

**AGREEMENT FOR THE
RESURRECTION OF OPERATIONS UPON
THE NORTHWESTERN PACIFIC RAILROAD LINE
AND
LEASE**

NORTH COAST RAILROAD AUTHORITY

and

NORTHWESTERN PACIFIC RAILROAD COMPANY

SEPTEMBER 2006

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Agreement For The Resurrection of Operations Upon The Northwestern Pacific Railroad Line and Lease

I. Preamble

This Agreement is made this 13th Day of September 2006 by and between NORTH COAST RAILROAD AUTHORITY, ("NCRA") a public agency, and NORTHWESTERN PACIFIC RAILROAD COMPANY, ("NWP"), a California Corporation.

II. Recitals

- A. NCRA is the owner of portions of the Northwestern Pacific Line (the "NWP Line") and the holder of certain easements of the NWP Line;**
- B. NCRA is an agency created by the Legislature of the State of California pursuant to the Government Code Sections 93000, *et seq.* with a statutory duty to provide freight rail service on the NWP Line;**
- C. NCRA has residual common carrier responsibility for the NWP Line by reason of ownership of railroad property as defined by Interstate Commerce Commission Termination Act of 1995 and the implementing regulations adopted by the Surface Transportation Commission;**
- D. NCRA was authorized by the Legislature of the State of California pursuant to Government Code Section 93023(d) to select a franchisee to finance and operate the railroad system;**
- E. To fulfill its statutory duties and to fulfill its common carrier responsibilities, NCRA in January 2006 issued a Request for Proposals for a franchisee to assume the management of NCRA properties and to operate the Northwestern Pacific Rail Line;**
- F. NCRA received five responses, including the response of Northwestern Pacific Railroad Company, a California corporation; and**

G. NCRA evaluated the responses and selected Northwestern Pacific Railroad Company, a California Corporation as its franchisee on May 31, 2006.

III. Definitions

The following terms shall have the following meanings as used in this Agreement:

- A. "Affiliate" means, with respect to any person or entity, each stockholder, subsidiary, officer, director, agent and employee of that person or entity.

- B. "Easement Premises " are generally described as the Northwestern Pacific Line from NWP Milepost 68.22 near Healdsburg, California to NWP Milepost 40.60 near Schellville, California to SPT Milepost 63.40 near Lombard, California more particularly described and defined as the "Easement Land" in the Operating Agreement at Section 1.01; Exhibits A, B, and C, thereof, subject to the reservations to SMART as successor in interest to the NWPRA in Sections 1.02 and XV of the Operating Agreement.

- C. "Eel River Block" means all land owned, easements held, and licenses received by NCRA comprising the Northwestern Pacific Line from NWP Milepost 142.5 near Willits , California to NWP Milepost 238.00 near South Fork, California.

- D. "Humboldt Bay Block" means all land owned, easements held, and licenses received by NCRA comprising the Northwestern Pacific Railroad Line from NWP Milepost 238.00 near South Fork, California to NWP Milepost 302.90 near Samoa, California and NWP Milepost 295.57 near Arcata, California.

- E. "Indemnifiable Losses" means the aggregate of Losses and Litigation Expenses.

- F. "Indemnitee" means any person who makes a claim for indemnification under this Agreement, and each Affiliate of the Indemnitee.

- G.** "Indemnitor" means any person against whom a claim is made by an Indemnitee under this Agreement
- H.** "Leased Premises" means the Northwestern Pacific Railroad Line from NWP Milepost 142.5 near Willits, California to NWP Milepost 68.22 near Healdsburg, California including all of the property described as the "Willits Segment" in the NWPRRA and NCRA Principles of Agreement dated April 30, 1996.
- I.** "Litigation Expense" means any court filing fee, court cost, arbitration fee or cost, witness fee, and each other fee and cost of investigating and defending or asserting a claim for indemnification under this Agreement, including without limitation, in each case, attorneys' fees, or other professional's fees and disbursements.
- J.** "Loss" means any liability, loss, claim settlement payment, cost and expense interest, award, judgment, damages (including punitive damages), diminution in value, fines, fees and penalties or other charge, other than a Litigation Cost. As to the Easement Premises and for consistency with the Operating Agreement, "Loss" shall have the same meaning as defined in Section 9.04 of the Operating Agreement except the references to "NWPRRA" shall be deemed as being as to SMART and the references to "NCRA" shall be deemed as being as to NWP.
- K.** "NCRA Passenger Service" shall mean, with respect to the Leased Premises and Option Premises, rail passenger excursion and regional intercity passenger service and, with respect to the Easement Premises, shall have the same meaning as the term "Permitted Passenger Service" in the Operating Agreement.
- L.** "NWPRRA" means The Northwestern Pacific Railroad Authority, a dissolved joint powers agency, the rights and responsibilities of which were assigned to the Sonoma Marin Area Rapid Transit, ("SMART"), by the Memorandum of Understanding dated June 13, 2003.
- M.** "NWP Line" means the Northwestern Pacific Railroad Line encompassing the Easement Premises, Leased Premises, and Option Premises extending from SPT Milepost 63.40 near Lombard to NWP Milepost 302.90 near Samoa and NWP Milepost 295.57 near Arcata, including all branch lines.

- N. "Operating Agreement" means the Operating Agreement For Northwestern Pacific Line, with exhibits, dated August 19, 1996 by and between NWPRRA and NCRA.
- O. "Option Premises" means the Eel River Block or the Humboldt Bay Block, if the option for such Block has been effectively exercised.
- P. "Premises" shall mean the Leased Premises, the Easement Premises, or any Block the option for which NWP has been effectively exercised .
- Q. "Railroad Owner" means NCRA as to the Leased Premises, and the Option Premises and SMART as to the Easement Premises.
- R. "Railroad Property" means the Leased Premises, the Option Premises, and the Easement Premises".
- S. "SMART" means the Sonoma Marin Area Rapid Transit, or to any agency succeeding to its rights and obligations
- T. "STB" means the Surface Transportation Board, or such successor federal agency as may be established in the future for the purpose of regulating the railroad industry.
- U. "Track" means all rail and fastenings, switches and frogs complete, ties, ballast and signals.
- V. "Track Support Structure" means all appurtenances to the Track, including without limitation bumpers, roadbed, embankment, bridges, trestles, tunnels, culverts and any other structures or things necessary for support or construction thereof, pavement, any crossing planks and other similar materials or facilities used in lieu of pavement or other street surfacing material at vehicular crossings of tracks, culverts, drainage facilities and crossing warning devices.
- W. "Willits Block" shall have the same meaning as the "Leased Premises."

IV. Conditions

This Agreement is conditioned upon:

- A.** NCRA having obtained any necessary consents from Sonoma Marin Rail Transit "SMART") pursuant to Paragraph 16.04 of the Operating Agreement; together with the cancellation of the note dated April 18, 2001 in the sum of \$250,000 and the reconveyance of the deed of trust of even date encumbering the Ukiah Depot property securing a loan for the improvement of the Haystack Bridge the cancellation and reconveyance being in accord with the First Amendment to Promissory Note dated February 5 2004,
- B.** NCRA and NWP having executed an Equipment Lease for all equipment being transferred to NWP in accordance with the terms of this Agreement.
- C.** NCRA having complied with the California Environmental Quality Act ("CEQA") as it may apply to this transaction.
- D.** NCRA having obtained any necessary approvals or having made any appropriate notifications concerning the Private Activity Tax Rules relating to property acquired with Proposition 116 Bond funds.

V. Conveyance of Premises

A. Easement Premises

NCRA assigns all of its interest in the Easement Premises to NWP in accord with the terms and conditions of this Agreement.

B. Leased Premises

NCRA Leases all of its interest in the Leased Premises to NWP in accord with the terms and conditions of this Agreement.

C. Option Premises

NCRA grants to NWP options to the Option Premises as described in this Agreement in accord with the terms and conditions of this Agreement for:

1. The Eel River Block
2. The Humboldt Bay Block

D. All of the Leased Premises, Easement Premises , and Option Premises that are conveyed by this Agreement from NCRA to NWP shall be used for railroad purposes unless NCRA and NWP agree in writing that specific properties are not needed to provide railroad service and may be leased to others. In that event, an independent real estate appraiser shall determine the fair market value of the property and an appropriate lease rate that is reasonably expected to reflect market conditions over the expected life of the lease.

E. Excepted from the conveyance above is:

1. The Passenger Easement granted by NCRA to NWPRA upon the Willits Block April 30, 1996, which easement was assigned by NWPRA to SMART;
2. The Grant of Easement for Passenger Rail Operations- Sonoma County for the operation of regularly scheduled passenger commute service, and intercity and intermittent or seasonal passenger service originating or terminating from points south of Healdsburg, including the right to effect improvements;
3. Any rock deposits upon property owned by NCRA. However, NCRA grants the right of extraction of such rock without royalty, provided that such rock is utilized for construction , rehabilitation, or improvement of any portion of the Northwestern Pacific Railroad Line, upon documentation of such use as may be in the future be agreed to in writing by and between the parties;
4. The reservation set forth in Article IX C herein.

VI. Term

- A.** This Agreement shall commence as of September 13, 2006 and continue for an initial term of five (5) years.
- B.** The NWP is granted the following options to extend the term of this Agreement for an additional term; (i) twenty (20) years commencing upon the expiration of the initial term, (the "First Option"); (ii) a twenty-five (25) year commencing at the termination of the First Option, (the "Second

Option”); (iii) a forty-five (45) year option commencing at the termination of the Second Option, (the “Third Option”).

- C. The foregoing options may be effectively exercised by the NWP by delivery of a written Notice of Exercise delivered to the NCRA in the manner provided herein for delivery of notices, at a time the NWP is in material compliance with the terms of this Agreement, no sooner than eighteen (18) months prior to the expiration of the then applicable term, and no later than twelve (12) months prior to expiration of the then applicable term.
- D. Any notice of exercise of an Option shall be on the same terms and conditions as this Agreement, unless modifications are otherwise agreed to between the parties.
- E. Notwithstanding the foregoing, as an Alternative Option, the NWP is granted during the initial term an option to extend the term of this Agreement for an additional term of ninety-nine (99) years commencing upon expiration of the initial term, which may be exercised by the NWP only at such time that the NWP has made private capital investment in the Northwestern Pacific Railroad Line in an amount equal to or greater than the higher of : (1) \$10.5 Million; or (2) the aggregate amount of the investment of Proposition 116 funds or other public bond funds by the NCRA in the Northwestern Pacific Railroad Line as of the date of the commencement of this Agreement.
- F. The Alternative Option may be exercised by NWP by delivery of a written Notice of Exercise delivered to NCRA in the manner provided herein for delivery of Notices, at a time NWP is in material compliance with the terms of this Agreement, together with documentation of NWP private capital investment in the amount required in subsection E.
- G. For purposes of the Alternative Option, the following categories shall be considered “private capital investment:” (i) physical improvements to the Track or Track Structures; (ii) acquisition of railcars dedicated for use on the Northwestern Pacific Railroad Line; (iii) Acquisition of locomotives dedicated for use on the Northwestern Pacific Railroad Line; or (iv) investment in ancillary facilities which will contractually generate gross shipping revenues aggregating in excess of \$10.0 million during the Initial Term.

- H. The Alternative Option shall be on the same terms as this Agreement, except as to term, and as to term it will be ninety-nine (99) years without any other options.
- I. Notice of exercise of an Option for the Eel River Block or The Humboldt Bay Block will be on the same terms and conditions as this Agreement, except that the term for any such exercise will commence immediately upon the NCRA's compliance with the California Environmental Quality Act ("CEQA") unless modifications are otherwise agreed to between the parties.
- J. In the event of the exercise of an Option for the Eel River Block, or the Humboldt Bay Block, NCRA shall pursue compliance with CEQA, and NEPA if applicable, with due diligence and with the exercise of its best efforts.

VII. Rail Operations

A. NWP Line Restoration

The Parties agree that it shall be solely NCRA's responsibility to rehabilitate and restore all portions of the NWP Line to the Utility Levels specified in Section VIII. Until such Utility Levels have been achieved on each specified segment of any portion of the NWP Line, NWP shall have no obligation whatsoever to operate either rail freight service or rail passenger service on or to maintain that specific segment of any portion of the NWP Line. If, however, NWP elects to operate either rail freight service or rail passenger service over any portion of the NWP Line at a lesser Utility Level than is specified in Section VIII, then NWP must maintain that portion of the NWP over which rail operations will occur in accordance with the terms of this Agreement.

The Parties also agree that after the effective date of this Agreement, NWP may operate work train service over any portion of the NWP Line subject only to any required authorization by the Federal Railroad Administration, and that the operation of any work train service shall not be considered as either rail freight service or rail passenger service as those terms are used in this Agreement. For work train operations the insurance requirement set forth in Article XV I (1) (a) herein shall be relaxed to require a limit of \$5

million in the place and stead of the stated requirements for \$25 million limits.

B. Rail Freight Operations

1. After obtaining the necessary authority or exemption from the STB, NWP shall be the sole and exclusive provider of rail freight service to, from and across the Premises. Neither NCRA nor NWP shall grant to any third party any rights whatsoever to conduct rail freight operations on the Premises, without the prior, written consent of the other Party.
2. NWP shall not suspend or discontinue its operation as a common carrier over all or any part of the Premises without first applying for and obtaining from the STB and any other regulatory agency with jurisdiction, any necessary certificate of public convenience and necessity or other approval or exemption from regulation for such discontinuance of operations over the Easement Premises, Leased Premises, or any optioned portion of the Option Premises or any portion thereof.
3. NWP shall not seek regulatory authority for suspension or discontinuance of its operations or take any action to suspend or discontinue its operations on the NWP Line without first receiving written concurrence from NCRA, which shall not be unreasonably withheld. However, the concurrence of NCRA shall not be required for a suspension or discontinuance resulting from an event of Force Majeure or a lawful embargo.
4. NWP may in its sole discretion enter into any commercial arrangement with any other company, including but not limited to transloading, joint railroad or highway transportation operations, car haulage, and the like; provided, however, no such commercial arrangement may adversely affect (i) commuter passenger services, intercity excursion or other passenger service on the Easement Premises or (ii) NCRA Passenger Services on the Leased Premises or the Option Premises.
5. NWP shall manage, control and dispatch all train operations on the Leased Premises and on the Option Premises and subject to the limitations below, upon the Easement Premises. In the event SMART establishes commuter passenger, intercity, excursion, or other passenger

transit operations on the Easement Premises pursuant to the Operating Agreement, NWP shall act as NCRA's agent to negotiate the Coordination Agreement pursuant to Paragraph 3.09 of the Operating Agreement with reference to all of the topics therein contained including but not limited to the assumption by SMART or its franchisee of maintenance and/or dispatching functions as defined in Paragraph 3.07 (b) of the Operating Agreement.

6. NWP shall manage, control and have sole authority to grant and schedule access by third parties to the Leased Premises and the Option Premises to the extent consistent with Section XI herein relating to Capital Projects, and to the extent consistent with the Operating Agreement, and as may be provided for in the Coordination Agreement to be negotiated between NCRA (with NWP as NCRA's agent) and SMART, to the Easement Premises.
7. In the event that SMART undertakes to provide commuter rail, intercity, excursion or other passenger transit operations on the Easement Premises pursuant to the Operating Agreement, as amended, either directly or through the designation of a passenger service operator, NCRA agrees to designate NWP as a party agent and as a party of interest in the Coordination Agreement that will describe in detail the respective rights and obligations of the Parties with respect to maintenance, capital expenditures, dispatching, scheduling of operations, environmental liability, taxes and other matters concerning the joint use of the Easement Premises. NWP shall be entitled to negotiate the Coordination Agreement for all provisions of the coordination agreement except as the coordination agreement committing NCRA to capital improvements, or to reimbursement for such improvements for which matters the written consent of NCRA is to be necessary, and it shall negotiate in good faith with SMART, keeping NCRA informed as to status of all such negotiations.

C. Rail Passenger Service. NWP shall be the sole and exclusive use of the Leased Premises, Easement Premises, and the Option Premises, to the extent effectively exercised, to provide NCRA Passenger Service originating or terminating from points north of Healdsburg, provided that these operations shall be subordinate to regularly scheduled commuter operations conducted on the Easement Premises if any, as provided for in the Operating Agreement ("Permitted Passenger Service"). Further, the Operating Agreement provides that neither NWP nor NCRA may use the

Premises for any other type of passenger service; provided, however, that the term "passenger service" shall not include the transportation of officers, employees or invitees of either NCRA or NWP or the use of equipment utilized for the transportation of such persons.

If, at any time after two years from the date that any portion of the NWP Line has been rehabilitated to the FRA Class specified in Section VIII, NWP has not proposed to NCRA to operate NCRA Passenger Service over that portion of the NWP Line, or NCRA has not accepted such proposal within sixty (60) days of such proposal, then NWP agrees to join with NCRA in issuing a Request For Proposals ("Passenger RFP") for such service and the parties agree to then accept and consider applications to operate NCRA Passenger Service over that portion of the NWP Line from third party operators who are financially and operationally qualified. The parties shall require that any contract with a third party operator provides for safe operations, will not adversely affect NWP's freight service operations, will provide adequate compensation to NWP as defined below, will provide insurance and indemnification of NWP in accordance with the terms of this Agreement and provide for the retirement of the \$134,937 plus interest, franchise fee NCRA is contractually required to collect, payable in three annual installments.

The term "adequate compensation as used in the preceding paragraph shall be deemed to include, without limitation, the cost of locomotives; cars; train crews; engine crews; dispatching; track and track support structure maintenance; and property and liability insurance. It is the intent of the Parties that reimbursement to NWP shall reflect the principles for the direct assignment and separation of common expenses between passenger and freight service as promulgated by the STB in 49 CFR Part 1201 and 49 CFR Part 1242. NCRA shall not require that NWP accept any NCRA Passenger Service operation by another carrier over any portion of the NWP Line that is not then in active service by NWP, would not provide safe passenger train operations, would adversely affect NWP's freight service operations, would not provide insurance and indemnification in accordance with the terms of this Agreement, and would not adequately compensate NWP for any costs it would incur in accommodating such NCRA Passenger Service.

In the event that NCRA rejects a proposal from NWP for passenger service, such rejection shall be subject to the dispute resolution provisions of this agreement. NCRA may solicit third party operators during such dispute

resolution, but shall not accept any proposal from a third party operator so long as the dispute resolution is pending, and neither party has unnecessarily delayed such process.

- D. NCRA reserves the right to require NWP to admit contractors upon the Leased Premises for purposes of performing capital projects, subject to Section XI relating to Capital Projects.
- E. NCRA warrants that it has not granted rights to use the Easement Premises, Leased Premises, or Option Premises for rail operations to any third party except:
 1. A lease Agreement with NWPY and NORCARE, which agreement terminated June 30, 2005;
 2. A trackage rights agreement with California Northern Railroad relating to the Lombard-Schellville segment, which agreement both NCRA and California Northern Railroad consider to be terminated;
 3. A trackage rights agreement with California Western Railroad dated March 11, 1999 relating to the use of Willits Yard.

VIII. Maintenance, Rehabilitation, and Level of Utility

- A. NCRA has an interest in rehabilitating, restoring the level of utility and preserving the physical condition of the NWP Line to facilitate the further development of economical and efficient freight services and the eventual development of NCRA Passenger Services. As long as the Premises are exclusively used by NWP for rail freight service, NWP shall perform all Normalized Maintenance functions on the Premises at NWP's sole cost and expense, subject to the definition of "Normalized Maintenance" below. When NCRA Passenger Services are initiated, NWP shall perform all Normalized Maintenance functions for said NCRA Passenger Services on the Premises at the sole cost and expense of the operator of said NCRA Passenger Services, subject to the definition of "Normalized Maintenance" below. NCRA shall, however, bear all expense of storm damage repairs, rehabilitation and restoration of the level of utility of the Premises as defined in Subsection B, below.

B. The following specific principles and understandings shall govern NCRA's maintenance responsibilities:

1. The Parties acknowledge that the freight revenue stream generated historically by traffic moving on the NWP Line has been inadequate either to fund the Normalized Maintenance requirements of the NWP Line, or to maintain it to the FRA Track Classes specified in Paragraph (4) below.
2. As a result of the foregoing, the Parties agree that, during the Term of this Lease Agreement, including any extensions thereof, NCRA shall utilize its best efforts to (i) bear all expenses of rehabilitating and restoring the level of utility of the Easement, Lease, and Option Premises, (ii) bear all expense of repairing any present or future damage to the Easement, Lease, and Option Premises attributable to all forms of Force Majeure, including, but not limited to, natural calamity, and (iii) NCRA shall independently, and with the solicited assistance of SMART, seek to obtain potentially available public funds for the rehabilitation, restoration, and continuation of the level of utility of the Easement, Lease, and Option Premises (without detriment to similar needs of any part of the Premises). The foregoing notwithstanding, the parties understand and agree that any reasonable unreimbursed capital expenditure for the rehabilitation or restoration of the Premises borne by NWP shall be capitalized by NWP as a leasehold improvement and will be subject to recapture as provided in Section XII, provided however that prior to commencement of construction NWP receives NCRA's written concurrence, which will not be unreasonably or unseasonably withheld, and further provided, however, that NWP shall report to the NCRA not less than annually at the time of submitting its financial statement all such capitalized leasehold improvements made during the immediately preceding calendar year and shall have been designated in writing as a capitalized leasehold improvement when made pursuant to Section XI relating to privately funded Capital Projects.
3. NCRA commits that all available public funds which are, or may be, designated for rehabilitation, restoration, and improvement projects of the NWP Line shall be invested in the NWP Line in a timely and efficient manner.
4. It shall be solely NCRA's responsibility to use its best efforts to seek public funding to reopen, rehabilitate, restore, and continue the level of