

**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

Table of Contents

I.	Preamble.....	1
II.	Recitals	1
III.	Definitions	2
IV.	Conditions	5
V.	Conveyance of Premises.....	5
VI.	Term	6
VII.	Rail Operations.....	8
VIII.	Maintenance, Rehabilitation, and Level of Utility	12
IX.	Consent Decree Compliance.....	20
X.	Lease Payments Fund	21
XI.	Business Arrangements as to Capital Projects	24
XII.	Termination	38
XIII.	Events of Default	40
XIV.	Remedies.....	41
XV.	Indemnity and Insurance.....	44
XVI.	Reopener Clause Following SMART Negotiation	52
XVII.	Accounting and Reporting.....	54
XVIII.	Right of First Refusal	55
XIX.	Notices.....	55
XX.	Modification Of Agreement.....	57
XXI.	Waivers.....	57
XXII.	Number.....	59
XXIII.	Captions.....	59
XXIV.	Presumption of Consideration	60
XXV.	Severability.....	60

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

utility of the NWP Line at the following FRA Classes in order to achieve the following minimum acceptable track standards (“Utility Levels”):

- (a) Lombard – Ignacio Segment: FRA Class 3;
- (b) Ignacio – Healdsburg Segment: FRA Class 3;
- (c) Healdsburg – Redwood Valley: FRA Class 3;
- (d) Redwood Valley – Willits: FRA Class 2; and
- (e) Willits – Arcata/Samoa: FRA Class 3.

The Parties recognize and agree that actual track conditions and FRA Classes for most of the Premises do not meet these standards as of this date. NCRA shall use its best efforts to fund restoration of the Utility Levels set forth above. Prior to the commencement of rail operations on any portion of the NWP Line, NCRA and NWP shall make appropriate joint inspections of the Premises to document the actual condition and the FRA Classes of the Track and Track Support Structures.

- 5. Upon the commencement of rail operations on any portion of the NWP Line, NWP shall assume exclusive responsibility for performing (i) all Normalized Maintenance, (ii) all privately funded capital improvement projects, and (iii) and to the extent permitted by applicable law or regulation or exercise of regulatory authority, all disaster relief management and emergency repairs of damage sustained by the Premises as the result of natural disasters for and on behalf of NWP and the NCRA.
 - 6. Accounting for maintenance of way expenditures must be performed in accordance with Generally Accepted Accounting Principles as consistently applied in the railroad industry and subject to any and all orders of the STB or other entity with jurisdiction over NWP’s accounting. To the extent of any conflict between GAAP and orders of the STB, the policies and procedures of GAAP must apply.
- C. In the event that NWP determines that it is not economical in consideration of traffic volumes on any portion of the NWP Line to perform Normalized Maintenance on such line segment, NWP may seek to suspend or discontinue service or embargo the line upon ninety (90) days of notice to NCRA. In the event that NWP obtains regulatory authority or exemption to suspend or discontinue service on any portion of the NWP Line, the standard of maintenance for such line segment(s) may be suspended by

NWP. In the event that NCRA unsuccessfully opposes such suspension or discontinuance of service it may terminate this Agreement as to any section or any portion of a section of the NWP line necessary in its sole discretion to restore service to the portion of the NWP line to which service has been suspended. In addition, to the extent that NWP lawfully and in good faith embargoes a portion of the NWP Line, the Normalized Maintenance obligations of NWP shall be suspended for so long as the embargo remains in effect.

D. Normalized Maintenance

1. For the purposes of this Lease Agreement, "Normalized Maintenance" is defined as the annual operating expenses necessary to preserve the Levels of Utility of the Track and Track Support Structures, as is reasonable and appropriate following restoration of the Track and Track Support Structures to the standards established in Paragraph 1(e) above, from the combined effects of actual freight railroad usage and the passage of time, excluding any effects of Force Majeure events. Excluded from the definition of Normalized Maintenance specifically are those costs actually reimbursed to NCRA by the Federal Emergency Management Administration ("FEMA"), or the Governor's Office of Emergency Services, "(OES").
2. Normalized Maintenance for NCRA Passenger Services shall be the obligation of, and paid for by, the third-party operators, and performed by NWP. During the Term hereof, all NCRA contracts for the operation of NCRA Passenger Services shall provide for a reasonable roadway maintenance expense and capital expenditure recovery in such amounts as agreed between NCRA, NWP, and the third party operators, in accordance with the principles and costing methodology promulgated by the STB in 49 CFR Part 1201 and 49 CFR Part 1242.
3. As long as the Premises are exclusively used for rail freight service by NWP and NCRA Passenger Service by, or on behalf of, NCRA, NWP shall perform any and all work required by lawful authority in connection with maintenance and operation of the Track and Track Support Structures, including but not limited to roadway, bridges, and tunnels on the NWP Line, and all additions thereto; provided, however, payment for all expenses in excess of Normalized Maintenance shall be solely the responsibility of NCRA. All work required for passenger services by lawful authority in connection with maintenance and

operation of the Track and Track Support Structures on the Easement Premises, and all additions thereto, shall be performed at the sole expense of NCRA or its third party passenger operator.

- E. Upon commencement of rail operations on any portion of the NWP Line authorized by the Federal Railroad Administration, NWP shall assume exclusive responsibility for providing all ordinary and normalized maintenance on such portion of the NWP Line and only on those portions of the NWP Line that NWP operates.
- F. As to the Leased Premises including any portion of the NWP Line for which an Option has been exercised, NCRA shall own, and as to the Easement Premises, SMART shall own, all fixtures, improvements, and materials added to the Track and Track Support Structures unless otherwise agreed to in writing by NCRA or SMART as the case may be. Materials removed from the Track and Track Support Structures shall to the extent not prohibited by law, or agreements to which NCRA is a party, become the property of NWP provided that such materials are replaced by NWP. No rail or other material utilized for railroad operations shall be replaced with lesser weight or size rail or material without the prior written consent of NCRA or SMART as the case may be. However, nothing contained herein shall prohibit NWP from making emergency or other temporary repairs with lesser weight or size rail or other inferior materials provided that with respect to the Easement Premises, SMART consent is first obtained and with respect to the Leased Premises, NCRA consent is first obtained, and permanent repairs are made within a reasonable time thereafter and that such permanent repairs comply with the standards set forth in this Paragraph.
- G. NWP shall comply with all laws affecting the Premises or requiring any alterations or improvements to be made thereon; shall not commit or permit waste thereof; shall not commit, suffer, or permit any act upon the Premises in violation of law; and shall do all other acts which from the character or use of the Premises for rail freight and permitted passenger operations may be reasonably necessary, the specific enumeration herein not excluding the general.

H. Inspection of Premises

- 1. NCRA shall have the right at any time, upon reasonable advance notice (except for emergencies, where no notice is required) and from time to

time to inspect the Premises for conformity with the maintenance standards of this Agreement and to verify compliance with this Agreement; provided, that such inspections shall not unreasonably interfere with NWP's freight operations.

2. If, and when, SMART exercises its rights pursuant to the Operating Agreement to inspect the Easement Premises at any time, upon reasonable advance notice (except for emergencies, where no notice is required), and from time to time to inspect for conformity with the standards of maintenance contained in the Operating Agreement and to verify compliance with the Operating Agreement, then NWP shall grant access to the Easement Premises, provided, however, that such inspections shall not unreasonably interfere with NWP's freight service operations or any Permitted Passenger Service operations.

I. Maintenance Records and Documentation

1. NWP shall maintain full and complete records of all maintenance, rehabilitation, track relocation or removal performed on the Premises and shall maintain track profiles and track charts in a current condition so as to disclose and show all program maintenance and rehabilitation performed on the Track and Track Support Structures, together with all crossings permitted by NWP (the Track Charts"). NCRA shall have the right at all reasonable times and places to inspect such records and Track Charts. Copies of records and track charts shall be provided by NWP to NCRA promptly upon request.
2. NWP shall provide copies of all reports of track inspections by Federal Railroad Administration ("FRA") or California Public Utilities Commission ("CPUC") inspectors to NCRA as to the Leased Premises and to SMART as to the Easement Premises promptly upon receipt of said reports; the term "reports" shall include all notices or citations alleging deficiencies from FRA track standards.
3. NWP shall annually submit its maintenance plan and budget (the "Maintenance Plan") to NCRA for consideration and consent of NCRA on or before the March meeting of the Board of Directors of NCRA, such consent not to be unreasonably withheld by NCRA. The Maintenance Plan shall be in sufficient detail to enable NCRA to meet its contractual requirements to SMART set forth in the Operating Agreement.

- J.** NWP shall not use nor permit the use of the Premises in any manner that will tend to create waste or a nuisance or would materially interfere with the continued commercial, industrial or transportation corridor uses of the Premises. In using the Premises, and in constructing, maintaining operating and using the Track and Track Support Structures, NWP shall comply with any and all requirements imposed by federal or state statutes, or by ordinances, orders or regulations or any governmental body having jurisdiction, including, but not limited to, building and zoning ordinances regulating the occupancy, use or enjoyment of the Premises or regulating the character, dimensions or location of any Track and Track Support Structures on the Premises, subject to such exemptions from jurisdiction as may be set forth in the Interstate Commerce Commission Termination Act of 1995, 49 USC 10500 et seq. Nothing herein shall diminish by this Agreement any rights under law or regulation to which NWP is entitled as a railroad providing common carrier service on any portion of the NWP Line.
- K.** Subject to the provisions hereof, NWP may construct or relocate sidetracks or industrial spur tracks on the Leased Premises and Option Premises (and upon the Easement Premises upon written consent of SMART) as required in the ordinary course of business so long as such work is done in conformity with applicable governmental regulations. Sidetracks or industrial spurs in place on the Leased Premises as of the effective date of this Agreement may not be removed from the Leased Premises without consent of NCRA, which consent will not be unreasonably withheld and in the event any tracks are removed and track materials sold for salvage, the net proceeds (after removal costs) of such sale shall belong to NCRA, or SMART as the case may be, unless otherwise agreed to in writing; provided that NWP may remove sidetracks and industrial spurs it installs, and retain the proceeds from the sale of such materials, without obtaining the prior consent of NCRA.

L. Transfer of Road Inventories

On the effective date of this Agreement, NCRA shall transfer possession and convey by itemized written description all of its equitable interests and title in and to all inventories of (i) track, signal, communication and other roadway materials, parts and supplies of every kind or description, and all other consumable roadway supplies of every kind whatsoever, wherever situated on the Leased Premises or the Option Premises (collectively, the "Roadway Inventories") to NWP and (ii) all freight car, locomotive,

vehicles, maintenance machinery, and roadway equipment parts and supplies to NWP, subject to the following understandings:

1. NCRA may reserve from the transfer any Roadway Inventories acquired for a specific capital project, including without limitation the signal equipment acquired by NCRA in November 2005 , and also any property acquired with bond funds shall be conveyed unless and until any necessary consent of the California Transportation Commission is obtained.
2. Transfer and conveyance of NCRA's title and interests in the Roadway Inventories to NWP is subject to any and all lawful, surviving property rights of every local, state or federal governments, including SMART's passenger rail easement over the Willits Block and of all public agencies, with jurisdiction over the NCRA or SMART and such surviving property rights, if any, (the "Public Property Rights") shall survive transfer of the Roadway Inventories to NWP and shall become an obligation of NWP that is subject to the general indemnification of NCRA and SMART by NWP given in Section XV infra;
3. Subject to reservation of the Public Property Rights described in the immediately preceding subsection, NWP may use the Roadway Inventory only for publicly funded maintenance, rehabilitation, and improvements to the Leased Premises;
4. Any Roadway Inventory applied to Normalized Maintenance or other privately funded improvement projects shall be promptly replaced in kind by NWP; and
5. The signal crossing sets now stored at the Cloverdale Maintenance Facility shall remain at such facility pending a Capital Improvement program for replacement of the Signal Systems as contemplated by the Initial Capital Project described in the Capital Project Agreement at which point the possession of such signal systems shall be delivered to the contractor selected for the Signal Replacement Capital component of the Initial Capital Project.
6. NWP shall maintain, and preserve for inspection by NCRA and/or SMART, for a minimum of three (3) years, records, reports and supporting documentation of the transfer, use and replacement of the Roadway Inventories.

IX. Consent Decree Compliance

- A.** The parties acknowledge that NCRA has provided NWP with a copy of the Consent Decree and Stipulated Judgment entered on July 14, 1999 in the matter of *Hight vs. NCRA*, Mendocino Superior Court Case # CV80240.
- B.** NWP must comply with the following Paragraphs of the Consent Decree: 3-7; 10-18; 20-21; 23; 25-26; 32-33; 37; and 52.
- C.** To comply with Consent Decree Paragraph 22, and prior to commencement of operations, NWP shall provide training to all employees involved in the management or handling of hazardous wastes as required by 22 Cal. Code of Regulations 66265.15(a); deliver to NCRA records of all required employee training specified in 22 Cal. Code Regulations 66265.15(d)(4); provide a complete list of the job titles, job description, job duties and required training for all employees who manage or handle hazardous waste as specified in 22 Cal Code Reg 66265.15(d)(1),(2),(3) along with the name of the individual assigned to each position. NWP shall assign an officer to be responsible for environmental compliance at any maintenance facility operated by NWP, and shall require such officer to attend Modules 1 through 4 of the California Compliance School given by the California Community Colleges Foundation, or such substitute training as NCRA may approve.
- D.** Prior to commencement of any rail operations, NWP shall provide the documents required by Consent Decree Paragraph 24 to NCRA. NWP shall be in compliance with Consent Decree Paragraphs 27-28 as of the date of commencement of operations. Within sixty (60) days after the commencement of operations in or through Willits, NWP shall comply with Consent Decree Paragraphs 29-30.
- E.** In the event that NWP exercises the Option contained herein for the Humboldt Bay Block, NWP shall comply with Consent Decree Paragraph 31.
- F.** Prior to the commencement of operations on any Block of the NWP Line NWP shall meet and confer with NCRA as to the status of compliance with the provisions of this Paragraph. Thereafter, NWP shall provide NCRA

with a written Report upon its compliance with the Consent Decree on the first day of each quarter.

X. Lease Payments Fund

A. Structure of the Fund

1. The purposes of the NCRA/NWP Lease Payments Fund (“Fund”) shall be to accept the required annual lease payments from NWP, to disburse to NCRA the required annual Administrative Payment, to make emergency and other repairs, to make capital improvements to the NWP Line, and for any other purposes, including the payment of the costs of litigation, that are agreed-upon by the parties which are intended to preserve and protect the capability of the NWP Line to provide continuing rail service over all or any portion of the NWP Line.
2. The Fund shall be jointly administered by the Executive Director of NCRA and the President of NWP, or their designees. The NCRA and NWP administrators must agree in writing to any withdrawal from the Fund except for the agreed-upon required Administrative Payment in any year.
3. The primary duties of the joint administrators shall be to authorize withdrawals from the Fund, to safeguard the monies in the Fund, to invest the monies in the Fund in authorized securities, and to maximize the Fund’s earnings from such investments.
4. The Fund shall be held in a segregated account in an established and reputable bank or brokerage firm.
5. The parties agree that all of the Section 130 funds received by NCRA for grade crossing warning system maintenance shall be paid to NWP by NCRA as reimbursement for providing such grade crossing warning system maintenance and are not Lease Payment contributions or withdrawals to be made to or from the Fund.

B. Contributions to the Fund

1. NWP shall make annual Lease Payments in the amount of 20% of its Net Income, as determined by STB and GAAP accounting principles,

commencing in the first year after NWP has generated positive Net Income in excess of \$5.0 million, subject to the Maximum Required Balance.

2. NCRA agrees to grant to NWP the exclusive rights to manage, develop, lease, and otherwise control all of the property owned by NCRA that is not used to provide railroad service. All real estate Lease Revenues received by NWP that are derived from all property owned by NCRA and leased by NWP that is not used to provide railroad service but is leased to others shall be paid to NCRA annually, subject to the maximum annual Administrative Payment requirement, as reduced by the total of all of NCRA's income from other sources (as defined in Subsection C.1).
3. NWP may make advance Lease Payments in any amount to the Fund in any year before NWP has achieved positive Net Income. All such advance Lease Payments shall be credited so as to reduce NWP's required annual Lease Payments in future years, on a dollar-for-dollar basis. Either a portion or all of such advance Lease Payments may be paid to NCRA as Administrative Payments.
4. The Maximum Required Balance that may be maintained in the Fund at the end of any fiscal year is \$20.0 million, adjusted for inflation.
5. When the Maximum Required Balance of \$20.0 million of unobligated funds is held in the Fund as of June 30 of each year, NWP shall not be required to make a Lease Payment for that July 1 – June 30 fiscal year.

C. Withdrawals from the Fund

1. The Fund shall make maximum annual Administrative Payments to NCRA of \$1.0 million per year, adjusted for inflation. The maximum annual Administrative Payment to be paid to NCRA shall be reduced by the total of all of NCRA's income from other sources, including but not limited to its income from real estate leases and fees, easements, crossing fees and charges, proceeds from the sale of its assets, and its boxcar lease, which the parties calculate at this time to total about \$500,000. However, unbudgeted administration fees funded by FEMA or the Governor's Office of Emergency Services, or any other source dedicated for administration of specific projects, shall not cause reduction of the maximum annual Administrative Payment. When the

parties agree that management of NCRA's real estate and crossing leases and fees, its leased box cars, and other sources will be transferred to NWP, then the Fund's obligation to pay to NCRA shall increase to the maximum annual Administrative Payment of \$1.0 million per year, adjusted for inflation as provided in Section D below.

2. The Fund shall distribute the annual Administrative Payment to which NCRA is entitled in monthly amounts that have been agreed upon by the parties.
3. The use of Administrative Payments shall be restricted to payment for those goods and services incurred during the term of this agreement that are used and necessary for the administration of NCRA, have been included in NCRA's budget, and have been approved by the NCRA Board of Directors.
4. When withdrawals from the Fund are made for emergency or other repairs, for capital improvements, or for any other purposes for which the parties expect NCRA to be reimbursed, the parties shall, at the time of the withdrawal, enter into an agreement that specifies the expected dates that reimbursement of NCRA and the Fund shall occur and the business arrangements by which NWP's contributions to the Fund shall be reduced during the time period when reimbursement is pending.
5. Upon termination of this Agreement for any reason, the balance of funds held in the Lease Payment Fund shall be distributed to NWP.

D. Adjustments for Inflation

1. The Maximum Required Balance in the Fund of \$20.0 million and the maximum annual Administrative Payment from the Fund to NCRA of \$1.0 million shall be adjusted for inflation every third year commencing from the date of this Agreement.
2. The adjustment for inflation shall be made using the Rail Cost Adjustment Factor (RCAF-Adjusted), adjusted by the productivity adjustment factor, as determined by the STB and published as a part of the AAR Railroad Cost Indexes.
3. The adjustment shall be calculated for the calendar Base Year 2006 as the arithmetic average of the RCAF (Adjusted) for the four quarters, Q-

1 through Q-4.

4. The adjustment for inflation shall be calculated by comparing the RCAF (Adjusted) for the 2006 Base Year with the RCAF (Adjusted) in every third year. To illustrate, the calendar Year 2009 RCAF (Adjusted) would be compared to the Base Year 2006 RCAF (Adjusted) in order to calculate the adjustment for inflation that would be applicable for the three years 2010 – 2012.
5. At no time shall the application of the adjustment for inflation reduce the Maximum Required Balance below \$20.0 million nor shall it reduce the maximum Administrative Payments below \$1.0 million per year.

E. Renegotiation Related To Diminution Of Public Funding

NCRA and NWP shall use all good-faith efforts to draw down public funds currently allocated for the benefit of capital improvements to the railroad, including, but not limited to, environmental remediation, track repair, signal repair, stabilization of roadway, etc. and to seek such further public funding as may be required to reinstate and improve service on the line. In the event public funding, for whatever reason, is not forthcoming so as to render operation of the NWP Line economically infeasible, or in the event public funds are made available so as to render operation of only some sections of the Line economically feasible, then, upon Notice given to the NCRA Board by NWP, the parties hereto shall renegotiate the provisions of this Section and adjust the payments required to be made by NWP commensurate with such diminution of public funding. No such renegotiation shall be Noticed or take place within the first two years of this Contract.

XI. Business Arrangements as to Capital Projects

A. All Capital Projects

1. Recitals

- (a) Restoration and enhancement of service as contemplated by this agreement will require substantial rehabilitation of the NWP Line, and its signals and structures.

- (b) Rehabilitation will require the integration of functions by the parties who each enjoy different roles and objectives in project implementation:
- (1) NCRA has the responsibility to ensure that public funds are utilized for their intended purpose in an efficient and effective matter, and to ensure the serviceability of the railroad;
 - (2) NWP, as the Operator, is obligated by its Certificate of Convenience and Necessity (as granted by the STB) to provide safe, adequate, and efficient facilities and service;
 - (3) A "Railroad" as defined by the Federal Railroad Administration, NWP is the Operator responsible for complying with all FRA and CPUC safety regulations including 49 CFR Parts 209 through 240, Parts 171.15, 172.7 and 174, and the National Grade Crossing Inventory), as well as all current, applicable California Public Utilities Commission General Orders, including GO 26D, 72-B, 75-C, 95 and 118;
 - (4) As the designated Operator, NWP has the responsibility to ensure that capital projects effectively implement its Business Plan in terms of promoting safe, efficient, and reliable service over the long-term;
 - (5) The contemplated application of public and private funding or financing to implement these responsibilities will require joint project planning, contract award, contractor supervision and inspections, and acceptance of all contractor work;
- (c) It is the intention of the parties to utilize "value engineering" as that term is utilized in Federal Regulations, specifically 49 CFR 18.36(b)(7), to provide for the provision of construction project contract items or tasks at the overall lowest cost.

2. Consultation Between the Parties

- (a) The parties shall consult with each other frequently and prior to the finalization of the definition and scope of each Capital Project ("the Work");

- (b) The parties shall consult with each other prior to the finalization of the sources and uses of funds for such Capital Project;
- (c) The parties shall consult with each other prior to the environmental clearance by NCRA of the scope for each Capital Project;
- (d) The parties shall consult with each other prior to the finalization of the specifications and contractual documents for each Capital Project; and
- (e) The parties shall consult with each other from time-to-time throughout the duration of each Capital Project.

3. Access to NWP Property by Third Parties

Because it controls the movement of trains over and maintains the rail Line, NWP shall exclusively coordinate and oversee the physical access to, and railroad operations on the Line, provided that NCRA and its agents shall have the right to enter upon any portion of the Line or grant entry to NCRA's contractors and agents, subject to compliance with NWP's operating and safety rules in effect. NCRA will grant entry to third parties to enter upon the Line, subject only to compliance with the operating and safety rules in effect and to appropriate indemnities for NCRA and NWP. Third parties shall sign a standard right of entry permit agreement in a form to be provided by the NCRA. NCRA shall provide to NWP reimbursement as provided herein for all requested services, including engineering, flagging, inspection, training and other services rendered in connection with access granted by NCRA to the Line by third parties. Such reimbursement shall be limited to the rates and charges agreed to by NCRA and NWP on an annual basis to uniformly apply for such services, with NCRA and NWP having the mutual duty each year to meet and confer in good faith for the establishment of such reimbursement rates and charges in accordance with the terms and conditions of the Capital Project Support Services provision in this Section.

B. Publicly Funded Capital Projects

1. NWP Approval of Plans

Prior to commencing construction of any publicly funded Capital Project, NCRA shall submit to NWP for its approval, reasonably detailed plans and specifications for such improvements, together with proposed dates upon which NCRA expects to begin and end such construction. NWP shall not unreasonably withhold its consent to such plans and specifications, or construction dates, and shall be deemed to have consented thereto unless NCRA is given written notice disapproving the plans or specifications, or construction dates, within 30 days after such matters have been submitted to NWP. Any disapproval shall set forth in reasonable detail the reasons therefore.

2. All Capital Projects undertaken hereunder shall be accomplished substantially in accordance with the approved plans and specifications and timetable. All work undertaken by NCRA shall be accomplished in a manner which does not interfere in any material way with NWP's passenger and freight service.

3. Supervision of Work

- (a) During the construction of the publicly funded Capital Project, supervision of the project shall be bifurcated.
- (b) NCRA (acting by and through its Executive Director, Project Engineer, and On-Call Engineer) shall have the sole responsibility for ensuring compliance with the provisions of all contract conditions and obligations, including compliance with contract specifications, and including, but not necessarily limited to:
 - (1) Compliance with permit conditions;
 - (2) Compliance with the Consent Decree;
 - (3) Compliance with any applicable Fund Transfer Agreements;
 - (4) Coordination with other governmental entities with contractual jurisdiction over the Work, including but not limited to SMART;
 - (5) Defining the final project scope and content to be submitted to the funding agencies;
 - (6) Writing project specifications;