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January 31, 2007

Mitch Stogner
NCRA
419 Talmage Road, Ste. M
Ukiah, CA 95482

RE: Review of NCRA/NWPRC Lease Agreement

Dear Mitch:

Pursuant to our recent discussions, set forth below is our analysis regarding the proposed North Coast Railroad Authority ("NCRA") and Northwestern Pacific Railroad Company ("NWPRC") Lease Agreement ("Lease Agreement").

I. Key Points and Procedural Issues

A. *Review By SMART Operations Committee*

As I mentioned in our telephone discussion on January 18th, at its January Board Meeting, SMART established an Operations Committee. Our plan is to provide the Operations Committee with our comments, and NCRA's response to our comments, at an upcoming Committee meeting, and to receive direction. In advance of the Operations Committee, and following your review of this letter, we would like to meet with you to discuss the agenda and presentation for that committee meeting. Once the Operations Committee has completed its review and analysis of the Lease Agreement, we anticipate that it will then make a recommendation to the SMART Board of Directors. The SMART Board of Directors must ultimately approve the Lease Agreement.

B. *Approval of Lease Agreement by NCRA*

It is our understanding that NCRA takes the position that it approved the Lease Agreement at its September, 2006 Board meeting. We are aware of several NCRA press releases to that effect. However, in reviewing the NCRA Board agenda for September, the Lease Agreement was not explicitly called out. The agenda merely indicates an agreement with NWPRC is to be considered and that staff's recommendation is for approval of the agreement. Our concern is that opponents to rail service may argue when SMART acts to approve the Lease Agreement that NCRA did not properly notify the public and provide the public with a fair opportunity to comment on the Lease Agreement prior to NCRA's approval of the Lease Agreement.

C. *Environmental Review*

The September, 2006 NCRA Board meeting did not appear to indicate that the NCRA Board had considered and approved or certified a mitigated negative declaration or environmental impact report prior to consideration or approval of the Lease Agreement. The Lease Agreement appears to qualify as a "project" under CEQA (see Public Resources Code §21065) ("Project" means an activity which may cause either a direct physical change in the environment, or a reasonably foreseeable indirect physical change in the environment, and which is . . . (c) An activity that involves the issuance to a person of a lease . . . or other entitled for use by one or more public agencies."). In approving the Lease Agreement, SMART will also have to comply with CEQA; and, therefore, SMART will need to have before it the environmental document considered by the NCRA Board when it approved the Lease Agreement. To the extent that NCRA is claiming a categorical or other type of exemption, such that a mitigated negative declaration or EIR is not necessary, we will need further explanation. NCRA's position regarding environmental compliance must also be presented to the SMART Board when it considers the Lease Agreement.

D. *Operating Agreement*

Because the Lease Agreement contemplates renegotiation of the Operating Agreement and specifically calls out provisions to be renegotiated, it appears that the Operating Agreement should be renegotiated immediately and prior to approval of the Lease Agreement.

II. *Comments on Specific Provisions*

A. *Conveyance of Premises*

On page 6 of the Lease, paragraph E, it lists those interests excepted from the conveyance from NCRA to NWPRC. More specifically, subparagraph E(2) identifies the "Grant of Easement for Passenger Rail Operations - Sonoma County." Subparagraph E(2) fails to identify the Grant of Easement provided by NCRA to SMART for Mendocino County.

B. *Term - Long-Term Lease*

The Lease Agreement appears to contemplate a potentially long-term agreement with NWPRC. The Lease Agreement provides for an initial five year term; however, the Lease Agreement provides for options to extend the Lease Agreement for 20, 25, 40 and 99 years. The longer extensions, especially the 99 year term, are of concern to SMART. First, the Lease Agreement does not provide for any further approval by NCRA or SMART for these options to be exercised. Second, the long term leases have the potential to significantly impact the working relationship between SMART and NCRA. For example, the Lease Agreement appears to contemplate an almost wholesale transfer of NCRA's rights and obligations to NWPRC. In a number of provisions, NWPRC has been designated the right to exclusively negotiate with SMART in regard to a Coordinating Agreement and a new Operating Agreement. Rather than SMART staff and SMART Board members working directly with NCRA

staff and NCRA Board members, it appears that SMART will now be working and negotiating directly with NWPRC. We believe the better approach is for NCRA to continue to maintain its authority to work with and negotiate with SMART directly on the Coordination and Operating Agreements.

At page 7, paragraph E, the Lease indicates that the 99 year term lease may be exercised within the initial term. What is considered the commencement date of the initial term? When the contract was approved by the NCRA Board in September 2006 or, when the SMART Board authorizes the lease?

C. *Nature of Conveyance*

The Lease Agreement is entitled as a "lease"; however, as to the Easement Premises, the Lease Agreement categorizes the transfer as an "assignment." It's possible, as written that the Lease Agreement could be interpreted as a permanent transfer of the easement rights to NWPRC. The Lease Agreement should be revised to indicate that the transfer is a lease of the easement rights, or that the assignment is only for the term of the lease and any easement rights terminate upon termination of the lease.

D. *Rail Freight Operations*

At page 9, paragraph 1, the Lease appears to imply that NCRA and NWPRC have the ability to further grant rights to other operators upon each party's consent. The Lease should be revised to also require SMART's consent as to the Easement Premises.

E. *Rail Passenger Service*

At page 10, the Lease appears to grant to NWPRC the "sole and exclusive" use of the Leased, Easement and Option Premises for Passenger Service, as previously defined. Pursuant to the easements granted by NCRA to SMART, SMART also has the right to use the Easement and Leased Premises for rail passenger excursion and regional intercity passenger service, in addition to commuter rail service. Accordingly, NCRA has the right to grant to NWPRC the ability to use the Leased and Easement Premises for rail passenger excursion and regional intercity passenger service, but NCRA does not have the ability to grant to NWPRC the "sole and exclusive right" to use those premises.

F. *Risk Management and Indemnity*

The Lease Agreement contains an indemnity provision and list both SMART and NCRA as being indemnified by NWPRC. However, the language of section XVA fails to mention claims against SMART. This appears to be an oversight.

III. *Miscellaneous Issues*

The following are additional issues that need to be discussed. Some of the issues may be redundant of what is discussed above.

A. At page 4, section S, SMART is incorrectly referred to as "Rapid" Transit.

SMART means Sonoma-Marín Area Rail Transit District.

B. At page 5, section A, the Lease Agreement indicates that NCRA "assigns" all of its interest in the Easement to NWPRC. As referenced earlier, the Lease Agreement should be revised to indicate that NCRA "leases" the Easement Premises or, in the alternative, NCRA assigns the Easement Premises to NWPRC for term of the lease.

C. At Page 6, section D, the Lease Agreement provides that NCRA and NWPRC may agree in writing to lease the premises to others. This paragraph should be clarified that in order to lease or assign the Easement Premises to others, further approval from SMART is required.

D. At Page 6, section E(2), the Lease Agreement only refers to the Grant Easement for Sonoma County. It should also reference the Grant Easement for Mendocino County.

E. At Page 9, section B(1), the Lease Agreement provides that NCRA and NWPRC may grant rights to third parties upon written consent of the other Party. The Lease Agreement should be revised to indicate that in order to grant rights to the Easement Premises to third parties, further approval from SMART is required. Additionally, the term "Party" is not defined.

F. At page 9-10, section B(5), the Lease Agreement indicates that NWPRC shall act as NCRA's agent to negotiate the Coordination Agreement. We recognize that NWPRC should be allowed to participate in the discussions with SMART regarding a Coordination Agreement. However, we believe it is more appropriate that NCRA remain the lead party to negotiate the Coordination Agreement in regard to freight operations. Similarly, at page 10, section B(7) NCRA should remain as the lead party in re-negotiating an Operating Agreement.

G. At page 13, section VIII(A)(2), the Lease Agreement contains language that "NCRA shall independently, and with the solicited assistance of SMART, seek to obtain potentially available public funds for rehabilitation, restoration and continuation of the level of utility of the Easement, Lease and Option Premises." Similar language is contained in the Operating Agreement. Though similar, it is not identical. This sentence should be revised to mirror the language contained in the Operating Agreement.

H. At page 17, section H(2), the Lease Agreement appears to contain an ambiguity. It seems to imply that SMART must obtain NWPRC's approval in order to obtain access to the Easement Premises. During our conversation on January 18, 2007, you or Chris Neary indicated that this tracks the language found in the Operating Agreement. Upon review of the Operating Agreement, we were unable to find that provision. This needs to be verified. Is it that the Lease Agreement requires approval by NWPRC to inspect improvements made by NWPRC or does the Lease

Agreement actually require approval by NWPRC at any time that SMART seeks access to its own property.

I. At page 18, section L, the Lease Agreement again contains language which appears to state that all equitable interests and title shall be transferred to NWPRC. This section appears to be limited to the Leased and Option Premises. Notwithstanding, is it NCRA's intent to actually transfer "title" to these properties, or is it NCRA's intent to lease these interests to NWPRC?

J. At page 19, section L(6), the Lease Agreement contains a document retention provision which is limited to 3 years. Because SMART, NCRA, and now NWPRC are all subject to possible claims or lawsuits in regard to any failure to maintain public property, it is prudent to provide for a longer document retention period in case any of the parties need to establish in civil matter that maintenance was performed on the rail line and the extent of the maintenance. A 10 year document retention policy may be more appropriate. And, in particular, as for insurance policy documents, the document retention policy should be longer.

K. Lastly, the Operating Agreement requires that NCRA perform trash and waste abatement. The Lease Agreement currently does not address this issue.

IV. Renegotiation of the Operating Agreement

As mentioned previously, in light of the fact that the Lease Agreement contemplates significant re-negotiation of provisions in the Operating Agreement, including but not limited to provision pertaining to maintenance, revenues, and payment of trackage fees, it may be more appropriate to begin discussing those matters immediately and delaying final approval of the Lease Agreement until the terms of the Operating Agreement are finalized.

As indicated in the Lease Agreement, NCRA has identified a number of issues that it believes need to be revisited. At this point, SMART also has a number of issues it would also wish to discuss. In particular, it may be important to begin discussing the possible situation in the future in which freight is operating, but SMART needs to make improvements to the rail line in order to raise the level of the rail line to support commuter passenger rail services. It may be appropriate to consider that scenario now and consider how the parties will address that issue in the future.

V. Conclusion

In conclusion, thank you for providing us with the opportunity to comment on the proposed Lease Agreement. As mentioned above, it is our plan to provide these comments, and your response to comments, to our Operations Committee in mid-

Mitch Slogner
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February. The SMART Board of Directors has consistently supported the reintroduction of freight service on the NWP. All of SMART's planning, preliminary engineering and environmental analysis have assumed freight service. We look forward to working with you on these matters to resolve them as expeditiously as possible.

In the meantime, if you have any questions, please do not hesitate to contact me.

Sincerely,



Lillian Hames
General Manager
Sonoma-Marín Area Rail Transit District

Cc: Mike Kerns, SMART Chairperson
Charles McGlashan, SMART Co-Chairperson
Deborah Fudge, SMART Board Member
Operations Chairperson
Greg Dion, Sonoma County Deputy County Counsel
SMART Legal Counsel