions of Paragraphs 2.2 (Condition), 2.3 (Compliance), 4.2 (Operating Expenses), 6 (Use), 7.1 (Lessee's Obligations), 9 (Damage or Destruction) and 14 (Condemnation), Lessor, subject to reimbursement pursuant to Paragraph 4.2, shall keep in good order, condition and repair the foundations, exterior walls, structural condition of interior bearing walls, exterior roof, fire sprinkler system, fire alarm and/or smoke detection systems, fire hydrants, and the Common Areas. Lessee expressly waives the benefit of any statute now or hereafter in effect to the extent it is inconsistent with the terms of this Lease.

7.3 **Utility Installations; Trade Fixtures; Alterations**.

(a) **Definitions**. The term **"Utility Installations"** refers to all floor and window coverings, air lines, vacuum lines, power panels, electrical distribution, security and fire protection systems, communication cabling, lighting fixtures, HVAC equipment, and plumbing in or on the Premises. The term **"Trade Fixtures"** shall mean Lessee's machinery and equipment that can be removed without doing material damage to the Premises. The term **"Alterations"** shall mean any modification of the improvements, other than Utility Installations or Trade Fixtures, whether by addition or deletion. **"Lessee Owned Alterations and/or Utility Installations"** are defined as Alterations and/or Utility Installations made by Lessee that are not yet owned by Lessor pursuant to Paragraph 7.4(a).

(b) **Consent**. Lessee shall not make any Alterations or Utility Installations to the Premises without Lessor's prior written consent. ~~Lessee may, however, make non structural Utility Installations to the interior of the Premises (excluding the roof) without such consent but upon notice to Lessor, as long as they are not visible from the outside, do not involve puncturing, relocating or removing the roof, ceiling, floors or any existing walls, will not affect the electrical, plumbing, HVAC, and/or life safety systems, and the cumulative cost thereof during this Lease as extended does not exceed $2000. Notwithstanding the foregoing,~~ Lessee shall not make or permit any roof penetrations and/or install anything on the roof without the prior written approval of Lessor. Lessor may, as a precondition to granting such approval, require Lessee to utilize a contractor chosen and/or approved by Lessor. Any Alterations or Utility Installations that Lessee shall desire to make and which require the consent of the Lessor shall be presented to Lessor in written form with detailed plans. Consent shall be deemed conditioned upon Lessee's: (i) acquiring all applicable governmental permits, (ii) furnishing Lessor with copies of both the permits and the plans and specifications prior to commencement of the work, and (iii) compliance with all conditions of said permits and other Applicable Requirements in a prompt and expeditious manner. Any Alterations or Utility Installations shall be performed in a workmanlike manner with good and sufficient materials. Lessee shall promptly upon completion furnish Lessor with asbuilt plans and specifications. For work which costs an amount in excess of one month's Base Rent, Lessor may condition its consent upon Lessee providing a lien and completion bond in an amount equal to 150% of the estimated cost of such Alteration or Utility Installation and/or upon Lessee's posting an additional Security Deposit with Lessor.

(c) **Liens; Bonds**. Lessee shall pay, when due, all claims for labor or materials furnished or alleged to have been furnished to or for Lessee at or for use on the Premises, which claims are or may be secured by any mechanic's or materialmen's lien against the Premises or any interest therein. Lessee shall give Lessor not less than 10 days notice prior to the commencement of any work in, on or about the Premises, and Lessor shall have the right to post notices of non-responsibility. If Lessee shall contest the validity of any such lien, claim or demand, then Lessee shall, at its sole expense defend and protect itself, Lessor and the Premises against the same and shall pay and satisfy any such adverse judgment that may be rendered thereon before the enforcement thereof. If Lessor shall require, Lessee shall furnish a surety bond in an amount equal to 150% of the amount of such contested lien, claim or demand, indemnifying Lessor against liability for the same. If Lessor elects to participate in any such action, Lessee shall pay Lessor's attorneys' fees and costs.

7.4 **Ownership; Removal; Surrender; and Restoration**.

(a) **Ownership**. Subject to Lessor's right to require removal or elect ownership as hereinafter provided, all Alterations and Utility Installations made by Lessee shall be the property of Lessee, but considered a part of the Premises. Lessor may, at any time, elect in writing to be the owner of all or any specified part of the Lessee Owned Alterations and Utility Installations. Unless otherwise instructed per paragraph 7.4(b) hereof, all Lessee Owned Alterations and Utility Installations shall, at the expiration or termination of this Lease, become the property of Lessor and be surrendered by Lessee with the Premises.

(b) **Removal**. By delivery to Lessee of written notice from Lessor not earlier than 90 and not later than 30 days prior to the end of the term of this Lease, Lessor may require that any or all Lessee Owned Alterations or Utility Installations be removed by the expiration or termination of this Lease. Lessor may require the removal at any time of all or any part of any Lessee Owned Alterations or Utility Installations made without the required consent.

(c) **Surrender; Restoration**. Lessee shall surrender the Premises by the Expiration Date or any earlier termination date, with all of the improvements, parts and surfaces thereof clean and free of debris, and in good operating order, condition and state of repair, ordinary wear and tear excepted. "Ordinary wear and tear" shall not include any damage or deterioration that would have been prevented by good maintenance practice. Notwithstanding the foregoing, if this Lease is for 12 months or less, then Lessee shall surrender the Premises in the same condition as delivered to Lessee on the Start Date with NO allowance for ordinary wear and tear. Lessee shall repair any damage occasioned by the installation, maintenance or removal of Trade Fixtures, Lessee owned Alterations and/or Utility Installations, furnishings, and equipment as well as the removal of any storage tank installed by or for Lessee. Lessee shall also completely remove from the Premises any and all Hazardous Substances brought onto the Premises by or for Lessee, or any third party (except Hazardous Substances which were deposited via underground migration from areas outside of the Project) even if such removal would require Lessee to perform or pay for work that exceeds statutory requirements. Trade Fixtures shall remain the property of Lessee and shall be removed by Lessee. The failure by Lessee to timely vacate the Premises pursuant to this Paragraph 7.4(c) without the express written consent of Lessor shall constitute a holdover under the provisions of Paragraph 26 below.

8. **Insurance; Indemnity.**

8.1 **Insurance Premiums.** The cost of the premiums for the insurance policies maintained by Lessor pursuant to paragraph 8 are included as Operating Expenses (see paragraph 4.2 (c)(iv)). Said costs shall include increases in the premiums resulting from additional coverage related to requirements of the holder of a mortgage or deed of trust covering the Premises, Building and/or Project, increased valuation of the Premises, Building and/or Project, and/or a general premium rate increase. Said costs shall not, however, include any premium increases resulting from the nature of the occupancy of any other tenant of the Building. If the Project was not insured for the entirety of the Base Year, then the base premium shall be the lowest annual premium reasonably obtainable for the required insurance as of the Start Date, assuming the most nominal use possible of the Building and/or Project. In no event, however, shall Lessee be responsible for any portion of the premium cost attributable to liability insurance

coverage in excess of $2,000,000 procured under Paragraph 8.2(b).

8.2 **Liability Insurance**.

(a) **Carried by Lessee**. Lessee shall obtain and keep in force a Commercial General Liability policy of insurance protecting Lessee, Lessor and Lessor's Agent(s) as an additional insured(s) against claims for bodily injury, personal injury and property damage based upon or arising out of the ownership, use, occupancy or maintenance of the Premises and all areas appurtenant thereto. Such insurance shall be on an occurrence basis providing single limit coverage in an amount not less than $1,000,000 per occurrence with an annual aggregate of not less than $2,000,000, an "Additional Insured-Managers or Lessors of Premises Endorsement" and contain the "Amendment of the Pollution Exclusion Endorsement" for damage caused by heat, smoke or fumes from a hostile fire. The policy shall not contain any intra-insured exclusions as between insured persons or organizations, but shall include coverage for liability assumed under this Lease as an **"insured contract"** for the performance of Lessee's indemnity obligations under this Lease. The limits of said insurance shall not, however, limit the liability of Lessee nor relieve Lessee of any obligation hereunder. All insurance carried by Lessee shall be primary to and not contributory with any similar insurance carried by Lessor, whose insurance shall be considered excess insurance only.

(b) **Carried by Lessor**. Lessor shall maintain liability insurance as described in Paragraph 8.2(a), in addition to, and not in lieu of, the insurance required to be maintained by Lessee. Lessee shall not be named as an additional insured therein.

8.3 **Property Insurance — Building, Improvements and Rental Value**.

(a) **Building and Improvements**. Lessor shall obtain and keep in force a policy or policies of insurance in the name of Lessor, with loss payable to Lessor, any ground-lessor, and to any Lender insuring loss or damage to the Building and/or Project. The amount of such insurance shall be equal to the full replacement cost of the Building and/or Project, as the same shall exist from time to time, or the amount required by any Lender, but in no event more than the commercially reasonable and available insurable value thereof. Lessee Owned Alterations and Utility Installations, Trade Fixtures, and Lessee's personal property shall be insured by Lessee under Paragraph 8.4. If the coverage is available and commercially appropriate, such policy or policies shall insure against all risks of direct physical loss or damage (except the perils of flood and/or earthquake unless required by a Lender), including coverage for debris removal and the enforcement of any Applicable Requirements requiring the upgrading, demolition, reconstruction or replacement of any portion of the Premises as the result of a covered loss. Said policy or policies shall also contain an agreed valuation provision in lieu of any coinsurance clause, waiver of subrogation, and inflation guard protection causing an increase in the annual property insurance coverage amount by a factor of not less than the adjusted U.S. Department of Labor Consumer Price Index for All Urban Consumers for the city nearest to where the Premises are located. If such insurance coverage has a deductible clause, the deductible amount shall not exceed $1,000 per occurrence.

(b) **Rental Value**. Lessor shall also obtain and keep in force a policy or policies in the name of Lessor with loss payable to Lessor and any Lender, insuring the loss of the full Rent for one year with an extended period of indemnity for an additional 180 days **("Rental Value insurance").** Said insurance shall contain an agreed valuation provision in lieu of any coinsurance clause, and the amount of coverage shall be adjusted annually to reflect the projected Rent otherwise payable by Lessee, for the next 12 month period.

(c) **Adjacent Premises**. Lessee shall pay for any increase in the premiums for the property insurance of the Building and for the Common Areas or other buildings in the Project if said increase is caused by Lessee's acts, omissions, use or occupancy of the Premises.

(d) **Lessee's Improvements**. Since Lessor is the Insuring Party, Lessor shall not be required to insure Lessee Owned Alterations and Utility Installations unless the item in question has become the property of Lessor under the terms of this Lease.

8.4 **Lessee's Property; Business Interruption Insurance**.

(a) **Property Damage**. Lessee shall obtain and maintain insurance coverage on all of Lessee's personal property, Trade Fixtures, and Lessee Owned Alterations and Utility Installations. Such insurance shall be full replacement cost coverage with a deductible of not to exceed $1,000 per occurrence. The proceeds from any such insurance shall be used by Lessee for the replacement of personal property, Trade Fixtures and Lessee Owned Alterations and Utility Installations. Lessee shall provide Lessor with written evidence that such insurance is in force.

(b) **Business Interruption**. Lessee shall obtain and maintain loss of income and extra expense insurance in amounts as will reimburse Lessee for direct or indirect loss of earnings attributable to all perils commonly insured against by prudent lessees in the business of Lessee or attributable to prevention of access to the Premises as a result of such perils.

(c) **No Representation of Adequate Coverage**. Lessor makes no representation that the limits or forms of coverage of insurance specified herein are adequate to cover Lessee's property, business operations or obligations under this Lease.

8.5 **Insurance Policies**. Insurance required herein shall be by companies duly licensed or admitted to transact business in the state where the Premises are located, and maintaining during the policy term a "General Policyholders Rating" of at least B+, V, as set forth in the most current issue of "Best's Insurance Guide", or such other rating as may be required by a Lender. Lessee shall not do or permit to be done anything which invalidates the required insurance policies. Lessee shall, prior to the Start Date, deliver to Lessor certified copies of policies of such insurance or certificates evidencing the existence and amounts of the required insurance. No such policy shall be cancelable or subject to modification except after 30 days prior written notice to Lessor. Lessee shall, at least 30 days prior to the expiration of such policies, furnish Lessor with evidence of renewals or "insurance binders" evidencing renewal thereof, or Lessor may order such insurance and charge the cost thereof to Lessee, which amount shall be payable by Lessee to Lessor upon demand. Such policies shall be for a term of at least one year, or the length of the remaining term of this Lease, whichever is less. If either Party shall fail to procure and maintain the insurance required to be carried by it, the other Party may, but shall not be required to, procure and maintain the same.

8.6 **Waiver of Subrogation**. Without affecting any other rights or remedies, Lessee and Lessor each hereby release and relieve the other, and waive their entire right to recover damages against the other, for loss of or damage to its property arising out of or incident to the perils required to be insured against herein. The effect of such releases and waivers is not limited by the amount of insurance carried or required, or by any deductibles applicable hereto. The Parties agree to have their respective property damage insurance carriers waive any right to subrogation that such companies may have against Lessor or Lessee, as the case may be, so long as the insurance is not invalidated thereby.

8.7 **Indemnity**. Except for Lessor's gross negligence or willful misconduct, Lessee shall indemnify, protect, defend and hold harmless the Premises, Lessor and its agents, Lessor's master or ground lessor, partners and Lenders, from and against any and all claims, loss of rents and/or damages, liens, judgments, penalties, attorneys' and consultants' fees, expenses and/or liabilities arising out of, involving, or in connection with, the use and/or occupancy of the Premises by Lessee. If any action or proceeding is brought against Lessor by reason of any of the foregoing matters, Lessee shall upon notice defend the same at Lessee's expense by counsel reasonably satisfactory to Lessor and Lessor shall cooperate with Lessee in such defense. Lessor need not have first paid any such claim in order to be defended or indemnified.

8.8 **Exemption of Lessor from Liability**. Lessor shall not be liable for injury or damage to the person or goods, wares, merchandise or other property of Lessee, Lessee's employees, contractors, invitees, customers, or any other person in or about the Premises, whether such damage or injury is caused by or results from fire, steam, electricity, gas, water or rain, or from the breakage, leakage, obstruction or other defects of pipes, fire sprinklers, wires, appliances, plumbing, HVAC or lighting fixtures, or from any other cause, whether the said injury or damage results from conditions arising upon the Premises or upon other portions of the Building, or from other sources or places. Lessor shall not be liable for any damages arising from any act or neglect of any other tenant of Lessor nor from the failure of Lessor to enforce the provisions of any other lease in the Project. Notwithstanding Lessor's negligence or breach of this Lease, Lessor shall under no circumstances be liable for injury to Lessee's business or for any loss of income or profit therefrom.

9. **Damage or Destruction.**

9.1 **Definitions**.

(a) **"Premises Partial Damage"** shall mean damage or destruction to the improvements on the Premises, other than Lessee Owned Alterations and Utility Installations, which can reasonably be repaired in 3 months or less from the date of the damage or destruction, and the cost thereof does not exceed a sum equal to 6 month's Base Rent. Lessor shall notify Lessee in writing within 30 days from the date of the damage or destruction as to whether or not the damage is Partial or Total.

(b) **"Premises Total Destruction"** shall mean damage or destruction to the improvements on the Premises, other than Lessee Owned Alterations and Utility Installations and Trade Fixtures, which cannot reasonably be repaired in 3 months or less from the date of the damage or destruction and/or the cost thereof exceeds a sum equal to 6 month's Base Rent. Lessor shall notify Lessee in writing within 30 days from the date of the damage or destruction as to whether or not the damage is Partial or Total.

(c) **"Insured Loss"** shall mean damage or destruction to improvements on the Premises, other than Lessee Owned Alterations and Utility Installations and Trade Fixtures, which was caused by an event required to be covered by the insurance described in Paragraph 8.3(a), irrespective of any deductible amounts or coverage limits involved.

(d) **"Replacement Cost"** shall mean the cost to repair or rebuild the improvements owned by Lessor at the time of the occurrence to their condition existing immediately prior thereto, including demolition, debris removal and upgrading required by the operation of Applicable Requirements, and without deduction for depreciation.

(e) **"Hazardous Substance Condition"** shall mean the occurrence or discovery of a condition involving the presence of, or a contamination by, a Hazardous Substance as defined in Paragraph 6.2(a), in, on, or under the Premises which requires repair, remediation, or restoration.

9.2 **Partial Damage — Insured Loss.** If a Premises Partial Damage that is an Insured Loss occurs, then Lessor shall, at Lessor's expense, repair such damage (but not Lessee's Trade Fixtures or Lessee Owned Alterations and Utility Installations) as soon as reasonably possible and this Lease shall continue in full force and effect; provided, however, that Lessee shall, at Lessor's election, make the repair of any damage or destruction the total cost to repair of which is $5,000 or less, and, in such event, Lessor shall make any applicable insurance proceeds available to Lessee on a reasonable basis for that purpose. Notwithstanding the foregoing, if the required insurance was not in force or the insurance proceeds are not sufficient to effect such repair, the Insuring Party shall promptly contribute the shortage in proceeds as and when required to complete said repairs. In the event, however, such shortage was due to the fact that, by reason of the unique nature of the improvements, full replacement cost insurance coverage was not commercially reasonable and available, Lessor shall have no obligation to pay for the shortage in insurance proceeds or to fully restore the unique aspects of the Premises unless Lessee provides Lessor with the funds to cover same, or adequate assurance thereof, within 10 days following receipt of written notice of such shortage and request therefor. If Lessor receives said funds or adequate assurance thereof within said 10 day period, the party responsible for making the repairs shall complete them as soon as reasonably possible and this Lease shall remain in full force and effect. If such funds or assurance are not received, Lessor may nevertheless elect by written notice to Lessee within 10 days thereafter to: (i) make such restoration and repair as is commercially reasonable with Lessor paying any shortage in proceeds, in which case this Lease shall remain in full force and effect, or (ii) have this Lease terminate 30 days thereafter. Lessee shall not be entitled to reimbursement of any funds contributed by Lessee to repair any such damage or destruction. Premises Partial Damage due to flood or earthquake shall be subject to Paragraph 9.3, notwithstanding that there may be some insurance coverage, but the net proceeds of any such insurance shall be made available for the repairs if made by either Party.

9.3 **Partial Damage — Uninsured Loss.** If a Premises Partial Damage that is not an Insured Loss occurs, unless caused by a negligent or willful act of Lessee (in which event Lessee shall make the repairs at Lessee's expense), Lessor may either: (i) repair such damage as soon as reasonably possible at Lessor's expense, in which event this Lease shall continue in full force and effect, or (ii) terminate this Lease by giving written notice to Lessee within 30 days after receipt by Lessor of knowledge of the occurrence of such damage. Such termination shall be effective 60 days following the date of such notice. In the event Lessor elects to terminate this Lease, Lessee shall have the right within 10 days after receipt of the termination notice to give written notice to Lessor of Lessee's commitment to pay for the repair of such damage without reimbursement from Lessor. Lessee shall provide Lessor with said funds or satisfactory assurance thereof within 30 days after making such commitment. In such event this Lease shall continue in full force and effect, and Lessor shall proceed to make such repairs as soon as reasonably possible after the required funds are available. If Lessee does not make the required commitment, this Lease shall terminate as of the date specified in the termination notice.

9.4 **Total Destruction.** Notwithstanding any other provision hereof, if a Premises Total Destruction occurs, this Lease shall terminate 60 days following such Destruction. If the damage or destruction was caused by the gross negligence or willful misconduct of Lessee, Lessor shall have the right to recover Lessor's damages from Lessee, except as provided in Paragraph 8.6.

9.5 **Damage Near End of Term.** If at any time during the last 6 months of this Lease there is damage for which the cost to repair exceeds one month's Base Rent, whether or not an Insured Loss, Lessor may terminate this Lease effective 60 days following the date of occurrence of such damage by giving a written termination notice to Lessee within 30 days after the date of occurrence of such damage. Notwithstanding the foregoing, if Lessee at that time has an exercisable option to extend this Lease or to purchase the Premises, then Lessee may preserve this Lease by, (a) exercising such option and (b) providing Lessor with any shortage in insurance proceeds (or adequate assurance thereof) needed to make the repairs on or before the earlier of (i) the date which is 10 days after Lessee's receipt of Lessor's written notice purporting to terminate this Lease, or (ii) the day prior to the date upon which such option expires. If Lessee duly exercises such option during such period and provides Lessor with funds (or adequate assurance thereof) to cover any shortage in insurance proceeds, Lessor shall, at Lessor's commercially reasonable expense, repair such damage as soon as reasonably possible and this Lease shall continue in full force and effect. If Lessee fails to exercise such option and provide such funds or assurance during such period, then this Lease shall terminate on the date specified in the termination notice and Lessee's option shall be extinguished.

9.6 **Abatement of Rent; Lessee's Remedies.**

(a) **Abatement.** In the event of Premises Partial Damage or Premises Total Destruction or a Hazardous Substance Condition for which Lessee is not responsible under this Lease, the Rent payable by Lessee for the period required for the repair, remediation or restoration of such damage shall be abated in proportion to the degree to which Lessee's use of the Premises is impaired, but not to exceed the proceeds received from the Rental Value insurance. All other obligations of Lessee hereunder shall be performed by Lessee, and Lessor shall have no liability for any such damage, destruction, remediation, repair or restoration except as provided herein.

(b) **Remedies.** If Lessor shall be obligated to repair or restore the Premises and does not commence, in a substantial and meaningful way, such repair or restoration within 90 days after such obligation shall accrue, Lessee may, at any time prior to the commencement of such repair or restoration, give written notice to Lessor and to any Lenders of which Lessee has actual notice, of Lessee's election to terminate this Lease on a date not less than 60 days following the giving of such notice. If Lessee gives such notice and such repair or restoration is not commenced within 30 days thereafter, this Lease shall terminate as of the date specified in said notice. If the repair or restoration is commenced within such 30 days, this Lease shall continue in full force and effect. "Commence" shall mean either the unconditional authorization of the preparation of the required plans, or the beginning of the actual work on the Premises, whichever first occurs.

9.7 **Termination; Advance Payments.** Upon termination of this Lease pursuant to Paragraph 6.2(g) or Paragraph 9, an equitable adjustment shall be made concerning advance Base Rent and any other advance payments made by Lessee to Lessor. Lessor shall, in addition, return to Lessee so much of Lessee's Security Deposit as has not been, or is not then required to be, used by Lessor.

9.8 **Waive Statutes.** Lessor and Lessee agree that the terms of this Lease shall govern the effect of any damage to or destruction of the Premises with respect to the termination of this Lease and hereby waive the provisions of any present or future statute to the extent inconsistent herewith.

10. **Real Property Taxes.**

10.1 **Definitions.** As used herein, the term **"Real Property Taxes"** shall include any form of assessment; real estate, general, special, ordinary or extraordinary, or rental levy or tax (other than inheritance, personal income or estate taxes); improvement bond; and/or license fee imposed upon or levied against any legal or equitable interest of Lessor in the Project, Lessor's right to other income therefrom, and/or Lessor's business of leasing, by any authority having the direct or indirect power to tax and where the funds are generated with reference to the Project address and where the proceeds so generated are to be applied by the city, county or other local taxing authority of a jurisdiction within which the Project is located. **"Real Property Taxes"** shall also include any tax, fee, levy, assessment or charge, or any increase therein, imposed by reason of events occurring during the term of this Lease, including but not limited to, a change in the ownership of the Project or any portion thereof or a change in the improvements thereon.

10.2 **Payment of Taxes.** Except as otherwise provided in Paragraph 10.3, Lessor shall pay the Real Property Taxes applicable to the Project, and said payments shall be included in the calculation of Operating Expenses in accordance with the provisions of Paragraph 4.2.

10.3 **Additional Improvements.** Operating Expenses shall not include Real Property Taxes specified in the tax assessor's records and work sheets as being caused by additional improvements placed upon the Project by other lessees or by Lessor for the exclusive enjoyment of such other lessees. Notwithstanding Paragraph 10.2 hereof, Lessee shall, however, pay to Lessor at the time Operating Expenses are payable under Paragraph 4.2, the entirety of any increase in Real Property Taxes if assessed solely by reason of Alterations, Trade Fixtures or Utility Installations placed upon the Premises by Lessee or at Lessee's request.

10.4 **Joint Assessment.** If the Building is not separately assessed, Real Property Taxes allocated to the Building shall be an equitable proportion of the Real Property Taxes for all of the land and improvements included within the tax parcel assessed, such proportion to be determined by Lessor from the respective valuations assigned in the assessor's work sheets or such other information as may be reasonably available. Lessor's reasonable determination thereof, in good faith, shall be conclusive.

10.5 **Personal Property Taxes.** Lessee shall pay prior to delinquency all taxes assessed against and levied upon Lessee Owned Alterations and Utility Installations, Trade Fixtures, furnishings, equipment and all personal property of Lessee contained in the Premises. When possible, Lessee shall cause its Lessee Owned Alterations and Utility Installations, Trade Fixtures, furnishings, equipment and all other personal property to be assessed and billed separately from the real property of Lessor. If any of Lessee's said property shall be assessed with Lessor's real property, Lessee shall pay Lessor the taxes attributable to Lessee's property within 10 days after receipt of a written statement setting forth the taxes applicable to Lessee's property.

11. **Utilities and Services.**

11.1 **Services Provided by Lessor.** Lessor shall provide heating, ventilation, air conditioning, reasonable amounts of electricity for normal lighting and office machines, water for reasonable and normal drinking and lavatory use in connection with an office, and replacement light bulbs and/or fluorescent tubes and ballasts for standard overhead fixtures. ~~Lessor shall also provide janitorial services to the Premises and Common Areas 5 times per week, excluding Building Holiday, or pursuant to the attached janitorial schedule if any.~~ Lessor shall not, however, be required to provide janitorial services to kitchens or storage areas included within the Premises.

11.2 **Services Exclusive to Lessee.** Lessee shall pay for all water, gas, heat, light, power, telephone and other utilities and services specially or exclusively supplied and/or metered exclusively to the Premises or to Lessee, together with any taxes thereon. If a service is deleted by Paragraph 1.13 and such service is not separately metered to the Premises, Lessee shall pay at Lessor's option, either Lessee's Share or a reasonable proportion to be determined by Lessor of all charges for such jointly metered service.

11.3 **Hours of Service.** Said services and utilities shall be provided during times set forth in Paragraph 1.12. Utilities and services required

at other times shall be subject to advance request and reimbursement by Lessee to Lessor of the cost thereof.

11.4 **Excess Usage by Lessee.** Lessee shall not make connection to the utilities except by or through existing outlets and shall not install or use machinery or equipment in or about the Premises that uses excess water, lighting or power, or suffer or permit any act that causes extra burden upon the utilities or services, including but not limited to security and trash services, over standard office usage for the Project. Lessor shall require Lessee to reimburse Lessor for any excess expenses or costs that may arise out of a breach of this subparagraph by Lessee. Lessor may, in its sole discretion, install at Lessee's expense supplemental equipment and/or separate metering applicable to Lessee's excess usage or loading.

11.5 **Interruptions.** There shall be no abatement of rent and Lessor shall not be liable in any respect whatsoever for the inadequacy, stoppage, interruption or discontinuance of any utility or service due to riot, strike, labor dispute, breakdown, accident, repair or other cause beyond Lessor's reasonable control or in cooperation with governmental request or directions.

12. **Assignment and Subletting.**

12.1 **Lessor's Consent Required.**

(a) Lessee shall not voluntarily or by operation of law assign, transfer, mortgage or encumber (collectively, **"assign or assignment"**) or sublet all or any part of Lessee's interest in this Lease or in the Premises without Lessor's prior written consent.

(b) Unless Lessee is a corporation and its stock is publicly traded on a national stock exchange, a change in the control of Lessee shall constitute an assignment requiring consent. The transfer, on a cumulative basis, of 25% or more of the voting control of Lessee shall constitute a change in control for this purpose.

(c) The involvement of Lessee or its assets in any transaction, or series of transactions (by way of merger, sale, acquisition, financing, transfer, leveraged buyout or otherwise), whether or not a formal assignment or hypothecation of this Lease or Lessee's assets occurs, which results or will result in a reduction of the Net Worth of Lessee by an amount greater than 25% of such Net Worth as it was represented at the time of the execution of this Lease or at the time of the most recent assignment to which Lessor has consented, or as it exists immediately prior to said transaction or transactions constituting such reduction, whichever was or is greater, shall be considered an assignment of this Lease to which Lessor may withhold its consent. **"Net Worth of Lessee"** shall mean the net worth of Lessee (excluding any guarantors) established under generally accepted accounting principles.

(d) An assignment or subletting without consent shall, at Lessor's option, be a Default curable after notice per Paragraph 13.1(c), or a noncurable Breach without the necessity of any notice and grace period. If Lessor elects to treat such unapproved assignment or subletting as a noncurable Breach, Lessor may either: (i) terminate this Lease, or (ii) upon 30 days written notice, increase the monthly Base Rent to 110% of the Base Rent then in effect. Further, in the event of such Breach and rental adjustment, (i) the purchase price of any option to purchase the Premises held by Lessee shall be subject to similar adjustment to 110% of the price previously in effect, and (ii) all fixed and non-fixed rental adjustments scheduled during the remainder of the Lease term shall be increased to 110% of the scheduled adjusted rent.

(e) Lessee's remedy for any breach of Paragraph 12.1 by Lessor shall be limited to compensatory damages and/or injunctive relief.

12.2 **Terms and Conditions Applicable to Assignment and Subletting.**

(a) Regardless of Lessor's consent, no assignment or subletting shall: (i) be effective without the express written assumption by such assignee or sublessee of the obligations of Lessee under this Lease, (ii) release Lessee of any obligations hereunder, or (iii) alter the primary liability of Lessee for the payment of Rent or for the performance of any other obligations to be performed by Lessee.

(b) Lessor may accept Rent or performance of Lessee's obligations from any person other than Lessee pending approval or disapproval of an assignment. Neither a delay in the approval or disapproval of such assignment nor the acceptance of Rent or performance shall constitute a waiver or estoppel of Lessor's right to exercise its remedies for Lessee's Default or Breach.

(c) Lessor's consent to any assignment or subletting shall not constitute a consent to any subsequent assignment or subletting.

(d) In the event of any Default or Breach by Lessee, Lessor may proceed directly against Lessee, any Guarantors or anyone else responsible for the performance of Lessee's obligations under this Lease, including any assignee or sublessee, without first exhausting Lessor's remedies against any other person or entity responsible therefore to Lessor, or any security held by Lessor.

(e) Each request for consent to an assignment or subletting shall be in writing, accompanied by information relevant to Lessor's determination as to the financial and operational responsibility and appropriateness of the proposed assignee or sublessee, including but not limited to the intended use and/or required modification of the Premises, if any. Lessee agrees to provide Lessor with such other or additional information and/or documentation as may be reasonably requested. (See also Paragraph 36)

(f) Any assignee of, or sublessee under, this Lease shall, by reason of accepting such assignment or entering into such sublease, be deemed to have assumed and agreed to conform and comply with each and every term, covenant, condition and obligation herein to be observed or performed by Lessee during the term of said assignment or sublease, other than such obligations as are contrary to or inconsistent with provisions of an assignment or sublease to which Lessor has specifically consented to in writing.

(g) Lessor's consent to any assignment or subletting shall not transfer to the assignee or sublessee any Option granted to the original Lessee by this Lease unless such transfer is specifically consented to by Lessor in writing. (See Paragraph 39.2)

12.3 **Additional Terms and Conditions Applicable to Subletting.** The following terms and conditions shall apply to any subletting by Lessee of all or any part of the Premises and shall be deemed included in all subleases under this Lease whether or not expressly incorporated therein:

(a) Lessee hereby assigns and transfers to Lessor all of Lessee's interest in all Rent payable on any sublease, and Lessor may collect such Rent and apply same toward Lessee's obligations under this Lease; provided, however, that until a Breach shall occur in the performance of Lessee's obligations, Lessee may collect said Rent. Lessor shall not, by reason of the foregoing or any assignment of such sublease, nor by reason of the collection of Rent, be deemed liable to the sublessee for any failure of Lessee to perform and comply with any of Lessee's obligations to such sublessee. Lessee hereby irrevocably authorizes and directs any such sublessee, upon receipt of a written notice from Lessor stating that a Breach exists in the performance of Lessee's obligations under this Lease, to pay to Lessor all Rent due and to become due under the sublease. Sublessee shall rely upon any such notice from Lessor and shall pay all Rents to Lessor without any obligation or right to inquire as to whether such Breach exists, notwithstanding any claim from Lessee to the contrary.

(b) In the event of a Breach by Lessee, Lessor may, at its option, require sublessee to attorn to Lessor, in which event Lessor shall undertake the obligations of the sublessor under such sublease from the time of the exercise of said option to the expiration of such sublease; provided, however, Lessor shall not be liable for any prepaid rents or security deposit paid by such sublessee to such sublessor or for any prior Defaults or Breaches of such sublessor.

(c) Any matter requiring the consent of the sublessor under a sublease shall also require the consent of Lessor.

(d) No sublessee shall further assign or sublet all or any part of the Premises without Lessor's prior written consent.

(e) Lessor shall deliver a copy of any notice of Default or Breach by Lessee to the sublessee, who shall have the right to cure the Default of Lessee within the grace period, if any, specified in such notice. The sublessee shall have a right of reimbursement and offset from and against Lessee for any such Defaults cured by the sublessee.

13. **Default; Breach; Remedies.**

13.1 **Default; Breach. A "Default"** is defined as a failure by the Lessee to comply with or perform any of the terms, covenants, conditions or Rules and Regulations under this Lease. A**"Breach"** is defined as the occurrence of one or more of the following Defaults, and the failure of Lessee to cure such Default within any applicable grace period:

(a) The abandonment of the Premises; or the vacating of the Premises without providing a commercially reasonable level of security, or where the coverage of the property insurance described in Paragraph 8.3 is jeopardized as a result thereof, or without providing reasonable assurances to minimize potential vandalism.

(b) The failure of Lessee to make any payment of Rent or any Security Deposit required to be made by Lessee hereunder, whether to Lessor or to a third party, when due, to provide reasonable evidence of insurance or surety bond, or to fulfill any obligation under this Lease which endangers or threatens life or property, where such failure continues for a period of 3 business days following written notice to Lessee.

(c) The failure by Lessee to provide (i) reasonable written evidence of compliance with Applicable Requirements, (ii) the service contracts, (iii) the rescission of an unauthorized assignment or subletting, (iv) an Estoppel Certificate, (v) a requested subordination, (vi) evidence concerning any guaranty and/or Guarantor, (vii) any document requested under Paragraph 41 (easements), or (viii) any other documentation or information which Lessor may reasonably require of Lessee under the terms of this Lease, where any such failure continues for a period of 10 days following written notice to Lessee.

(d) A Default by Lessee as to the terms, covenants, conditions or provisions of this Lease, or of the rules adopted under Paragraph 2.9 hereof, other than those described in subparagraphs 13.1(a), (b) or (c), above, where such Default continues for a period of 30 days after written notice; provided, however, that if the nature of Lessee's Default is such that more than 30 days are reasonably required for its cure, then it shall not be deemed to be a Breach if Lessee commences such cure within said 30 day period and thereafter diligently prosecutes such cure to completion.

(e) The occurrence of any of the following events: (i) the making of any general arrangement or assignment for the benefit of creditors; (ii) becoming a **"debtor"** as defined in 11 U.S.C. § 101 or any successor statute thereto (unless, in the case of a petition filed against Lessee, the same is dismissed within 60 days); (iii) the appointment of a trustee or receiver to take possession of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where possession is not restored to Lessee within 30 days; or (iv) the attachment, execution or other judicial seizure of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where such seizure is not discharged

within 30 days; provided, however, in the event that any provision of this subparagraph (e) is contrary to any applicable law, such provision shall be of no force or effect, and not affect the validity of the remaining provisions.

(f) The discovery that any financial statement of Lessee or of any Guarantor given to Lessor was materially false.

(g) If the performance of Lessee's obligations under this Lease is guaranteed: (i) the death of a Guarantor, (ii) the termination of a Guarantor's liability with respect to this Lease other than in accordance with the terms of such guaranty, (iii) a Guarantor's becoming insolvent or the subject of a bankruptcy filing, (iv) a Guarantor's refusal to honor the guaranty, or (v) a Guarantor's breach of its guaranty obligation on an anticipatory basis, and Lessee's failure, within 60 days following written notice of any such event, to provide written alternative assurance or security, which, when coupled with the then existing resources of Lessee, equals or exceeds the combined financial resources of Lessee and the Guarantors that existed at the time of execution of this Lease.

13.2 **Remedies.** If Lessee fails to perform any of its affirmative duties or obligations, within 10 days after written notice (or in case of an emergency, without notice), Lessor may, at its option, perform such duty or obligation on Lessee's behalf, including but not limited to the obtaining of reasonably required bonds, insurance policies, or governmental licenses, permits or approvals. The costs and expenses of any such performance by Lessor shall be due and payable by Lessee upon receipt of invoice therefor. If any check given to Lessor by Lessee shall not be honored by the bank upon which it is drawn, Lessor, at its option, may require all future payments to be made by Lessee to be by cashier's check. In the event of a Breach, Lessor may, with or without further notice or demand, and without limiting Lessor in the exercise of any right or remedy which Lessor may have by reason of such Breach:

(a) Terminate Lessee's right to possession of the Premises by any lawful means, in which case this Lease shall terminate and Lessee shall immediately surrender possession to Lessor. In such event Lessor shall be entitled to recover from Lessee: (i) the unpaid Rent which had been earned at the time of termination; (ii) the worth at the time of award of the amount by which the unpaid rent which would have been earned after termination until the time of award exceeds the amount of such rental loss that the Lessee proves could have been reasonably avoided; (iii) the worth at the time of award of the amount by which the unpaid rent for the balance of the term after the time of award exceeds the amount of such rental loss that the Lessee proves could be reasonably avoided; and (iv) any other amount necessary to compensate Lessor for all the detriment proximately caused by the Lessee's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result therefrom, including but not limited to the cost of recovering possession of the Premises, expenses of reletting, including necessary renovation and alteration of the Premises, reasonable attorneys' fees, and that portion of any leasing commission paid by Lessor in connection with this Lease applicable to the unexpired term of this Lease. The worth at the time of award of the amount referred to in provision (iii) of the immediately preceding sentence shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of the District within which the Premises are located at the time of award plus one percent. Efforts by Lessor to mitigate damages caused by Lessee's Breach of this Lease shall not waive Lessor's right to recover damages under Paragraph 12. If termination of this Lease is obtained through the provisional remedy of unlawful detainer, Lessor shall have the right to recover in such proceeding any unpaid Rent and damages as are recoverable therein, or Lessor may reserve the right to recover all or any part thereof in a separate suit. If a notice and grace period required under Paragraph 13.1 was not previously given, a notice to pay rent or quit, or to perform or quit given to Lessee under the unlawful detainer statute shall also constitute the notice required by Paragraph 13.1. In such case, the applicable grace period required by Paragraph 13.1 and the unlawful detainer statute shall run concurrently, and the failure of Lessee to cure the Default within the greater of the two such grace periods shall constitute both an unlawful detainer and a Breach of this Lease entitling Lessor to the remedies provided for in this Lease and/or by said statute.

(b) Continue the Lease and Lessee's right to possession and recover the Rent as it becomes due, in which event Lessee may sublet or assign, subject only to reasonable limitations. Acts of maintenance, efforts to relet, and/or the appointment of a receiver to protect the Lessor's interests, shall not constitute a termination of the Lessee's right to possession.

(c) Pursue any other remedy now or hereafter available under the laws or judicial decisions of the state wherein the Premises are located. The expiration or termination of this Lease and/or the termination of Lessee's right to possession shall not relieve Lessee from liability under any indemnity provisions of this Lease as to matters occurring or accruing during the term hereof or by reason of Lessee's occupancy of the Premises.

13.3 **Inducement Recapture.** Any agreement for free or abated rent or other charges, or for the giving or paying by Lessor to or for Lessee of any cash or other bonus, inducement or consideration for Lessee's entering into this Lease, all of which concessions are hereinafter referred to as **"Inducement Provisions",** shall be deemed conditioned upon Lessee's full and faithful performance of all of the terms, covenants and conditions of this Lease. Upon Breach of this Lease by Lessee, any such Inducement Provision shall automatically be deemed deleted from this Lease and of no further force or effect, and any rent, other charge, bonus, inducement or consideration theretofore abated, given or paid by Lessor under such an Inducement Provision shall be immediately due and payable by Lessee to Lessor, notwithstanding any subsequent cure of said Breach by Lessee. The acceptance by Lessor of rent or the cure of the Breach which initiated the operation of this paragraph shall not be deemed a waiver by Lessor of the provisions of this paragraph unless specifically so stated in writing by Lessor at the time of such acceptance.

13.4 **Late Charges.** Lessee hereby acknowledges that late payment by Lessee of Rent will cause Lessor to incur costs not contemplated by this Lease, the exact amount of which will be extremely difficult to ascertain. Such costs include, but are not limited to, processing and accounting charges, and late charges which may be imposed upon Lessor by any Lender. Accordingly, if any Rent shall not be received by Lessor within 5 days after such amount shall be due, then, without any requirement for notice to Lessee, Lessee shall pay to Lessor a one-time late charge equal to 10% of each such overdue amount or $100, whichever is greater. The parties hereby agree that such late charge represents a fair and reasonable estimate of the costs Lessor will incur by reason of such late payment. Acceptance of such late charge by Lessor shall in no event constitute a waiver of Lessee's Default or Breach with respect to such overdue amount, nor prevent the exercise of any of the other rights and remedies granted hereunder. In the event that a late charge is payable hereunder, whether or not collected, for 3 consecutive installments of Base Rent, then notwithstanding any provision of this Lease to the contrary, Base Rent shall, at Lessor's option, become due and payable quarterly in advance.

13.5 **Interest.** Any monetary payment due Lessor hereunder, other than late charges, not received by Lessor, when due as to scheduled payments (such as Base Rent) or within 30 days following the date on which it was due for nonscheduled payment, shall bear interest from the date when due, as to scheduled payments, or the 31st day after it was due as to nonscheduled payments. The interest **("Interest")** charged shall be computed at the rate of 10% per annum but shall not exceed the maximum rate allowed by law. Interest is payable in addition to the potential late charge provided for in Paragraph 13.4.

13.6 **Breach by Lessor.**

(a) Notice of Breach. Lessor shall not be deemed in breach of this Lease unless Lessor fails within a reasonable time to perform an obligation required to be performed by Lessor. For purposes of this Paragraph, a reasonable time shall in no event be less than 30 days after receipt by Lessor, and any Lender whose name and address shall have been furnished Lessee in writing for such purpose, of written notice specifying wherein such obligation of Lessor has not been performed; provided, however, that if the nature of Lessor's obligation is such that more than 30 days are reasonably required for its performance, then Lessor shall not be in breach if performance is commenced within such 30 day period and thereafter diligently pursued to completion.

(b) **Performance by Lessee on Behalf of Lessor.** In the event that neither Lessor nor Lender cures said breach within 30 days after receipt of said notice, or if having commenced said cure they do not diligently pursue it to completion, then Lessee may elect to cure said breach at Lessee's expense and offset from Rent the actual and reasonable cost to perform such cure, provided however, that such offset shall not exceed an amount equal to the greater of one month's Base Rent or the Security Deposit, reserving Lessee's right to seek reimbursement from Lessor. Lessee shall document the cost of said cure and supply said documentation to Lessor.

14. **Condemnation**. If the Premises or any portion thereof are taken under the power of eminent domain or sold under the threat of the exercise of said power (collectively**"Condemnation"),** this Lease shall terminate as to the part taken as of the date the condemning authority takes title or possession, whichever first occurs. If more than 10% of the rentable floor area of the Premises, or more than 25% of Lessee's Reserved Parking Spaces, if any, are taken by Condemnation, Lessee may, at Lessee's option, to be exercised in writing within 10 days after Lessor shall have given Lessee written notice of such taking (or in the absence of such notice, within 10 days after the condemning authority shall have taken possession) terminate this Lease as of the date the condemning authority takes such possession. If Lessee does not terminate this Lease in accordance with the foregoing, this Lease shall remain in full force and effect as to the portion of the Premises remaining, except that the Base Rent shall be reduced in proportion to the reduction in utility of the Premises caused by such Condemnation. Condemnation awards and/or payments shall be the property of Lessor, whether such award shall be made as compensation for diminution in value of the leasehold, the value of the part taken, or for severance damages; provided, however, that Lessee shall be entitled to any compensation for Lessee's relocation expenses, loss of business goodwill and/or Trade Fixtures, without regard to whether or not this Lease is terminated pursuant to the provisions of this Paragraph. All Alterations and Utility Installations made to the Premises by Lessee, for purposes of Condemnation only, shall be considered the property of the Lessee and Lessee shall be entitled to any and all compensation which is payable therefor. In the event that this Lease is not terminated by reason of the Condemnation, Lessor shall repair any damage to the Premises caused by such Condemnation.

15. **Brokerage Fees.**

15.1 **Additional Commission** . ~~In addition to the payments owed pursuant to Paragraph 1.10 above, and unless Lessor and the Brokers otherwise agree in writing, Lessor agrees that: (a) if Lessee exercises any Option, (b) if Lessee acquires from Lessor any rights to the Premises or other premises owned by Lessor and located within the Project, (c) if Lessee remains in possession of the Premises, with the consent of Lessor, after the expiration of this Lease, or (d) if Base Rent is increased, whether by agreement or operation of an escalation clause herein, then, Lessor shall pay~~

~~Broker's a fee in accordance with the schedule of the Brokers in effect at the time of the execution of this Lease~~.

15.2 **Assumption of Obligations**. Any buyer or transferee of Lessor's interest in this Lease shall be deemed to have assumed Lessor's obligation hereunder. Brokers shall be third party beneficiaries of the provisions of Paragraphs 1.10, 15, 22 and 31. If Lessor fails to pay to Brokers any amounts due as and for brokerage fees pertaining to this Lease when due, then such amounts shall accrue Interest. In addition, if Lessor fails to pay any amounts to Lessee's Broker when due, Lessee's Broker may send written notice to Lessor and Lessee of such failure and if Lessor fails to pay such amounts within 10 days after said notice, Lessee shall pay said monies to its Broker and offset such amounts against Rent. In addition, Lessee's Broker shall be deemed to be a third party beneficiary of any commission agreement entered into by and/or between Lessor and Lessor's Broker for the limited purpose of collecting any brokerage fee owed.

15.3 **Representations and Indemnities of Broker Relationships**. Lessee and Lessor each represent and warrant to the other that it has had no dealings with any person, firm, broker or finder (other than the Brokers, if any) in connection with this Lease, and that no one other than said named Brokers is entitled to any commission or finder's fee in connection herewith. Lessee and Lessor do each hereby agree to indemnify, protect, defend and hold the other harmless from and against liability for compensation or charges which may be claimed by any such unnamed broker, finder or other similar party by reason of any dealings or actions of the indemnifying Party, including any costs, expenses, attorneys' fees reasonably incurred with respect thereto.

16. **Estoppel Certificates**.

(a) Each Party (as "**Responding Party**") shall within 10 days after written notice from the other Party (the**"Requesting Party"**) execute, acknowledge and deliver to the Requesting Party a statement in writing in form similar to the then most current "**Estoppel Certificate**" form published by the AIRCommercial Real Estate Association, plus such additional information, confirmation and/or statements as may be reasonably requested by the Requesting Party.

(b) If the Responding Party shall fail to execute or deliver the Estoppel Certificate within such 10 day period, the Requesting Party may execute an Estoppel Certificate stating that: (i) the Lease is in full force and effect without modification except as may be represented by the Requesting Party, (ii) there are no uncured defaults in the Requesting Party's performance, and (iii) if Lessor is the Requesting Party, not more than one month's rent has been paid in advance. Prospective purchasers and encumbrancers may rely upon the Requesting Party's Estoppel Certificate, and the Responding Party shall be estopped from denying the truth of the facts contained in said Certificate.

(c) If Lessor desires to finance, refinance, or sell the Premises, or any part thereof, Lessee and all Guarantors shall deliver to any potential lender or purchaser designated by Lessor such financial statements as may be reasonably required by such lender or purchaser, including but not limited to Lessee's financial statements for the past 3 years. All such financial statements shall be received by Lessor and such lender or purchaser in confidence and shall be used only for the purposes herein set forth.

17. **Definition of Lessor**. The term "**Lessor**" as used herein shall mean the owner or owners at the time in question of the fee title to the Premises, or, if this is a sublease, of the Lessee's interest in the prior lease. In the event of a transfer of Lessor's title or interest in the Premises or this Lease, Lessor shall deliver to the transferee or assignee (in cash or by credit) any unused Security Deposit held by Lessor. Except as provided in Paragraph 15, upon such transfer or assignment and delivery of the Security Deposit, as aforesaid, the prior Lessor shall be relieved of all liability with respect to the obligations and/or covenants under this Lease thereafter to be performed by the Lessor. Subject to the foregoing, the obligations and/or covenants in this Lease to be performed by the Lessor shall be binding only upon the Lessor as hereinabove defined.

18. **Severability**. The invalidity of any provision of this Lease, as determined by a court of competent jurisdiction, shall in no way affect the validity of any other provision hereof.

19. **Days**. Unless otherwise specifically indicated to the contrary, the word "**days**" as used in this Lease shall mean and refer to calendar days.

20. **Limitation on Liability**. The obligations of Lessor under this Lease shall not constitute personal obligations of Lessor or its partners, members, directors, officers or shareholders, and Lessee shall look to the Project, and to no other assets of Lessor, for the satisfaction of any liability of Lessor with respect to this Lease, and shall not seek recourse against Lessor's partners, members, directors, officers or shareholders, or any of their personal assets for such satisfaction.

21. **Time of Essence**. Time is of the essence with respect to the performance of all obligations to be performed or observed by the Parties under this Lease.

22. **No Prior or Other Agreements; Broker Disclaimer**. This Lease contains all agreements between the Parties with respect to any matter mentioned herein, and no other prior or contemporaneous agreement or understanding shall be effective. Lessor and Lessee each represents and warrants to the Brokers that it has made, and is relying solely upon, its own investigation as to the nature, quality, character and financial responsibility of the other Party to this Lease and as to the use, nature, quality and character of the Premises. Brokers have no responsibility with respect thereto or with respect to any default or breach hereof by either Party. The liability (including court costs and attorneys' fees) of any Broker with respect to negotiation, execution, delivery or performance by either Lessor or Lessee under this Lease or any amendment or modification hereto shall be limited to an amount up to the fee received by such Broker pursuant to this Lease; provided, however, that the foregoing limitation on each Broker's liability shall not be applicable to any gross negligence or willful misconduct of such Broker.

23. **Notices**.

23.1 **Notice Requirements**. All notices required or permitted by this Lease or applicable law shall be in writing and may be delivered in person (by hand or by courier) or may be sent by regular, certified or registered mail or U.S. Postal Service Express Mail, with postage prepaid, or by facsimile transmission, and shall be deemed sufficiently given if served in a manner specified in this Paragraph 23. The addresses noted adjacent to a Party's signature on this Lease shall be that Party's address for delivery or mailing of notices. Either Party may by written notice to the other specify a different address for notice, except that upon Lessee's taking possession of the Premises, the Premises shall constitute Lessee's address for notice. A copy of all notices to Lessor shall be concurrently transmitted to such party or parties at such addresses as Lessor may from time to time hereafter designate in writing.

23.2 **Date of Notice**. Any notice sent by registered or certified mail, return receipt requested, shall be deemed given on the date of delivery shown on the receipt card, or if no delivery date is shown, the postmark thereon. If sent by regular mail the notice shall be deemed given 48 hours after the same is addressed as required herein and mailed with postage prepaid. Notices delivered by United States Express Mail or overnight courier that guarantee next day delivery shall be deemed given 24 hours after delivery of the same to the Postal Service or courier. Notices transmitted by facsimile transmission or similar means shall be deemed delivered upon telephone confirmation of receipt (confirmation report from fax machine is sufficient), provided a copy is also delivered via delivery or mail. If notice is received on a Saturday, Sunday or legal holiday, it shall be deemed received on the next business day.

24. **Waivers**. No waiver by Lessor of the Default or Breach of any term, covenant or condition hereof by Lessee, shall be deemed a waiver of any other term, covenant or condition hereof, or of any subsequent Default or Breach by Lessee of the same or of any other term, covenant or condition hereof. Lessor's consent to, or approval of, any act shall not be deemed to render unnecessary the obtaining of Lessor's consent to, or approval of, any subsequent or similar act by Lessee, or be construed as the basis of an estoppel to enforce the provision or provisions of this Lease requiring such consent. The acceptance of Rent by Lessor shall not be a waiver of any Default or Breach by Lessee. Any payment by Lessee may be accepted by Lessor on account of moneys or damages due Lessor, notwithstanding any qualifying statements or conditions made by Lessee in connection therewith, which such statements and/or conditions shall be of no force or effect whatsoever unless specifically agreed to in writing by Lessor at or before the time of deposit of such payment.

25. **Disclosures Regarding The Nature of a Real Estate Agency Relationship**.

(a) When entering into a discussion with a real estate agent regarding a real estate transaction, a Lessor or Lessee should from the outset understand what type of agency relationship or representation it has with the agent or agents in the transaction. Lessor and Lessee acknowledge being advised by the Brokers in this transaction, as follows:

(i) Lessor's Agent. A Lessor's agent under a listing agreement with the Lessor acts as the agent for the Lessor only. A Lessor's agent or subagent has the following affirmative obligationsTo the Lessor: A fiduciary duty of utmost care, integrity, honesty, and loyalty in dealings with the Lessor.To the Lessee and the Lessor: a. Diligent exercise of reasonable skills and care in performance of the agent's duties, b. A duty of honest and fair dealing and good faith, c. A duty to disclose all facts known to the agent materially affecting the value or desirability of the property that are not known to, or within the diligent attention and observation of, the Parties. An agent is not obligated to reveal to either Party any confidential information obtained from the other Party which does not involve the affirmative duties set forth above.

(ii) Lessee's Agent. An agent can agree to act as agent for the Lessee only. In these situations, the agent is not the Lessor's agent, even if by agreement the agent may receive compensation for services rendered, either in full or in part from the Lessor. An agent acting only for a Lessee has the following affirmative obligations. To the Lessee: A fiduciary duty of utmost care, integrity, honesty, and loyalty in dealings with the Lessee. To the Lessee and the Lessor: a. Diligent exercise of reasonable skills and care in performance of the agent's duties, b. A duty of honest and fair dealing and good faith, c. A duty to disclose all facts known to the agent materially affecting the value or desirability of the property that are not known to, or within the diligent attention and observation of, the Parties. An agent is not obligated to reveal to either Party any confidential information obtained from the other Party which does not involve the affirmative duties set forth above.

(iii) Agent Representing Both Lessor and Lessee. A real estate agent, either acting directly or through one or more associate licenses, can legally be the agent of both the Lessor and the Lessee in a transaction, but only with the knowledge and consent of both the Lessor and the Lessee. In a dual agency situation, the agent has the following affirmative obligations to both the Lessor and the Lessee: a. A fiduciary

duty of utmost care, integrity, honesty and loyalty in the dealings with either Lesser or the Lessee, b. Other duties to the Lessor and the Lessee as stated above in subparagraphs (i) or (ii). In representing both Lessor and Lessee, the agent may not without the express permission of the respective Party, disclose to the other Party that the Lessor will accept rent in an amount less than that indicated in the listing or that the Lessee is willing to pay a higher rent than that offered. The above duties of the agent in a real estate transaction do not relieve a Lessor or Lessee from the responsibility to protect their own interests. Lessor and Lessee should carefully read all agreements to assure that they adequately express their understanding of the transaction. A real estate agent is a person qualified to advise about real estate. If legal or tax advise is desired, consult a competent professional.

(b) Brokers have no responsibility with respect to any default or breach hereof by either Party. The liability (including court costs and attorneys' fees), of any Broker with respect to any breach of duty, error or omission relating to this Lease shall not exceed the fee received by such Broker pursuant to this Lease; provided, however, that the foregoing limitation on each Broker's liability shall not be applicable to any gross negligence or willful misconduct of such Broker.

(c) Buyer and Seller agree to identify to Brokers as "Confidential" any communication or information given Brokers that is considered by such Party to be confidential.

26. **No Right To Holdover**. Lessee has no right to retain possession of the Premises or any part thereof beyond the expiration or termination of this Lease. In the event that Lessee holds over, then the Base Rent shall be increased to 150% of the Base Rent applicable immediately preceding the expiration or termination. Nothing contained herein shall be construed as consent by Lessor to any holding over by Lessee.

27. **Cumulative Remedies**. No remedy or election hereunder shall be deemed exclusive but shall, wherever possible, be cumulative with all other remedies at law or in equity.

28. **Covenants and Conditions; Construction of Agreement**. All provisions of this Lease to be observed or performed by Lessee are both covenants and conditions. In construing this Lease, all headings and titles are for the convenience of the Parties only and shall not be considered a part of this Lease. Whenever required by the context, the singular shall include the plural and vice versa. This Lease shall not be construed as if prepared by one of the Parties, but rather according to its fair meaning as a whole, as if both Parties had prepared it.

29. **Binding Effect; Choice of Law**. This Lease shall be binding upon the Parties, their personal representatives, successors and assigns and be governed by the laws of the State in which the Premises are located. Any litigation between the Parties hereto concerning this Lease shall be initiated in the county in which the Premises are located.

30. **Subordination; Attornment; Non-Disturbance.**

30.1 **Subordination**. This Lease and any Option granted hereby shall be subject and subordinate to any ground lease, mortgage, deed of trust, or other hypothecation or security device (collectively, **"Security Device"),** now or hereafter placed upon the Premises, to any and all advances made on the security thereof, and to all renewals, modifications, and extensions thereof. Lessee agrees that the holders of any such Security Devices (in this Lease together referred to as **"Lender")** shall have no liability or obligation to perform any of the obligations of Lessor under this Lease. Any Lender may elect to have this Lease and/or any Option granted hereby superior to the lien of its Security Device by giving written notice thereof to Lessee, whereupon this Lease and such Options shall be deemed prior to such Security Device, notwithstanding the relative dates of the documentation or recordation thereof.

30.2 **Attornment**. In the event that Lessor transfers title to the Premises, or the Premises are acquired by another upon the foreclosure or termination of a Security Device to which this Lease is subordinated (i) Lessee shall, subject to the nondisturbance provisions of Paragraph 30.3, attorn to such new owner, and upon request, enter into a new lease, containing all of the terms and provisions of this Lease, with such new owner for the remainder of the term hereof, or, at the election of such new owner, this Lease shall automatically become a new Lease between Lessee and such new owner, upon all of the terms and conditions hereof, for the remainder of the term hereof, and (ii) Lessor shall thereafter be relieved of any further obligations hereunder and such new owner shall assume all of Lessor's obligations hereunder, except that such new owner shall not: (a) be liable for any act or omission of any prior lessor or with respect to events occurring prior to acquisition of ownership; (b) be subject to any offsets or defenses which Lessee might have against any prior lessor, (c) be bound by prepayment of more than one month's rent, or (d) be liable for the return of any security deposit paid to any prior lessor.

30.3 **Non-Disturbance**. With respect to Security Devices entered into by Lessor after the execution of this Lease, Lessee's subordination of this Lease shall be subject to receiving a commercially reasonable non-disturbance agreement (a **"Non-Disturbance Agreement")** from the Lender which Non-Disturbance Agreement provides that Lessee's possession of the Premises, and this Lease, including any options to extend the term hereof, will not be disturbed so long as Lessee is not in Breach hereof and attorns to the record owner of the Premises. Further, within 60 days after the execution of this Lease, Lessor shall use its commercially reasonable efforts to obtain a Non-Disturbance Agreement from the holder of any pre-existing Security Device which is secured by the Premises. In the event that Lessor is unable to provide the Non-Disturbance Agreement within said 60 days, then Lessee may, at Lessee's option, directly contact Lender and attempt to negotiate for the execution and delivery of a Non-Disturbance Agreement.

30.4 **Self-Executing**. The agreements contained in this Paragraph 30 shall be effective without the execution of any further documents; provided, however, that, upon written request from Lessor or a Lender in connection with a sale, financing or refinancing of the Premises, Lessee and Lessor shall execute such further writings as may be reasonably required to separately document any subordination, attornment and/or Non-Disturbance Agreement provided for herein.

31. **Attorneys' Fees**. If any Party or Broker brings an action or proceeding involving the Premises whether founded in tort, contract or equity, or to declare rights hereunder, the Prevailing Party (as hereafter defined) in any such proceeding, action, or appeal thereon, shall be entitled to reasonable attorneys' fees. Such fees may be awarded in the same suit or recovered in a separate suit, whether or not such action or proceeding is pursued to decision or judgment. The term, **"Prevailing Party"** shall include, without limitation, a Party or Broker who substantially obtains or defeats the relief sought, as the case may be, whether by compromise, settlement, judgment, or the abandonment by the other Party or Broker of its claim or defense. The attorneys' fees award shall not be computed in accordance with any court fee schedule, but shall be such as to fully reimburse all attorneys' fees reasonably incurred. In addition, Lessor shall be entitled to attorneys' fees, costs and expenses incurred in the preparation and service of notices of Default and consultations in connection therewith, whether or not a legal action is subsequently commenced in connection with such Default or resulting Breach ($200 is a reasonable minimum per occurrence for such services and consultation).

32. **Lessor's Access; Showing Premises; Repairs**. Lessor and Lessor's agents shall have the right to enter the Premises at any time, in the case of an emergency, and otherwise at reasonable times for the purpose of showing the same to prospective purchasers, lenders, or tenants, and making such alterations, repairs, improvements or additions to the Premises as Lessor may deem necessary or desirable and the erecting, using and maintaining of utilities, services, pipes and conduits through the Premises and/or other premises as long as there is no material adverse effect to Lessee's use of the Premises. All such activities shall be without abatement of rent or liability to Lessee. Lessor may at any time place on the Premises any ordinary **"For Sale"** signs and Lessor may during the last 6 months of the term hereof place on the Premises any ordinary **"For Lease"** signs. In addition, Lessor shall have the right to retain keys to the Premises and to unlock all doors in or upon the Premises other than to files, vaults and safes, and in the case of emergency to enter the Premises by any reasonably appropriate means, and any such entry shall not be deemed a forcible or unlawful entry or detainer of the Premises or an eviction. Lessee waives any charges for damages or injuries or interference with Lessee's property or business in connection therewith.

33. **Auctions**. Lessee shall not conduct, nor permit to be conducted, any auction upon the Premises without Lessor's prior written consent. Lessor shall not be obligated to exercise any standard of reasonableness in determining whether to permit an auction.

34. **Signs**. Lessee shall not place any sign upon the Project without Lessor's prior written consent.

35. **Termination**; **Merger**. Unless specifically stated otherwise in writing by Lessor, the voluntary or other surrender of this Lease by Lessee, the mutual termination or cancellation hereof, or a termination hereof by Lessor for Breach by Lessee, shall automatically terminate any sublease or lesser estate in the Premises; provided, however, that Lessor may elect to continue any one or all existing subtenancies. Lessor's failure within 10 days following any such event to elect to the contrary by written notice to the holder of any such lesser interest, shall constitute Lessor's election to have such event constitute the termination of such interest.

36. **Consents**. Except as otherwise provided herein, wherever in this Lease the consent of a Party is required to an act by or for the other Party, such consent shall not be unreasonably withheld or delayed. Lessor's actual reasonable costs and expenses (including but not limited to architects', attorneys', engineers' and other consultants' fees) incurred in the consideration of, or response to, a request by Lessee for any Lessor consent, including but not limited to consents to an assignment, a subletting or the presence or use of a Hazardous Substance, shall be paid by Lessee upon receipt of an invoice and supporting documentation therefor. Lessor's consent to any act, assignment or subletting shall not constitute an acknowledgment that no Default or Breach by Lessee of this Lease exists, nor shall such consent be deemed a waiver of any then existing Default or Breach, except as may be otherwise specifically stated in writing by Lessor at the time of such consent. The failure to specify herein any particular condition to Lessor's consent shall not preclude the imposition by Lessor at the time of consent of such further or other conditions as are then reasonable with reference to the particular matter for which consent is being given. In the event that either Party disagrees with any determination made by the other hereunder and reasonably requests the reasons for such determination, the determining party shall furnish its reasons in writing and in reasonable detail within 10 business days following such request.

37. **Guarantor**.

37.1 **Execution**. The Guarantors, if any, shall each execute a guaranty in the form most recently published by the AIR Commercial Real Estate Association.

37.2 **Default**. It shall constitute a Default of the Lessee if any Guarantor fails or refuses, upon request to provide: (a) evidence of the execution of the guaranty, including the authority of the party signing on Guarantor's behalf to obligate Guarantor, and in the case of a corporate Guarantor, a certified copy of a resolution of its board of directors authorizing the making of such guaranty, (b) current financial statements, (c) an Estoppel Certificate, or (d) written confirmation that the guaranty is still in effect.

38. **Quiet Possession**. Subject to payment by Lessee of the Rent and performance of all of the covenants, conditions and provisions on Lessee's part to be observed and performed under this Lease, Lessee shall have quiet possession and quiet enjoyment of the Premises during the term hereof.

39. **Options**. If Lessee is granted an Option, as defined below, then the following provisions shall apply.

39.1 **Definition. "Option"** shall mean: (a) the right to extend the term of or renew this Lease ~~or to extend or renew any lease that Lessee has on other property of Lessor; (b) the right of first refusal or first offer to lease either the Premises or other property of Lessor; (c) the right to purchase to the right of first refusal to purchase the Premises or other property of Lessor.~~

39.2 **Options Personal To Original Lessee**. Any Option granted to Lessee in this Lease is personal to the original Lessee, and cannot be assigned or exercised by anyone other than said original Lessee and only while the original Lessee is in full possession of the Premises and, if requested by Lessor, with Lessee certifying that Lessee has no intention of thereafter assigning or subletting.

39.3 **Multiple Options**. In the event that Lessee has any multiple Options to extend or renew this Lease, a later Option cannot be exercised unless the prior Options have been validly exercised.

39.4 **Effect of Default on Options**.

(a) Lessee shall have no right to exercise an Option: (i) during the period commencing with the giving of any notice of Default and continuing until said Default is cured, (ii) during the period of time any Rent is unpaid (without regard to whether notice thereof is given Lessee), (iii) during the time Lessee is in Breach of this Lease, or (iv) in the event that Lessee has been given 3 or more notices of separate Default, whether or not the Defaults are cured, during the 12 month period immediately preceding the exercise of the Option.

(b) The period of time within which an Option may be exercised shall not be extended or enlarged by reason of Lessee's inability to exercise an Option because of the provisions of Paragraph 39.4(a).

(c) An Option shall terminate and be of no further force or effect, notwithstanding Lessee's due and timely exercise of the Option, if, after such exercise and prior to the commencement of the extended term or completion of the purchase, (i) Lessee fails to pay Rent for a period of 30 days after such Rent becomes due (without any necessity of Lessor to give notice thereof), or (ii) if Lessee commits a Breach of this Lease.

40. **Security Measures**. Lessee hereby acknowledges that the Rent payable to Lessor hereunder does not include the cost of guard service or other security measures, and that Lessor shall have no obligation whatsoever to provide same. Lessee assumes all responsibility for the protection of the Premises, Lessee, its agents and invitees and their property from the acts of third parties. In the event, however, that Lessor should elect to provide security services, then the cost thereof shall be an Operating Expense.

41. **Reservations**.

(a) Lessor reserves the right: (i) to grant, without the consent or joinder of Lessee, such easements, rights and dedications that Lessor deems necessary, (ii) to cause the recordation of parcel maps and restrictions, (iii) to create and/or install new utility raceways, so long as such easements, rights, dedications, maps, restrictions, and utility raceways do not unreasonably interfere with the use of the Premises by Lessee. Lessor may also: change the name, address or title of the Building or Project upon at least 90 days prior written notice; provide and install, at Lessee's expense, Building standard graphics on the door of the Premises and such portions of the Common Areas as Lessor shall reasonably deem appropriate; grant to any lessee the exclusive right to conduct any business as long as such exclusive right does not conflict with any rights expressly given herein; and to place such signs, notices or displays as Lessor reasonably deems necessary or advisable upon the roof, exterior of the Building or the Project or on pole signs in the Common Areas. Lessee agrees to sign any documents reasonably requested by Lessor to effectuate such rights. The obstruction of Lessee's view, air, or light by any structure erected in the vicinity of the Building, whether by Lessor or third parties, shall in no way affect this Lease or impose any liability upon Lessor.

(b) Lessor also reserves the right to move Lessee to other space of comparable size in the Building or Project. Lessor must provide at least 45 days prior written notice of such move, and the new space must contain improvements of comparable quality to those contained within the Premises. Lessor shall pay the reasonable out of pocket costs that Lessee incurs with regard to such relocation, including the expenses of moving and necessary stationary revision costs. In no event, however, shall Lessor be required to pay an amount in excess of two months Base Rent. Lessee may not be relocated more than once during the term of this Lease.

(c) Lessee shall not: (i) use a representation (photographic or otherwise) of the Building or Project or their name(s) in connection with Lessee's business; or (ii) suffer or permit anyone, except in emergency, to go upon the roof of the Building.

42. **Performance Under Protest**. If at any time a dispute shall arise as to any amount or sum of money to be paid by one Party to the other under the provisions hereof, the Party against whom the obligation to pay the money is asserted shall have the right to make payment "under protest" and such payment shall not be regarded as a voluntary payment and there shall survive the right on the part of said Party to institute suit for recovery of such sum. If it shall be adjudged that there was no legal obligation on the part of said Party to pay such sum or any part thereof, said Party shall be entitled to recover such sum or so much thereof as it was not legally required to pay.

43. **Authority**.

(a) If either Party hereto is a corporation, trust, limited liability company, partnership, or similar entity, each individual executing this Lease on behalf of such entity represents and warrants that he or she is duly authorized to execute and deliver this Lease on its behalf. Each party shall, within 30 days after request, deliver to the other party satisfactory evidence of such authority.

(b) If this Lease is executed by more than one person or entity as "Lessee", each such person or entity shall be jointly and severally liable hereunder. It is agreed that any one of the named Lessees shall be empowered to execute any amendment to this Lease, or other document ancillary thereto and bind all of the named Lessees, and Lessor may rely on the same as if all of the named Lessees had executed such document.

44. **Conflict**. Any conflict between the printed provisions of this Lease and the typewritten or handwritten provisions shall be controlled by the typewritten or handwritten provisions.

45. **Offer**. Preparation of this Lease by either party or their agent and submission of same to the other Party shall not be deemed an offer to lease to the other Party. This Lease is not intended to be binding until executed and delivered by all Parties hereto.

46. **Amendments**. This Lease may be modified only in writing, signed by the Parties in interest at the time of the modification. As long as they do not materially change Lessee's obligations hereunder, Lessee agrees to make such reasonable nonmonetary modifications to this Lease as may be reasonably required by a Lender in connection with the obtaining of normal financing or refinancing of the Premises.

47. **Multiple Parties**. If more than one person or entity is named herein as either Lessor or Lessee, such multiple Parties shall have joint and several responsibility to comply with the terms of this Lease.

48. **Waiver of Jury Trial. THE PARTIES HEREBY WAIVE THEIR RESPECTIVE RIGHTS TO TRIAL BY JURY IN ANY ACTION OR PROCEEDING INVOLVING THE PROPERTY OR ARISING OUT OF THIS AGREEMENT.**

49. **Mediation and Arbitration of Disputes**. An Addendum requiring the Mediation and/or the Arbitration of all disputes between the Parties and/or Brokers arising out of this Lease☐ is ☑ is not attached to this Lease.

50. **Americans with Disabilities Act**. In the event that as a result of Lessee's use, or intended use, of the Premises the Americans with Disabilities Act or any similar law requires modifications or the construction or installation of improvements in or to the Premises, Building, Project and/or Common Areas, the Parties agree that such modifications, construction or improvements shall be made at: ☐ Lessor's expense ☑ Lessee's expense.

LESSOR AND LESSEE HAVE CAREFULLY READ AND REVIEWED THIS LEASE AND EACH TERM AND PROVISION CONTAINED HEREIN, AND BY THE EXECUTION OF THIS LEASE SHOW THEIR INFORMED AND VOLUNTARY CONSENT THERETO. THE PARTIES HEREBY AGREE THAT, AT THE TIME THIS LEASE IS EXECUTED, THE TERMS OF THIS LEASE ARE COMMERCIALLY REASONABLE AND EFFECTUATE THE INTENT AND PURPOSE OF LESSOR AND LESSEE WITH RESPECT TO THE PREMISES.

ATTENTION: NO REPRESENTATION OR RECOMMENDATION IS MADE BY THE AIR COMMERCIAL REAL ESTATE ASSOCIATION OR BY ANY BROKER AS TO THE LEGAL SUFFICIENCY, LEGAL EFFECT, OR TAX CONSEQUENCES OF THIS LEASE OR THE TRANSACTION TO WHICH IT RELATES. THE PARTIES ARE URGED TO:

1. SEEK ADVICE OF COUNSEL AS TO THE LEGAL AND TAX CONSEQUENCES OF THIS LEASE.

2. RETAIN APPROPRIATE CONSULTANTS TO REVIEW AND INVESTIGATE THE CONDITION OF THE PREMISES. SAID INVESTIGATION SHOULD INCLUDE BUT NOT BE LIMITED TO: THE POSSIBLE PRESENCE OF HAZARDOUS SUBSTANCES, THE ZONING AND SIZE OF THE PREMISES, THE STRUCTURAL INTEGRITY, THE CONDITION OF THE ROOF AND OPERATING SYSTEMS, COMPLIANCE WITH THE AMERICANS WITH DISABILITIES ACT AND THE SUITABILITY OF THE PREMISES FOR LESSEE'S INTENDED USE.

INITIALS	/s/ TW **INITIALS**

WARNING: IF THE PREMISES ARE LOCATED IN A STATE OTHER THAN CALIFORNIA, CERTAIN PROVISIONS OF THE LEASE MAY NEED TO BE REVISED TO COMPLY WITH THE LAWS OF THE STATE IN WHICH THE PREMISES ARE LOCATED.

The parties hereto have executed this Lease at the place and on the dates specified above their respective signatures.

Executed at: Fremont, California		**Executed at:**	
On:		**On:**	
By LESSOR:		**By LESSEE:**	
Beretta Investment Group, a general partnership		Energy Recovery, Inc. a Delaware Corporation	
By:	/s/ David Beretta	**By:**	/s/ Tom Willardson
Name Printed:	David Beretta	**Name Printed:**	TOM WILLARDSON
Title:	General Partner	**Title:**	CFO
By:		**By:**	
Name Printed:		**Name Printed:**	
Title:		**Title:**	
Address:	39560 Stevenson Place, Suite 118 Fremont, CA 94 539	**Address:**	
Telephone:	(510) 797-5880	**Telephone:** (___)	
Facsimile:	(510) 797-1703	**Facsimile:** (___)	
Federal ID No.		**Federal ID No.**	
LESSOR'S BROKER:		**LESSEE'S BROKER:**	
Col1iers Internationa1		Lee & Associates	
Attn:	Anthony Stratton	**Attn:**	Doug Pearson
Address:	1999 Harrison Street, Suite 1750 Oakland, CA 94612	**Address:**	1111 Broadway, Suite 1670 Oakland, CA 94607
Telephone:	(510) 433-5818	**Telephone:**	(510) 903-7600
Facsimile:	(510) 986-6775	**Facsimile:**	(510) 836-7534

These forms are often modified to meet changing requirements of law and needs of the industry. Always write or call to make sure you are utilizing the most current form: AIR Commercial Real Estate Association, 700 South Flower Street, Suite 600, Los Angeles, CA 90017. (213)687-8777.

INITIALS	/s/ TW **INITIALS**
©1999 — AIR COMMERCIAL REAL ESTATE ASSOCIATION	**FORM OFG-1-9/99E** /s/

LEASE ADDENDUM

THIS LEASE ADDENDUM is being made and entered into, for reference purposes only, this**11th** day of **February 2008,** by and between **BERETTA INVESTMENT GROUP,** a general partnership, ('Lessor') and **ENERGY RECOVERY INC.,** a Delaware corporation ('Lessee'), with reference to those certain Premises located at**433 Hegenberger Road, Suite 220, Oakland, CA 94621.**

1. **Commencement Date**. The Commencement Date shall be the date upon which the tenant improvements have been substantially completed as determined by Lessor's architect or space planner, estimated to be about **April 1, 2008.** The commencement date of this Lease Agreement shall be agreed to upon substantial completion of the tenant improvements and shall be set forth on this document as follows:

Commencement Date:	April 1 2008	
Accepted:	/s/ DB	
	Lessor	Lessee

2. **Monthly Base Rent Adjustment**. The monthly base rent shall be as follows:

Months 1-12	$9,140.00	4/1/2008 — 3/31/2009
Months 13-24	$9,427.00	4/1/2009 — 3/31/2010

3. **Premises Janitorial Service**. Lessee shall be responsible for the contractual arrangement and payment of all services rendered to Lessee for its janitorial service within the Premises. Lessee's janitorial service provider shall be approved by Lessor and subject to said provider providing worker's compensation and liability insurance — Certificate of Insurance satisfactory to Lessor naming Lessor and Lessor's agents as additional insured — coverage limits in amount(s) of not less than One Million and No/100 Dollars ($1,000,000.00) per occurrence and Two Million and No/100 Dollars ($2,000,000.00) aggregate..

4. **Lessee in Possession**. Intentionally left blank.

5. **Premises Condition & Tenant Improvements by Lessor**. Lessee agrees to accept the premises in "as-is" condition except that Lessor shall demise and improve the premises pursuant to Lessor's standard specifications and space plan hereto attached as Exhibit "A" including all subsequent modifications thereof agreed to between Lessor and Lessee.

   The work performed shall be done by Lessor's contractors according to the final space plan, which shall be attached hereto when completed by Lessor.

   The sole Tenant Improvements in the Leased premises shall be the following:

   a. A kitchen similar to the existing kitchen in Suite 205, except that Lessor shall install an approximately 8 foot lower sink/cabinet unit and an upper cabinet unit. Lessor shall install building standard VCT flooring in kitchen room. All materials used shall be from Lessor's inventory of building materials.

   b. Lessor shall patch the existing carpet where required.

   c. Lessor shall install a new building standard storefront glass entry door where indicated on Exhibit "A".

   c. Lessor shall provide insulation to the electrical room adjacent to the leased premises and to the new demising wall. Lessor shall also add additional sheetrock above the ceiling grid in the two offices between the leased premises and the adjacent premises.

6. **Right to Sublease**. Lessee shall have the Right to Sublease all of Premises with Lessor's prior reasonable approval. Lessee shall be entitled to 25% of all sublease profits; Lessor shall be entitled to 75% of all sublease profits as herein defined. Sublease profits are herein defined as the excess rent any Sublessee pays in excess of base rent, operating expenses, common area maintenance charges or utility expense estimates required to be paid to Lessor pursuant to the Lease and deducting for sublease commission and marketing expenses approved by Lessor.

7. **Additional Subleasing Clarifications**. All Sublessees shall adhere to the Lease, Rules & Regulations, and insurance requirements independent of the Lessee/Sublessor. In no event shall Lessee sublease to current, former, or prospective lessees of Lessor and/or its affiliates. All sublease profits, if any, shall be split equally between Lessor and Lessee. Lessor's consent to any assignment or subletting shall not constitute consent to any subsequent assignment or subletting. No sublessee shall further assign or sublease all or any portion of the premises without Lessor's prior written consent.

8. **Signage**. Lessor shall provide initial directory and suite identification signage at Lessor's expense. Lessee, at Lessee's sole cost and expense, shall be granted the right to place signage on the exterior of the building subject to Lessor's review and approval of the size, style and copy of the proposed signage. Any exterior signage must also comply with all other pertinent government agencies requirements.

/s/ DB	/s/ TW
	/s/

9. **After Hours HVAC**. Lessee shall be able to have heating and cooling provided to the leased premises after normal building hours via a bypass control. Lessor shall have the right to charge $75 per hour for the cost of this after hours HVAC use by Lessee.

10. **Renewal Option**. Intentionally left blank.

IN WITNESS WHEREOF, the parties have executed this Addendum as of the date first written above.

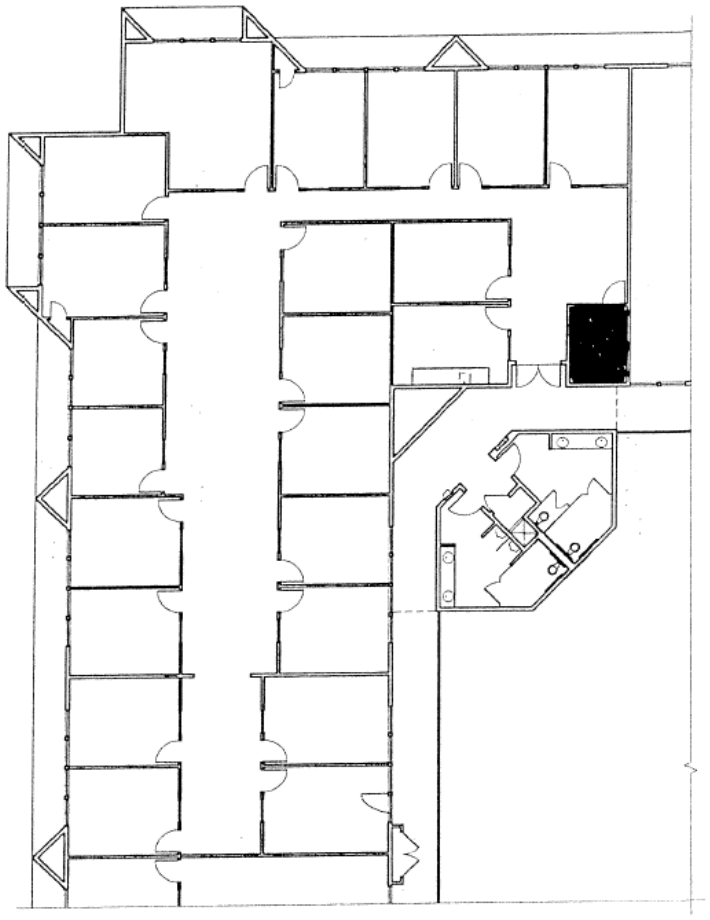
BERETTA INVESTMENT GROUP,
a general partnership

/s/ David Beretta 2/21/08
David Beretta
Title

Energy Recovery Inc.,
a Delaware Corporation

/s/ Tom Willardson
Name

EXHIBIT A



/s/

EXHIBIT "B"

RULES AND REGULATIONS
Air Park Plaza — 433 Hegenberger Road

1. No sign, placard, picture, advertisement, name or notice shall be installed or displayed on any part of the outside or inside of the Building without the prior written consent of Lessor. Lessor shall have the right to remove, at Lessee's expense and without notice, any sign installed or displayed in violation of this rule. All approved signs or lettering on doors and walls shall be printed, painted, affixed or inscribed at the expense of Lessee by a person chosen by Lessor.

2. If Lessor objects in writing to any curtains, blinds, shades, screens or hanging plants or other similar objects attached to or used in connection with any window or door of the Premises, Lessee shall immediately discontinue such use. No awning shall be permitted on any part of the Premises. Lessee shall not place anything against or near glass partitions or doors or windows which may appear unsightly from outside the Premises.

3. Lessee shall not obstruct any sidewalks, halls, passages, exits, entrances, elevators, escalators or stairways of the building. The halls, passages, exits, entrances, elevators, escalators and stairways are not for the general public, and Lessor shall in all cases retain the right to control and prevent access thereto of all persons whose presence in the judgment of Lessor would be prejudicial to the safety, character, reputation and interests of the Building and its tenants; provided that nothing herein contained shall be construed to prevent such access to persons with whom any tenant normally deals in the ordinary course of its business, unless such persons are engaged in illegal activities. No Lessee and no employee or invitee of any Lessee shall go upon the roof of the Building.

4. The directory of the Building will be provided exclusively for the display of the name and location of Lessees only, and Lessor reserves the right to exclude any other names therefrom.

5. All cleaning and janitorial services for the Building shall be provided exclusively through Lessor, Lessee shall contract for and/or provide cleaning and janitorial services to the Premises, and except with the written consent of Lessor, no person or persons other than those approved by Lessor shall be employed by Lessee or permitted to enter the building for the purpose of cleaning the same. Lessee shall not cause any unnecessary labor by carelessness or indifference to the good order and cleanliness of the Building. Lessor shall not in any way be responsible to any Lessee for any loss of property in the Building, however occurring, or for any damage to any Lessee's property by the janitor or any other employee or any other person.

6. Lessor will furnish Lessee, free of charge, with two keys to each lock located in the Premises. Lessor may make a reasonable charge for any additional keys. Lessee shall not make or have made additional keys, and Lessee shall not alter any lock or install a new additional lock or bolt on any door of its Premises. Lessee, upon the termination of its tenancy, shall deliver to Lessor the keys of all doors which have been furnished to Lessee, and in the event of loss of any keys so furnished, shall pay Lessor therefore.

7. If Lessee requires telegraphic, telephonic, burglar alarm or similar services, it shall first obtain, and comply with, Lessor's instructions in their installation.

8. Any freight elevator shall be available for use by all tenants in the Building, subject to such reasonable scheduling as Lessor in its discretion shall deem appropriate. No equipment, materials, furniture, packages, supplies, merchandise or other property will be received in the Building or carried in the elevators except between such hours and in such elevators as may be designated by Lessor.

9. Lessee shall not place a load upon any floor of the Premises which exceeds the load per square foot which such floor was designed to carry and which is allowed by law. Lessor shall have the right to prescribe the weight, size and position of all equipment, materials, furniture or other property brought into the Building. Heavy objects shall, if considered necessary by Lessee or Lessor, stand on such platforms as determined by Lessor to be necessary to properly distribute the weight. Business machines and mechanical equipment belonging to Lessee, which cause noise or vibration that may be transmitted to the structure of the Building or to any space therein to such a degree as to be objectionable to Lessor or to any tenants in the Building shall be placed and maintained by Lessee, at Lessee's expense, on vibration eliminators or other devices sufficient to eliminate noise or vibration. The person employed to move such equipment in or out of the Building must be acceptable to Lessor. Lessor will not be responsible for loss of, or damage to, any such equipment or other property from any cause, and all damage done to the Building by maintaining or moving such equipment or other property shall be repaired at the expense of Lessee.

10. Lessee shall not use or keep in the Premises any kerosene, gasoline or inflammable or combustible fluid or material other than those limited quantities necessary for the operation or maintenance of office equipment. Lessee shall not use or permit to be used in the Premises any foul or noxious gas or substance, or permit or allow the Premises to be occupied or used in a manner offensive

/s/

or objectionable to Lessor or other occupants of the Building by reason of noise, odors or vibrations, nor shall Lessee bring into or keeping on or about the Premises any birds or animals.

11. Lessee shall not use any method of hearing or air conditioning other than that supplied by Lessor.

12. Lessee shall not waste electricity, water or air-conditioning and agrees to cooperate fully with Lessor to assure the most effective operation of the Building's heating and air-conditioning and to comply with any governmental energy-saving rules, laws or regulations of which Lessee has actual notice, and shall refrain from attempting to adjust controls other than room thermostats installed for Lessee's use. Lessee shall keep corridor doors closed, and shall close window coverings at the end of each business day.

13. Lessor reserves the right, exercisable without liability to Lessor to change the name and street address of the Building.

14. Lessor reserves the right to exclude from the Building between the hours of 6 p.m. and 7 a.m. the following day, or such other hours as may be established from time to time by Lessor, and on Sundays and legal holidays, any person unless that person is known to the person or employees in charge of the Building and has a pass or is properly identified. Lessee shall be responsible for all persons for whom it requests passes and shall be liable for damages for any error with regard to the admission to or exclusion from the Building of any person. Lessor reserves the right to prevent access to the Building in case of invasion, mob, riot, public excitement or other commotion by closing the doors or by other appropriate action.

15. Lessee shall close and lock the doors of its Premises and entirely shut off all water faucets or other water apparatus, and electricity, gas or air outlets before Lessee and its employees leave the Premises. Lessee shall be responsible for any damage or injuries sustained by other tenants or occupants of the Building or by Lessor for noncompliance with this rule.

16. In the event the Premises include a balcony for use by Lessee, Lessee agrees not to allow the accessways to such balcony to remain open so as to cause an increase in utility charges as a result of increased heating or air-conditioning use. Lessor shall have the right to enter the Premises to assure compliance with this provision.

17. The toilet rooms, toilets, urinals, wash bowls and other apparatus shall not be used for any purpose other than that for which they were constructed and no foreign substance of any kind whatsoever shall be thrown therein. The expense of any breakage, stoppage or damage resulting from the violation of this rule shall be born by the Lessee who, or whose employees or invitees, shall have caused same.

18. Lessee shall not sell, or permit the sale at retail, of newspapers, magazines, periodicals, theater tickets or any other goods or merchandise to the general public in or on the Premises. Lessee shall not make any room-to-room solicitations of business from other tenants in the Building. Lessee shall not use the Premises for any business or activity other than that specifically provided for in Lessee's Lease.

19. Lessee shall not install any radio or television antenna, loudspeaker or other device on the roof or exterior walls of the Building. Lessee shall not interfere with radio or television broadcasting or reception from or in the Building or elsewhere.

20. Lessee shall not mark, drive nails, screw or drill into the partitions, woodwork or plaster or in any way deface the Premises or any part thereof. Lessor reserves the right to direct electricians as to where and how telephone and communication wires are to be introduced to the Premises. Lessee shall not cut or bore holes for wires. Lessee shall not affix any floor covering to the floor of the Premises in a manner except as approved by Lessor. Lessee shall repair any damage resulting from noncompliance with this rule.

21. Lessee shall not install, maintain or operate upon the Premises any vending machines without the written consent of Lessor. Canvassing, soliciting and distribution of handbills or any other written material and peddling in the Building are prohibited, and each Lessee shall cooperate to prevent same.

22. Lessor reserves the right to exclude or expel from the Building any person who, in Lessor's judgment, is intoxicated or under the influence of liquor or drugs or who is in violation of any of the Rules and Regulations of the Building.

23. Lessee shall store all its trash and garbage within its Premises. Lessee shall not place in any trash box or receptacle any material which cannot be disposed of in the ordinary and customary manner of trash and garbage disposal. All garbage and refuse disposal shall be made in accordance with directions issued from time to time by Lessor.

24. The Premises shall not be used for the storage of merchandise held for sale to the general public or for lodging or for manufacturing of any kind, nor shall the Premises be used for any improper, immoral or objectionable purpose. No cooking shall be done or permitted by any Lessee on the Premises, except that use by Lessee of Underwriter's Laboratory approved microwave and equipment for brewing coffee,

/s/

tea, hot chocolate and similar beverages shall be permitted, provided that such equipment and use is in accordance with all applicable federal, state, county and city laws, codes, ordinances, rules and regulations.

25. Lessee shall not use in any space or in the public halls of the Building any hand trucks, except those equipped with rubber tires and side guards or such other material-handling equipment as Lessor may approve. Lessee shall not bring any other vehicles of any kind into the Building.

26. Without the written consent of Lessor, Lessee shall not use the name of the Building in connection with or in promoting or advertising the business of Lessee except as Lessee's address.

27. Lessee shall comply with all safety, fire protection and evacuation procedures and regulations established by Lessor or any governmental agency.

28. Lessee assumes any and all responsibility for protecting its Premises from theft, robbery and pilferage, which includes keeping doors locked and other means of entry to the Premises closed.

29. Lessor reserves the right to modify and/or adopt such other reasonable and nondiscriminatory rules and regulations for the parking areas as it deems necessary for the operation of the parking area. Lessor may refuse to permit any person who violates the within rules to park in the parking area, and any violation of the rules shall subject the car to removal.

30. Parking area hours shall be 6:00 a.m. to 11:00 p.m. Cars must be parked entirely within the stall lines painted on the floor. All directional signs and arrows must be observed. The speed limit shall be 5 miles per hour. Parking is prohibited: (a) in areas not striped for parking, (b) in aisles, (c) where "no parking" signs are posted, (d) on ramps, (e) in cross hatched areas, and (f) in such other areas as may be designated by Lessor as reserved for the exclusive use of others. Washing, waxing, cleaning or servicing of any vehicle by anyone is prohibited. Lessee shall acquaint all persons to whom Lessee assigns parking spaces of these Rules and Regulations. Lessor further reserves the right to institute a system of charging for parking on a non-discriminatory basis.

31. The requirements of Lessee will be attended to only upon appropriate application to the office of the Building by an authorized individual. Employees of Lessor shall not perform any work or do anything outside of their regular duties unless under special instructions from Lessor, and no employee of Lessor will admit any person (Lessee or otherwise) to any office without specific instructions from Lessor.

32. Lessee shall not park its vehicles in any parking areas designated by Lessor as areas for parking by visitors to the Building. Lessee shall not leave vehicles in the Building parking areas overnight nor park any vehicles in the Building parking areas other than automobiles, motorcycles, motor driven or non-motor driven bicycles or four-wheeler trucks.

33. Lessor may waive any one or more of the Rules and Regulations for the benefit of Lessee or any other tenant, but no such waiver by Lessor shall be construed as a waiver of such Rules and Regulations in favor of Lessee or any other tenant, nor prevent Lessor from thereafter enforcing any such Rules and Regulations against any or all of the tenants of the Building.

34. These Rules and Regulations are in addition to, and shall not be construed to in any way modify or amend, in whole or in part, the terms, covenants, agreements and conditions of any lease of the premises in the Building.

35. Lessor reserves the right to make such other and reasonable Rules and Regulations as, in its judgment, may from time to time be needed for safety and security, for care and cleanliness of the Building and for the preservation of good order therein. Lessee agrees to abide by all such Rules and Regulations hereinabove stated and any additional rules and regulations which are adopted.

36. Lessee shall be responsible for the observance of all of the foregoing rules by Lessee's employees, agents, clients, customers, invitees and guests.

/s/

BERETTA PROPERTY MANAGEMENT

EXHIBIT "C"

BERETTA INVESTMENT GROUP
433 Hegenberger Road
Oakland, CA 94621

INSURANCE REQUIREMENTS — Tenants

Commercial General Liability Coverage

- Commercial General Liability with a limit not less than $1,000,000 per occurrence, $2,000,000 in the Aggregate
- Additional Insured endorsement (CG2011) naming Beretta Investment Group; Vintaco, Inc. dba: Beretta Property Management; Bergam, Inc.
- Policy must be endorsed to include 30 days Notice of Cancellation
- Clearly state or provide a schedule of the covered locations

Please forward all Certificates and Endorsements to:

Beretta Investment Group
C/O Vintaco, Inc. dba Beretta Property Management
39560 Stevenson Place, Suite 118
Fremont, CA 94539

Fax: 510-797-1703

Should you have any questions, please call 510-797-5880

/s/

BERETTA PROPERTY MANAGEMENT

EXHIBIT "D"
TENANT CONTACT/EMERGENCY LIST
Return VIA Facsimile to: 510-797-1703

PLEASE PRINT

BUSINESS NAME: _____

DBA NAME: _____
(if different from name on lease)

ADDRESS: _____

OFFICE PHONE: _____ FAX: _____

BILLING ADDRESS: _____

_____
(if different from above)

CONTACT NAME: _____

PHONE: _____ FAX: _____

ADDRESS FOR LEGAL NOTICES: _____

CONTACT NAME: _____

PHONE: _____ FAX: _____

_____

EMERGENCY CONTACTS:(must list person who has access to suite after hours)

(1) NAME: _____ TITLE: _____

PHONE: _____ ALTERNATE PHONE: _____

(2) NAME: _____ TITLE: _____

PHONE: _____ ALTERNATE PHONE: _____

(3) NAME: _____ TITLE: _____

PHONE: _____ ALTERNATE PHONE: _____

ALARM: _____

CONTACT: _____

FOR OFFICE USE ONLY:
OWNER/PROP: _____ UNIT _____

Exhibit 10.15

REGUS Business Centre Service Agreement

Service Agreement Type: ◉ Office ○ Cubes ○ Hotdesk

Agreement Date: 7th August 2006

MADRID, Puerta De Las Naciones

Street/Floor	Ribera del Loira 46 - Campo de las Naciones
City:	Madrid
State & Zip Code:	28042. Spain

Business Center Bank Details

Name:	Bankinter
Sort code:	BKBKESMM
Account number:	ES44 0128 9400 2401 0000 2902

Client details

Corporate Account ☒ Yes PCA ☐ Yes

Company Name:	Energy Recovery Iberia SL	VAT Number:	
Address:	Ribera del Loira, 46	Contact Name:	Borja Blanco
City / State:	Madrid, Spain	Title:	VP, AG-Large Projects
Zip Code:	28043	Telephone:	001 305 794 2234
Email Address:	bblanco@energy-recovery.com	Fax:	
Emergency Contact:		Emergency Phone:	

Invoicing details (if different)

Company Name:		Contact Name:	
Address:		Title:	
City / State:		Telephone:	
Zip Code:		Fax:	

The standard fee (excluding tax)

Office Number	Market Office Price per Month €	Monthly Office Price €	Number of workstations	Total per Month €	Comments
512	8.870,00 €	5.590,00 €	5	5.590,00 €	
				0,00 €	
				0,00 €	
				0,00 €	
				0,00 €	
				0,00 €	
				0,00 €	
		Total per Month		5.590,00 €	

Initial Payment:

☐ Check if Renewal

Monthly Office Payment				5.590,00 €
Service Retainer			2	11.180,00 €
Monthly Taxes	Rate	16,00%	%	894,40 €
Total Initial Payment				17.664,40 €

Monthly Payment:

Total Monthly Payment (excl. of services)	6.484,40 €

Direct Debit Option requested by client: ☐ (check, if accepted fill out "Direct Debit Authorization Form")

Length of Agreement

Start date (MM/DD/YY):	1st September 2006	End date (MM/DD/YY):	31st August 2008

Comments

5 x Telecoms Packs @ 49 euros per person per month. 5 x Connectivity Packs @ 49 euros per person per month. 1 x Car Parking Space @ 175 euros per month.
Glass cubicle to be constructed inside the office to the clients specifications and own cost.

Check here if you do not consent to Regus processing data in accordance with Clause 28 of this agreement. ☐

We are REGUS BUSINESS CENTER S.A. of Paseo de la Castellana, 93 - 4º, 28046 Madrid. This agreement incorporates our terms of business set out on attached Terms of Business which you confirm you have read and understood. We both agree to comply with those terms and our obligations as set out in them. Note that the Agreement does not come to an end automatically. See "Bringing your Agreement to an end"

Name (printed)	MARIA ELENA RUSS
Title (printed)	VICE PRESIDENT
Date (MM/DD/YY)	7th August 2006
SIGNED on your behalf (Client)	

Name (printed)	David William Abrahams
Title (printed)	Corporate Account Manager
Date (MM/DD/YY)	7th August 2006
SIGNED on our behalf (Regus)	

Terms of Business

USING REGUS CENTERS

1. We are Regus Business Centre, S.A hereafter referred to as "Regus". These are our terms of business. They apply to the service agreement which you have signed (which we refer to simply as your agreement).
Your agreement supersedes any previous agreement you may have with us for the same services and contains all the terms we have agreed.

STANDARD SERVICES INCLUDED IN YOUR STANDARD FEE

2. Furnished office accommodation
We are to provide the number of serviced and fully furnished rooms for which you have agreed to pay in the business centre stated in your agreement. Your agreement lists the rooms we have initially allocated for your use. Occasionally we may need to allocate different rooms, but these will be of equivalent size and we will try to agree these with you in advance.

3. Office services
We are to provide the services described on the front of this Agreement, the Service Order, the Regus workstation or cube offer and any other mutually agreed upon services such as internet and phone during normal operating hours Monday to Friday (Internet is available 24/7).
We are happy to discuss special arrangements for use of these services outside our normal opening hours. All services are subject to the availability of our center team at the time of any service request. We will endeavour to deal with a service request at the earliest opportunity, but will not be held responsible for any delay.
If in our opinion, we decide that a request for any particular Business Service is excessive, we reserve the right to charge an additional fee at our usual published rates based on the time taken to complete the service.

4. REGUSNET
You must comply with any copyright notices, license terms or other notices appearing on screen or as part of any material on the Internet or our network. You must not copy, use or exploit such software or other material in any way, unless we have explicitly given you permission to do so. You must strictly comply with the terms of any permissions which we give.
We do not make any representations as to the security of our network (or the Internet) or of any information which you place on it. You should adopt whatever security measures (such as encryption) you believe are appropriate to your circumstances.
We cannot guarantee that a particular degree of availability will be attained in connection with your use of the services.
You hereby warrant to us that, in the course of our provision of the RegusNet services to you, you will not nor will you cause us to, infringe the rights of any third party (such as, but not limited to, using their logo without consent on your website).
You will comply with the RegusNet Rules set out in the RegusNet access registration form.
We warrant that the services shall be provided and performed in a professional and workmanlike manner and shall conform to the description of the services set out in the offers for Regus Connectivity Services' and in the RegusNet access registration form. If we fail to provide the services as warranted, your sole and exclusive remedy shall be the remedy of such failure by us within a reasonable time after written notice.
The above warranty is in lieu of all other terms, conditions and warranties, whether express or implied by usage, custom, statute or otherwise, appertaining to the services and manner in which we perform our obligations and exercise our rights including, but without prejudice to the generality of the foregoing, such as relate to the description, performance, quality, suitability or fitness for any particular purposes, of the services. We do not warrant that the services will be uninterrupted or error free.

USING THE ACCOMMODATION

5. On moving in
You will be asked to sign an inventory of all accommodation, furniture and equipment you are permitted to use, together with a note of its condition, and details of the keys or entry cards issued to you. You may at any time have as many employees working in your accommodation(s) as there are maximum allowable workstations. This number is noted on the front of this Agreement. Anytime the number of people sharing an accommodation exceeds the maximum number of workstations allowable in that accommodation a Hot Desk Supplement fee equal to the monthly standard VO fee, (prices available on request), will apply for each person over the number of maximum workstations for the given accommodation. If at any time the number of people physically present exceeds the maximum number of workstations allowable, those employees will pay an additional hourly or daily rate for the additional accommodations.

6. The nature of your business
You must only use the accommodation for office purposes, and only for the business stated in your agreement or subsequently agreed with us. Office use of a 'retail' nature, involving frequent visits by members of the public, is not permitted. You must not carry on a business which competes with our business of providing serviced office accommodation. You must not use the name Regus in any way in connection with your business.

7. Your name and address
You may only carry on that business in your name or some other name that we previously agree. At your request and cost we will include that name in the house directory at the business centre, where this is available. You must not put up any signs on the doors to your accommodation or anywhere else which is visible from outside the rooms you are using. You may use the business centre address as your registered office address but only with our prior written consent and subject to any conditions that we may impose. In this case you must change it immediately after termination of your agreement. It is your responsibility to inform third parties of this change and all mail received after the termination of your agreement will be returned to the sender.

8. Taking care of our property
You must take good care of all parts of the business centre, its equipment, fittings and furnishings which you use. You must not alter any part of it. You are liable for any damage caused by you or those in the business centre with your permission or at your invitation.

9. Office furniture and equipment
You must not install any furniture or office equipment, cabling, IT or telecoms connections without our consent, which we may refuse at our absolute discretion.

10. Keys and security
Any keys or entry cards which we let you use remain our property at all times. You must not take any copies of them or allow anyone else to use them without our consent. Any loss must be reported to us immediately and you must pay the cost of replacement keys or cards and or changing locks, if required. If you are permitted to use the business centre outside normal working hours it is your responsibility to lock the doors to your accommodation and to the business centre when you leave.

11. Comply with the law
You must comply with all relevant laws and regulations in the conduct of your business. You must do nothing illegal. You must not do anything that may interfere with the use of the business centre by us or by others, cause any nuisance or annoyance, increase the insurance premiums we have to pay or cause loss or damage to us or to the owner of any interest in the building which contains the business centre. You acknowledge that (a) the terms of the foregoing sentence are a material inducement to us for the execution of your Agreement and (b) any violation by you of the foregoing sentence shall constitute a material default by you hereunder, entitling us to terminate your Agreement.

12. Comply with house rules
You must comply with any house rules which we impose generally on users of the business centre whether for reasons of health and safety, fire precautions or otherwise.

13. Insurance
It is your responsibility to arrange insurance for your own property which you bring into the business centre and for your own liability to your employees and to third parties.

PROVIDING THE SERVICES

14. Access to your accommodation
We can enter your accommodation at any time. However, unless there is an emergency we will as a matter of courtesy try to inform you in advance when we need access to carry out testing, repair or works other than routine inspection, cleaning and maintenance. We will also respect security procedures to protect the confidentiality of your business.

15. At the start of your agreement
If for any reason we cannot provide the number of rooms stated in your agreement by the date when your agreement is due to start we have no liability to you for any loss or damages but you may cancel the agreement without penalty. We will not charge you the standard fee for rooms you cannot use until they become available.

16. Suspension of services
We may by notice suspend the provision of services (including access to the accommodation) for reasons of political unrest, strikes, or other events beyond our reasonable control, in which event payment of the standard fee will also be suspended for the same period. We are not liable for the reception of any notification or communication that is not transmitted to you due to the suspension of services.

17. Our liability
We are not liable for any loss as a result of our failure to provide a service as a result of mechanical breakdown, strike, delay, failure of staff, termination of our interest in the building containing the business centre or otherwise unless we do so deliberately or are negligent. We are also not liable for any failure until you have told us about it and given us a reasonable time to put right.
You agree that we will not have any liability for any loss, damage or claim which arises as a result of, or in connection with, your agreement and/or your use of the services except to the extent that such loss, damage, expense or claim is directly attributable to our deliberate act or our negligence (our liability).
We will not in any circumstances have any liability for loss of business, loss of profits, loss of anticipated savings, loss of or damage to data, third party claims or any consequential loss. We strongly advise you to insure against all such potential loss, damage expense or liability.
In addition, client releases Regus from any liability arising out of or incurred in connection with any Client Mail and/or Packages received.

YOUR AGREEMENT

18. The nature of your agreement
Your agreement is the commercial equivalent of an agreement for accommodation in a hotel. The whole of the business centre remains our property and in our possession and control. We are giving you no interest in property just the right to share with us the use of the business centre so that we can provide the services to you. The agreement is personal to you and cannot be transferred to anyone else. We may transfer the benefit of your agreement and our obligations under it at any time.

19. Duration
Your agreement lasts for the period stated in it and will then automatically be renewed for successive periods equal to the initial or current term but no less than 3 months until brought to an end by you or us. All periods shall run to the last day of the month in which they would otherwise expire. The fees on any renewal will be the market price stated on the front of the Agreement, in all other respects your agreement will renew on the same terms and conditions.

20. Bringing your agreement to an end
Either of us can terminate your agreement at the end date stated in it, or at the end of any renewal period, by giving at least three months' notice to the other.
However, if your agreement is for three months or less and one of us wishes to terminate it, the notice period is two months or (if shorter) one week less than the period stated in your agreement.

21. Ending your agreement immediately
We may put an end to your agreement immediately by giving you notice if:

- you become insolvent, go into liquidation or become unable to pay your debts as they fall due,
- you are in breach of one of your obligations which cannot be put right or which we have given you notice to put right and which you have failed to put right within fourteen days of that notice, or
- your conduct, or that of someone at the business centre with your permission or at your invitation, is incompatible with ordinary office use.

If we put an end to the agreement for any of these reasons it does not put an end to any then outstanding obligations you may have and you must:

- pay for additional services you have used
- pay the standard fee for the remainder of the period for which your agreement would have lasted had we not ended it, or (if longer) for a further period of three months, and
- indemnify us against all costs and losses we incur as a result of the termination.

22. If the business centre is not available
In the unlikely event that we are no longer able to provide the services and accommodation at the business centre stated in your agreement then your agreement will end and you will only have to pay standard fees up to the date it ends and for the additional services you have used. We will try to find suitable alternative accommodation for you at another Regus business centre.

23. When your agreement ends

- Upon your departure or if you, at your option, choose to relocate to a different accommodation within the business center a flat fee (€150.00 per workstation/cube) will be assessed to cover the routine cost of repainting and redecorating the accommodation to return it to its original condition in addition to general maintenance to the common areas of the business center in which you have had access. We reserve the right to charge additional reasonable fees for any repairs needed above and beyond normal wear and tear. If you leave any of your own property in the business center we may dispose of it in any way we chose without owing you any responsibility for it or any proceeds of sale.
- In order to transition your mail and telephone calls from this business center, you will be automatically entered into a RVO Agreement with us on our standard terms at the time for 3 months. Current contract terms and pricing can be obtained through your Regus General Manager.

If you continue to use the accommodation when your agreement has ended:

- you are responsible for any loss, claim or liability we incur as a result of your failure to vacate on time
- we may, at our discretion, permit you an extension subject to a surcharge on the standard fee.

24. Employees
While your agreement is in force and for a period of six months after it ends, you must not solicit or offer employment to any of our staff nor to anyone who has left our employment in the last 3 months. If you do, we estimate our loss at the equivalent of one year's salary for each of the employees concerned and you must pay us damages equal to that amount.

25. Notices
All formal notices must be in writing. Client is responsible to keep updated address of record at the center.

26. Confidentiality
The terms of your agreement are confidential. Neither of us must disclose them without the other's consent unless required to do so by law or an official authority. This obligation continues after your agreement ends.

27. Enforcing your Agreement
You must pay any reasonable and proper costs including legal fees which we incur in enforcing your Agreement.

28. Data Protection
According to the terms stipulated in article 5 of the Ley Orgánica 15/1999, de 13 de diciembre, de Protección de Datos de Caracter Personal ("LOPD"), we inform you that personal data to which we have access in relation to your agreement will form part of a database which we will be responsible for, and at any moment you can exercise your right to access, correct, cancel or oppose the processing of your personal data, according to the terms and conditions within the LOPD.
You expressly agree that your personal data can be released or communicated by us, according to articles 11 and 34 e) of the LOPD, to companies in the "International Network" and other collaborating companies anywhere in the world, even to those who do not offer a protection level comparable to the one of the LOPD, with the only purpose of:
- informing you of offers of services similar to those provided by us which may be of your interest.
- assessment of the services provided and fraud prevention.
- compliance with the obligations derived from your agreement.

By accepting the terms in this clause, you are informed of all contents in article 27 of the LOPD relating to the communication of the first data release. Consent for the communication of personal data is revocable at any moment, but will have no retroactive effect.

29. Spanish law applies
Spanish law applies to your agreement. We both accept the non-exclusive jurisdiction of the Spanish Courts.

FEES

In the following clauses any references to "fees" alone means all of the standard service fee, pay-as-you-use fees, the Connectivity Services price and the Telecom Services price.

30. Office Set Up
A €75 per workstation fee will be charged to all clients upon office move in.

31. Standard services
The standard service fee, the Connectivity Services price (if applicable) and the Telecom Services price (if applicable), plus VAT in all cases, are payable in respect of the services to be provided during the following month in advance in full on the 25th day (or such other day as we designate) of each month. The charge for any such month will be 30 times the relevant fee. No refund will be given for months of less than 30 days nor will any additional charge be levied for months of more than 30 days. For a period of less than a month, the fees will be applied on a daily basis. Internet, Phone and Business Line services are mandatory for the Cube and Heldesk offering. The Heldesk product also has a mandatory Supplemental Services fee.

32. Pay-as-you-Use services
Fees for pay-as-you-use services, plus VAT, in accordance with our published rates which may change from time to time, are invoiced in arrears and payable on the 25th day (or such other day as we designate) of the month following the calendar month in which the pay-as-you-use services were provided.

33. Service Retainer
You will be required to pay a service retainer equivalent to 60 days standard service fee on entering into your agreement. This will be held by us as security for performance of all your obligations under your agreement. The Service Retainer, or any balance after deducting outstanding fees, three months VO fee for your VO Agreement, and other costs due to us, will be returned to you within 30 days of the date you have settled your account with us in full. We may require you to pay an increased retainer if outstanding fees exceed the Service Retainer held (including those services already rendered but still not invoiced) or you frequently fail to pay us when due.

34. Late payment
If you do not pay fees when due, a service fee of €25.00 plus 5% interest will be charged on all overdue balances under €1,000.00 or a fee of €50.00 plus 5% interest on all overdue balances will be charged on all overdue balances of €1,000.00 or greater. If you dispute a part of any invoice you must pay the amount not in dispute by the due date or be subject to late fees.

35. Cross Default
You agree that, if you are in default under a service agreement with us at a different business center ("Different Location Agreement") to the one specified in this Agreement, that we may recover any unpaid sums due under a Different Location Agreement from you under this Agreement and that we may, in particular (but not limited to), withhold services under this Agreement or deduct sums from the deposit held under this Agreement in respect of such unpaid sums.

36. Insufficient Funds & Bank charges Fees
You will pay a fee of €25.00 or the maximum amount permitted by law for the return of any payment for insufficient funds. Any bank charges or fees deducted by the originated bank shall be recharged to the client on the following service invoice.

37. Subordination
Your Agreement is subordinate to our lease with our landlord and to any other Agreements to which our lease with our landlord is subordinate.

38. Annual increase
We will increase your standard service fee on each and any annual anniversary of the start date of your agreement by a percentage amount equal to the increase in the Indice General Nacional de Precios de Consumo published by the Instituto Nacional de Estadística, or any other equivalent index which may substitute it in the future, over the previous year plus 2%. This will only apply to agreements that have an original start and end date constituting more than a 12 month term. Renewals do not fall under this category and will be reviewed as per clause 19 above.

SIGNED (Client): _____ SIGNED (Regus): _____

Exhibit 21.1

Energy Recovery, Inc.

List of Subsidiaries

Company Name	*Country/State of Incorporation/Formation*
Osmotic Power, Inc.	Delaware
Energy Recovery Iberia, S.L.	Spain
Energy Recovery, Inc. International	Delaware

Exhibit 23.1

Consent of Independent Registered Public Accounting Firm

Energy Recovery, Inc.
San Leandro, California

We hereby consent to the use in the Prospectus constituting a part of this Registration Statement of our report dated March 28, 2008, relating to the consolidated financial statements and schedule of Energy Recovery, Inc., which is contained in that Prospectus.

We also consent to the reference to us under the caption "Experts" in the Prospectus.

/s/ BDO Seidman, LLP
San Jose, California

March 28, 2008

Exhibit 99.1

CONSENT OF PERSON ABOUT TO BECOME DIRECTOR

The undersigned hereby consents to the use of his name and any references to him as a person who will become a director of Energy Recovery, Inc. ("ERI") after the completion of its intial public offering in ERI's Registration Statement on Form S-1, and any and all amendments thereto, to be filed with the Securities and Exchange Commission pursuant to the Securities Act of 1933, as amended.

Dated: March 24, 2008

By: /s/ Dominique Trempont
Dominique Trempont

Baker & McKenzie LLP
Two Embarcadero Center, 11th Floor
San Francisco, CA 94111

April 1, 2008

United States Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Energy Recovery, Inc.
Registration Statement on Form S-1

Ladies and Gentlemen:

Attached for filing on behalf of our client, Energy Recovery, Inc., a Delaware corporation (the "Company"), pursuant to the Securities Act of 1933, as amended (the "Securities Act"), is a Registration Statement on Form S-1, including exhibits, for registration of the Company's common shares for sale as described therein.

The registration fee in the amount of $6,877.50 has been calculated pursuant to Rule 457(o) under the Securities Act. The registration fee has been remitted to the Securities and Exchange Commission's account at US Bank by wire transfer.

Should you have any questions pertaining to this filing, you may reach the undersigned via telephone at (650) 251-5926 and via facsimile at (650) 856-9299.

Sincerely yours,

By: /s/ Jenny C. Yeh
Jenny C. Yeh

Enclosure