

**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 Indemnatee 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;

- (7) Soliciting bids;
- (8) Awarding contracts and issuing the Notice to Proceed to the contractor;
- (9) Overseeing contractor construction;
- (10) Managing/monitoring detailed project documentation;
- (11) Preparing reimbursement requests to public agencies, with supporting documentation;
- (12) Monitoring public agencies' reimbursement process; and
- (13) Making payments to contractors.

(c) NCRA shall consult with the NWP as to:

- (1) Project concept
- (2) Coordination with regulatory agencies with authority to approve project performance; and
- (3) Consideration of the qualifications, reputation, and capabilities of its proposed contractors.
- (4) Consideration and approval of contractor requests for Change Orders; and
- (5) Consideration and approval of contractor requests for interpretation of the construction contract or its specifications.

3. Acceptance of Work

- (a) NCRA and NWP shall have joint responsibility for final inspections of the work;
- (b) NCRA shall have the sole responsibility for the issuance of a Notice of Completion and the final acceptance of the work; and
- (c) NWP shall have the sole and exclusive responsibility to accept into railroad service any completed work. NWP may reject any completed work that does not comply with its construction standards, is of poor quality materials, or does not comply with NWP, FRA, or CPUC safety standards.

4. NWP Invitation to Bid

NWP may be invited to submit bids for construction work in accordance with project specifications, so long as NWP has not participated in the preparation of such project specifications. Said work may include, but is not limited to: engineering services, project planning and scoping, track inspection, cross-tie replacement, grade crossing repairs, track surfacing, rail line maintenance, switch tie replacements, rail replacements, turnout/crossover renewals, and the like. Unless invited to do so by NCRA, NWP may not participate in bidding for any construction work contemplated herein directly by it or indirectly through any related entity.

5. Public Funding Requirements

The following provisions shall apply to any such work awarded to NWP under Section XI utilizing Traffic Congestion Reduction Program funds:

- (a) All work shall be accomplished in accordance with the applicable provisions of Public Utilities Code, the Streets and Highways Code, the Government Code and other applicable statutes and regulations.
- (b) Project related travel and subsistence and travel expenses of NWP claimed for reimbursement or as local match credit shall not exceed rates authorized to be paid State employees under current State Department of Personnel Administration (DPA) rules.
- (c) NWP shall establish and maintain an accounting system and records that properly accumulate and segregate incurred project costs and matching funds by line item for the project together with the cost of administering the project. In doing so NWP shall conform to Generally Accepted Accounting Principles (GAAP) and enable the determination of incurred costs at interim points of completion and provide support for reimbursement payment vouchers or invoices. NWP shall retain all accounting records and supporting papers for a minimum of three years from the date of final payment from the State, and such records shall be held open to inspection and audit by representatives of the State, the California State Auditor, and upon request copies of such records

shall be furnished by NWP to the NCRA, the State, or both of them.

- (d) NWP agrees that the Contract Cost Principles and Procedures, 48 CFR, Federal Acquisition System, Chapter 1, Part 3 et seq. shall be used to determine the allowability of individual project costs items, and that NWP shall comply with Federal administrative procedures in accordance with 49 CFR, Part 18, Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments.
- (e) In the performance of such work NWP shall not unlawfully discriminate, harass or allow harassment, against any employee or applicant for employment because of sex, race, color, ancestry, religions creed, national origin, physical disability (including FUV and Aids, mental disability, medical condition, including cancer, age, marital status of family care leave. Furthermore, NWP shall insure that the evaluation and treatment of employees and applicants for employment are free from such discrimination and harassment. NWP shall comply with the provisions of the Fair Employment and Housing Act, Government Code section 12900 et seq., and the applicable regulations promulgated thereunder including but not limited to California Code of Regulations, Title 2, Section 7285.0 et seq.
- (f) The applicable regulations of the Fair Employment and Housing Commission implementing Government Code Section 12900(a)-(f) and the provisions of California Code of Regulations, Title 2, Chapter 5, Division 4 shall be deemed incorporated into any such contract by reference and made a part thereof as if set forth therein in full.
- (g) NWP shall give written notice of its obligations under this paragraph to labor organizations with which it has a collective bargaining agreement or other agreement.
- (h) NWP shall permit access to all records of employment, employment advertisements, application forms, and other pertinent data and records by the State Fair Employment Practices and Housing Commission, or any other agency of the State of

California designated by the State for the purpose of investigation to ascertain compliance with the provisions hereof.

- (i) NWP shall pay all workers employed on the project not less than general prevailing wage rates predetermined by the Department of Industrial Relations.
- (j) NWP shall include the provisions of subparagraphs A-I inclusive in all contracts with any subcontractors performing work for the project.

For any projects funded by the federal government, including without limitation, the ISTEA program, all of the foregoing requirements will be applicable, plus any requirements peculiar to the federal program requirements. For such projects, where the provisions of TCRP conflict with the federal requirement, the federal requirement shall prevail.

6. NWP Capital Project Support Services

(a) Definition of Capital Project Support Services

NWP shall perform Capital Project Support Services. NWP shall be employed either as a contractor to NCRA or as a sub-contractor to NCRA's On-Call Engineer and shall be compensated for its Project Support Services by the contracting entity. Such Project Support Services shall be furnished on an as-needed basis in accordance with Work Directives issued by NCRA. A Work Directive is an agreed-upon document issued by NCRA that requires the NWP to perform specified Project Support Services. Ongoing projects, other than ordinary maintenance, to improve and modernize the NWP's signal and communications system as well as track work, civil work, engineering, and any other work on the Line may require such Project Support Services. A representative listing of Project Support Services is as follows:

- (1) Providing engineering services that cannot be provided solely by NCRA's On-Call Engineer which are judged by NCRA to be of value in any aspect of a Capital Project, with specific reference to compliance with the requirement to use value engineering;

- (2) Providing engineers, managers, and technical specialists to assist in project planning and scoping, construction staging and operations, and managing all aspects of construction work windows;
 - (3) Furnishing flagmen and inspection and repair crews for construction projects;
 - (4) Providing specialized rail equipment with qualified operators to support construction work;
 - (5) Identifying, marking and performing minor protection and relocation of underground signal and communications cables;
 - (6) Providing access to signal house, signal case, and all other signal facilities for outside contractors;
 - (7) Providing inspection, minor repair, and defect correction services;
 - (8) Performing minor track, signal, bridge and station projects;
 - (9) Providing training, testing, and rules qualification to NCRA staff and other NCRA contractors;
 - (10) Organizing and coordinating site specific work plans and performing inspection of contractor work sites, and performing inspections of contractor work in progress;
 - (11) Furnishing train and engine crews and locomotives to operate work trains; and
 - (12) Assuring that up-to-date signal plans, as provided by NCRA, are in all signal equipment shelters.
- (b) Compensation
- (1) Mobilization/Start-Up Regarding Support Services. NCRA will pay NWP its verifiable and actual Direct Costs incurred by NWP which, to the satisfaction of the NCRA, have been

adequately documented as costs associated with NWP's approved Mobilization, Transition, and Start-up Plan with regard to Project Support Services. In addition to reimbursement of its Direct Costs, the NWP shall receive payment of its corresponding General and Administrative Overhead costs, plus a reasonable Mobilization Fixed Fee to be negotiated on a project-by-project basis.

- (2) Work Directives. NCRA may issue a Work Directive to the NWP at any time, and NWP shall provide the Project Support Services specified by the Work Directive on an on-call basis. NWP shall establish reasonable rates for the provision of FRA qualified train crews, work train equipment (cars and locomotives) where required, dispatching services, and flagging and other construction Project Support Services. Such rates shall be equally available to all potential construction contractors for the provision of like services. Unless specifically negotiated by NCRA and NWP to the contrary, NWP shall be compensated for each Work Directive as set forth below:

- (a) Labor, Materials, Equipment, and Incidental Costs. For each Work Directive, NWP will be paid for its reasonably incurred labor costs (including fringe benefits and injury costs), materials, equipment and incidental costs at the unit rates set forth in NWP's Proposal for the Work Directive.

NWP may use consultants, and to the extent that NWP utilizes consultants to provide Project Support Services, their allowable total hourly rates shall be approved by NCRA and shall not exceed the total hourly rates for comparable classifications of NCRA's On-Call Engineering personnel, including all components of direct labor, fringe benefits, overhead and general administration, and fixed fees.

The maximum rental or lease rate for equipment shall not exceed the monthly ownership and hourly operating costs provided in the Blue Book for Railroad Equipment, most current edition, or the prices furnished

in NWP's Proposal for the Work Directive, whichever is less, provided, however, that in no event will NWP be required to furnish equipment hereunder at prices which do not, at a minimum, equal NWP's Direct Costs of such equipment, plus applicable General and Administrative Overhead Costs and Fixed Fees.

When utilizing the *Blue Book*, the hourly ownership rate shall be determined by utilizing the appropriate monthly rate and dividing by 176. Added to this hourly rate will be the estimated hourly operating cost plus the rate for any attachments. The rate adjustment table will be applied for machine age differences; for standby rates (where equipment is on the job and available for work but not working), the rate will be established as the adjusted monthly rate multiplied by 0.65 and assuming not more than 176 hours worked per month. Rental time will not be allowed while equipment is inoperative due to breakdowns.

During the process of each Work Directive, the NWP shall carefully account for and monitor its incurred costs in the performance of the work.

For each Work Directive, the NWP shall keep full and complete records of the cost of that work and shall submit those records to the NCRA on a monthly basis. NWP's failure to maintain daily accounting records shall be a valid basis for NCRA's rejection of NWP's request for additional compensation.

NCRA, in its sole discretion, may decide that it would be in the best interests of both NCRA and NWP to arrange for NWP to perform work specified by a Work Directive on a stipulated sum or unit price basis. In such event, the parties will conduct good faith negotiations in an attempt to reach a mutual agreement concerning a fair and equitable means of compensation for the Work Directive at issue.

- (b) General and Administrative Overhead Costs. In addition to compensation for labor, materials, equipment, and incidental costs reasonably incurred with respect to each Work Directive, NCRA will pay NWP for its General and Administrative Overhead Costs associated with such expense.

General and Administrative and Overhead costs represent those general functions which are not directly identifiable to provision of the Project Support Services, but are, nevertheless, necessarily incurred by NWP for the provision of the Contract Services. Such general functions may include but are not limited to financial and accounting, contract administration, information systems, insurance, crew dispatching, operations and maintenance management, and railroad liaison.

Costs included in the General and Administrative and overhead category shall be permitted as allowed under Contract Cost Principles and Procedures, 48 CFR Federal Acquisition Regulations System, Chapter 1, part 31 et seq. Any costs for which payment has been made to NWP that are determined by subsequent audit to be unallowable under 49 CFR Part 18, "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments," are subject to repayment by NWP to NCRA.

- (c) Fixed Fee Per Work Directive. For each Work Directive, NCRA will pay a Fixed Fee for the work covered by the Work Directive. The Fixed Fee percentage shall not exceed the Fixed Fee percentage negotiated with NCRA's On-Call Engineer, and shall be subject to concurrence by any and all of the agencies from which NCRA receives funding for projects carried out under the Work Directive process described herein. In cases where such concurrence is not forthcoming, NCRA and NWP will negotiate a Fixed Fee which complies with any funding agency's requirements or directive related thereto.

Except as provided for immediately above, the percentage for Fixed Fee shall remain constant as applied to the compensation for Project Support Services during the entire term of the Work Directive.

- (d) Extra Work. For Extra Work that is not covered by the above methodology, NWP shall be compensated either on a cost-plus-fixed fee, a not-to-exceed ceiling, or a Fixed Price basis, at the sole discretion of NCRA.

C. NWP Funded Capital Projects

1. NCRA Approval of Plans

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

NWP shall, in submitting request for approvals, designate any such portion of the work it considers to be a capital project to be paid for by the Lease Payment Fund and/or for which it would be entitled to reimbursement under Subsection B of this Section. Within thirty days of the completion of the work, NWP as a condition for receiving either payment from the Lease Payment Fund or reimbursement pursuant to Section B shall certify the costs incurred for such project in accordance with GAAP.

2. Supervision of Work

- (a) During the construction of the NWP funded Capital Project, supervision of the project shall be bifurcated.

- (b) At the request of NWP, NCRA (acting by and through its Executive Director, Project Engineer, and On-Call Engineer) shall diligently and expeditiously execute on NWP's behalf any of its responsibilities that cannot be assumed by NWP for ensuring compliance with any of the public agency related 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) Coordination with other governmental entities with contractual jurisdiction over the Work, including but not limited to SMART.
- (c) NWP shall have the sole responsibility for:
 - (1) Defining the final project scope and content;
 - (2) Writing project specifications;
 - (3) Soliciting bids;
 - (4) Awarding contracts and issuing the Notice to Proceed to the contractor;
 - (5) Overseeing contractor construction;
 - (6) Managing/monitoring detailed project documentation; and
 - (7) Making payments to contractors.
- (d) NWP shall consult with the NCRA as to:
 - (1) Project Concept
 - (2) Coordination with regulatory agencies with authority to approve project performance; and
 - (3) Consideration of the qualifications, reputation, and capabilities of its proposed contractors.
 - (4) Consideration and approval of contractor requests for change orders; and

- (5) Consideration and approval of contractor requests for interpretation of the construction contract or its specifications.

3. Acceptance of Work

- (a) NCRA and NWP shall have joint responsibility for final inspections of the work;
- (b) NWP shall have the sole responsibility for the issuance of a Notice of Completion and the final acceptance of the work; and
- (c) NWP shall have the sole and exclusive responsibility to accept into railroad service any completed work. NWP may reject any completed work that does not comply with its construction standards, is of poor quality materials, or does not comply with NWP, FRA, or CPUC safety standards.

D. Jointly Funded Projects

For all capital projects that are jointly funded by NWP with private funds and by NCRA with public funds, the parties agree to assign rights and obligations in accordance with the provisions of this section.

XII. Termination

A. This Lease Agreement may be terminated as follows:

1. By NWP:

- (a) Upon not less than forty-five (45) days' written notice to NCRA, following NWP's obtaining all necessary regulatory approvals or exemptions to permit NWP to discontinue rail freight operations in accordance with Section VII.
- (b) Pursuant to Section XIII; and

2. By NCRA pursuant to Section XIII.

- B. In the event of expiration or termination of this Lease Agreement, NWP shall vacate the Leased Premises in an orderly manner and shall provide all hard copy and electronic data and documentation related to the leased premises such as property lease information, equipment inventory, and pending design or construction documents.
- C. NWP may cancel this Lease Agreement at any time upon not less than forty-five (45) days' prior written notice to NCRA, following NWP's obtaining all necessary regulatory approvals or exemptions to permit NWP to discontinue rail freight service operations if at anytime during the Term hereof, or any extension of the Term, NCRA agrees to the assignment, sale, conveyance, or transfer of NCRA's ownership, control, property or leasehold interests in the Premises to any third party without NWP's prior written consent.
- D. In the event NCRA terminates this Agreement, NCRA shall authorize the disbursement to NWP from the Lease Payment Fund and from other sources of an amount up to or equal to NWP's adjusted tax basis, including interest at the legal rate of interest for public entities, of all unrecovered investment in the Land, Track and Track Support Structures made by NWP on all or any portion of the NWP Line at NWP's expense, provided such expenditures are properly capitalized as leasehold improvements for Federal income tax purposes pursuant to Sections 1012 and 1016 of the Internal Revenue Code of 1966, as amended (hereinafter, the Code). For purposes of the preceding sentence, NWP's adjusted tax basis shall be determined at the time of the expiration or termination, as applicable, of this Amended Lease Agreement and shall be calculated under Section 1011 of the Code, taking into account all cost recovery elections and adjustments to tax basis legally permissible under the Code. However, NCRA's obligation will be limited by the amount on deposit in the Lease Payment Fund, in addition to the amount from any other source reasonably available to the NCRA including but not necessarily limited to contractually agreed payments by a successor operator.
- E. In the event of Termination, NWP shall at the written request of NCRA file within ten (10) days with the STB a petition, or Notice of Exemption, or such other filing as necessary, to transfer any certificate of Convenience and Necessity held by NWP upon any portion of the Northwestern Pacific Railroad Line to NCRA, or its designee to which the agreement has terminated. This obligation is unconditional to any other provision of this agreement and may be specifically enforced at the option of North Coast

Railroad Authority in any court of competent jurisdiction, notwithstanding any provisions in this agreement for arbitration. This provision shall survive the termination of this Agreement.

XIII. Events of Default

A. The following shall be Events of Default:

1. NWP fails to make any payment to NCRA when due, and such failure continues for thirty (30) days following written demand therefore by NCRA.
2. NWP fails: (i) to provide common carrier rail freight service, or (ii) to perform in any material respect any other provision of the Lease Agreement after receipt of written notice of such breach from NCRA and fails to commence to cure such default within forty-five (45) days, or, once commenced, fails to use due diligence to complete the cure.
3. NCRA fails to (i) to promptly utilize its best efforts to commence, continue and complete rehabilitation of the Premises and to restore the Utility Levels or (ii) to perform in any material respect any provision of this Lease Agreement, and, after receipt of written notice of such breach from NWP, fails to commence to cure such default within sixty (60) days, or once commenced, fails to use due diligence to utilize its best efforts to complete the cure.
4. NCRA fails to timely cure any breach or default of any agreement or instrument to which the NCRA is a party or obligee that has, or will have, a material adverse effect on the ability of NWP to operate or maintain the railroad.

B. NWP shall be able to cure an Event of Default by remedying the Event of Default within the respective notice period stated herein.

XIV. Remedies

A. Dispute Resolution

NCRA agrees in good faith to attempt to resolve amicably, without litigation, any dispute with NWP arising out of or relating to this Lease Agreement. When agreement has not been reached by NCRA and NWP on any issue, the disagreement shall be promptly mediated by subcommittees of the NCRA and NWP Boards of Directors consisting of not more than three members each. In the event that any dispute cannot be resolved through direct discussions between such NCRA and NWP Board subcommittees, the Parties agree to endeavor to settle the dispute by third party mediation. Either party may make a written demand for mediation, which demand shall specify the facts of the dispute. The matter shall be submitted to a third party mediator who shall hear the matter and provide an informal, nonbinding opinion and advice in order to help resolve the dispute. The mediator's fee shall be shared equally by the parties.

B. Arbitration

If the dispute cannot be resolved through mediation, the matter may be submitted to binding arbitration, in which event all expenses, consultant's fees, witness fees, court costs and attorneys' fees will be paid to the prevailing Party. The arbitration shall be conducted in such manner as the parties may agree in a written arbitration agreement developed by the parties within thirty days of the conclusion of mediation. In the event that the parties do not reach a written arbitration agreement within such thirty days the following arbitration provisions shall apply:

1. Any controversy or claim arising out of or relating to this Agreement is to be arbitrated, including, without limitation, any controversy or claim sounding in tort, (subject to the claim presentation provisions of the California Tort Claims Act), except that the parties shall adjudicate any controversy or claim within the jurisdiction of the Surface Transportation Board, or any successor adjudicatory body with jurisdiction over the railroad industry, and except that the parties shall adjudicate any controversy for which equitable relief is sought.
2. The parties agree to submit any arbitable controversy to arbitration administered by the American Arbitration Association under its Commercial Arbitration Rules.

3. The arbitration is to be conducted before a single arbitrator who the parties shall jointly select within sixty (60) days following the completion of mediation. If the parties are unable to agree upon the arbitrator, either party may request the American Arbitration Association to select the arbitrator. Prior to the commencement of hearings, the appointed arbitrator must provide an oath of impartiality.
4. Either party is entitled to seek from any court of competent jurisdiction any interim or provisional relief that is necessary to protect the rights or property of that party. The interim relief is to remain in effect until the arbitration award is rendered or the controversy otherwise resolved. By doing so, the party does not waive any right or remedy under this Agreement.
5. In rendering an award, the arbitrator is to determine the rights and obligations of the parties according to the substantive and procedural laws of the State of California.
6. Each party shall submit to any court of competent jurisdiction for purposes of the enforcement of any award, order or judgment. Any award, order or judgment pursuant to arbitration is final and may be entered and enforced in any court of competent jurisdiction.
7. Either party has the right to appeal the arbitration award to an appellant arbitrator by filing with the AAA, no later than twenty (20) days after the transmittal of the award a written brief, not to exceed thirty (30) pages, stating the reason the arbitration award should be reversed or modified. The opposing party shall file with the AAA and serve on the appealing party, no later than twenty (20) days after service of the appeal brief, an opposition brief not to exceed thirty (30) pages. The Appellant may file with the AAA and serve on the opposing party, a reply brief no later than seven days after service of the Opposition Brief, not to exceed five (5) pages. The AAA is to appoint the appellate arbitrator who is to be a retired judge of a court of record in California. The AAA shall make the appointment directly without submission of lists of proposed appellant arbitrators. Either party may request oral argument, which must be conducted no later than 14 days following the submission of the final brief. The appellate arbitration is to be based only on the record of the arbitration hearing and oral argument, if any.

The Appellate Arbitrator is to render a written decision no later than twenty (20) days after the appeal is submitted for decision. The appellate decision may be a final decision, or it may be a final decision or it may affirm, reverse, modify or remand for further proceedings by the initial arbitrator, in which case such proceedings shall be completed within twenty (20) days. However, the reversal, modification or remand may only be on one of the following grounds: Any ground specified in 9 U.S.C. 10 or 9 U.S.C. 11; the award contains material errors of applicable law; the award is arbitrary or capricious.

C. Other Rights and Remedies

If an Event of Default shall have occurred, the non-breaching Party (to the extent permitted by and subject to compliance with any mandatory requirements of applicable law then in effect) shall have the following rights and remedies, in addition to all other remedies at law or in equity, and none of the following, whether or not exercised by the non-breaching Party, shall preclude the exercise of any other right or remedy whether herein set forth or existing at law or in equity:

1. If NCRA is the non-breaching Party, NCRA may terminate this Amended Lease Agreement by giving Lessee notice in writing at any time as provided in Section XII. Upon termination of this Lease Agreement pursuant to this Section and obtaining the necessary regulatory authority or exemption, NWP shall surrender to NCRA the Premises as set forth herein.
2. If NCRA is the non-breaching Party, NCRA may maintain NWP's right to possession, in which case this Lease Agreement shall continue in effect whether or not NWP shall have abandoned the Premises. In such event, NCRA shall be entitled to enforce all of NCRA's rights and remedies under this Lease Agreement, including the right to recover Lease Payments payable under this Lease Agreement as they become due hereunder.
3. If an Event of Default shall have occurred, anything in this Lease Agreement to the contrary notwithstanding, upon obtaining the necessary regulatory authority or exemptions, NCRA may enter the Premises and assume all common carrier duties (including but not limited to the provision of freight service and dispatching), regardless of whether or not this Lease Agreement has been terminated.

4. If NWP is the non-breaching Party, NWP shall have the right to terminate this Lease Agreement pursuant to Section XII. Upon termination of this Lease Agreement pursuant to this Section and obtaining the necessary regulatory authority or exemption, NWP shall surrender to NCRA the Premises as set forth herein.
5. If NWP is the non-breaching Party, NWP shall have the right to withhold payment of Lease Payments without loss of possession of the Premises, until the breach has been cured and to collect from the NCRA, or any other party of interest, the costs and damages incurred by or on behalf of them by suit or suits or other proceedings brought from time to time on one or more occasion to enforce the terms and conditions of this Lease Agreement without NWP being obligated to wait until expiration of the Term, or if this Lease Agreement is terminated, the date on which such expiration would have occurred.

XV. Indemnity and Insurance

- A. It is the express intent of NCRA and NWP that NWP shall protect, defend, hold harmless, and indemnify NCRA and SMART from and against any and all demand, liability, damage, expense, cost, claim or suit, including reasonable attorney's fees (collectively, "Liability"), incurred by or assessed against NCRA, its agents, employees, affiliated companies and its successors and assigns on account of injuries, death, or property loss or damage arising from (i) use, operation or maintenance of the Premises, (ii) failure by NWP to perform any of its covenants under this Lease Agreement, (iii) failure of any representation or warranty of NWP under this Lease Agreement to be true and correct in all material respects as of the date made; except, however that all Liability, including Liability for any injury, death, or property loss or damages arising in connection with hazardous substances or environmental conditions shall be governed by the provisions of Subsection E of this Section below.
- B. It is the express intent of NCRA and NWP that NCRA shall protect, defend, hold harmless and indemnify NWP from and against any and all demand, liability, damage, expense, cost, claim or suit, including reasonable attorneys' fees (collectively, "Liability"), incurred by or assessed against NWP, their agents, employees, affiliated companies and

successors and assigns on account of injuries, death, property loss or damage (i) occurring prior to the Commencement Date and occurrences following NWP's vacation of the Premises, (ii) operations, construction or maintenance relating to passenger service during the term of this lease Agreement (except to the extent that such injuries, death, property loss or damage are caused by the willful neglect of NWP, its agents, employees, affiliated companies, successors or assigns), (iii) failure by NCRA to perform any of its covenants under this Lease Agreement, and (iv) failure of any representation or warranty of NCRA under this Lease Agreement to be true and correct in all material respects as of the date made, except, however, that all Liability, including Liability for any injury, death, or property loss or damages, arising in connection with hazardous substances or environmental conditions shall be governed by the provisions of Section E below.

- C. The foregoing notwithstanding, except in the instance of tortuous interference with the NWP's quiet enjoyment of the Premises by NCRA, neither Party shall have any claim against the other Party for interruption of or delay to such Party's business or for loss of profit or income. NWP shall have no cause of action against NCRA for the condition of the Leased Premises.
- D. Each Party hereto covenants and agrees that its obligations under this indemnity will be fulfilled whether or not such Liability arises during the time that this Lease Agreement is in effect or thereafter. The covenants of indemnity contained in this Lease Agreement shall continue in full force and effect notwithstanding the full payment of all sums due under this Lease Agreement, or the satisfaction, discharge or termination of this Lease Agreement in any matter whatsoever.
- E. As long as the Premises are used exclusively for the provision of freight service, unless modified by the Coordination Agreement contained in the Operating Agreement, it is the express intention of both NWP and NCRA that NWP assumes the risk of and agrees to indemnify and hold NCRA, SMART, or any party providing express indemnity to either NCRA or SMART for passive ownership of rail facilities, (the "Indemnities"), harmless, and to defend such indemnities against and from any orders, directives, judgments, causes of action, penalties, fees, claims, costs, liabilities, damages, losses and expense (including without limitation court costs and attorneys' fees and all costs of investigating, remediating, or responding to the existence of a claim), or demands of whatsoever nature or

source for (i) any defects or Environmental Problems, latent or obvious, discovered or undiscovered, in the Premises, including any improvements, fixtures or equipment associated with its use hereunder; (ii) real and chattel property to be leased hereunder and (iii) personal injury to or death of persons whomsoever (including without limitation employees, agents or contractors of indemnities, NWP, or any third party), (iv) property damage or destruction of whatsoever nature (including without limitation property of Indemnitees or NWP, or property in NWP's care, custody or control, and third party property, (v) violation of any Applicable Laws; and/or (vi) breach of this Lease Agreement (collectively, the "Claims") when such Claims arise out of acts, omissions (whether or not negligent) or events occurring on the Premises after the Commencement Date and before the termination of this Lease Agreement; provided that (i) NWP shall not indemnify or hold harmless Claimants to the extent that any Claims arise out of or in connection with acts, omissions or negligence of SMART, NCRA or any agent or licensee of SMART, NCRA, any officer, director, employee, lessee, contractor, or other third parties (other than agents, licensees, contractors or affiliates of NWP, prior to, during or following the term of this Lease (including operations, construction and maintenance in connection with passenger service and property management), and (ii) NWP shall not indemnify nor hold harmless Indemnitees in connection with any Environmental Problems of which Indemnitees have knowledge as of the date of this Agreement, including, without limitation all Environmental Problems identified in that certain Consent Decree and Stipulated Judgment between Lessor and the Superior Court in and for Mendocino County, dated as of July 14, 1999, the Time Schedule for Administrative Civil Liability, Order No. 97-134 of the North Coast Regional Water Quality Control Board, and any incremental liability arising in connection with such Environmental Problems during the term of this Lease.

It is the express intention of NWP that NCRA shall assume the risk of, and agrees to indemnify and hold NWP harmless from, and to defend NWP against any Claims for (i) any defects or Environmental Problems, latent or obvious, discovered or undiscovered, in the real and chattel property to be used by NWP hereunder, which NWP proves (a) existed prior to the Commencement Date or (b) occurred after the termination of this Lease Agreement and termination of the Freight Easement ("Excluded Environmental Claim"); (ii) for personal injury to or death of persons whomsoever (including without limitation employees, agents or contractors of NCRA or any third party) or property damage or destruction of

whatsoever nature (including without limitation property of NCRA, or property in its or their care, custody or control, and third party property) where such Claims arise out of acts, omissions or negligence or events occurring on the Premises prior to the Commencement Date or subsequent to the termination of the Lease Agreement; or (iii) where such Claims arise out of acts or omissions arising out of or in connection with the provision of commuter passenger service or construction in connection therewith on the Easement Premises during the term of this Lease Agreement (except to the extent such injuries, death, property losses or damages are caused by NWP, its agents, employees, affiliated companies, successors or assigns). Furthermore, nothing in this Lease Agreement shall be construed as modifying any agreement between SPTCO, or any SPTCO successor, and NCRA and SMART concerning responsibility for Environmental Problems. "Environmental Problems" shall mean any Claim arising under Applicable Laws or due to any violation thereof, including, without limit, federal, state or local legislation or other rules of law, and private causes of action of whatever nature, which regulate or concern the use, generation, storage, transportation, disposal, release, handling or presence of Hazardous Materials in or about the Premises or related to its use and operation.

F. Non-Third Party Claims

1. Notice of Claim. An Indemnitee shall notify each Indemnitor in writing and with reasonable promptness, of any Claim.
2. Contents of Notice. In the Notice of Claim an Indemnitee shall include the following:
 - (a) A description of any claim, event, or fact known to the Indemnitee that gives rise or may give rise to a claim by the Indemnitee against and Indemnitor based on this Agreement, including the nature and basis of the claim, event, or fact and the amount to the extent known.
 - (b) A statement in prominent and conspicuous type as follows:
 - (1) THE INDEMNITEE'S CLAIM IS CONCLUSIVELY DEEMED A LIABILITY OF THE INDEMNITOR IF THE INDEMNITOR DOES NOT DISPUTE ITS LIABILITY BY WRITTEN NOTICE TO THE INDEMNITEE BEFORE THE END OF THE 30-DAY

PERIOD FOLLOWING THE INDEMNITOR'S
RECEIPT OF THE NOTICE OF THE CLAIM.

- (c) **Indemnitor's Right to Dispute Claim.** An Indemnitor has the right, by a written notice, for a thirty (30) day period, to dispute its liability to an Indemnitee with respect to a Claim. The 30-Day period begins the day after the Indemnitor's receipt of the Indemnitee's notice and ends at 5:00 P.M. on the 30th day. Time is specifically of the essence for this provision.
- (d) **Good Faith Negotiation.** If an Indemnitor timely disputes its liability to an Indemnitee with respect to a Claim, the parties to the dispute shall negotiate in good faith to resolve the dispute.
- (e) **Deemed Loss.**
 - (1) **Circumstances under which a Claim is deemed a Loss.** The Claim set forth in the notice is conclusively deemed a Loss of an Indemnitor if:
 - (a) The Indemnitee has provided the Indemnitor notice as required in Subsections (a) and (b), above; and
 - (b) The Indemnitor does not dispute its liability pursuant to Subsection (c), above;
 - (2) **Payment of a Deemed Loss.** If a claim has been deemed a Loss, the Indemnitor shall pay the amount of the Loss to the Indemnitee on demand; or on the later date when the amount of the Loss (or a portion of it) becomes finally determined if the Indemnitee estimated the amount of the Loss (or any portion of it) in its notice.
 - (3) **Other Payments.** In addition to making the payment under this section F 2, the Indemnitor shall make any other payments required by this Section including, without limitation, the payment of the Indemnitee's Litigation Expenses.
 - (4) **SMART Demands.** In the event that SMART makes an indemnity demand to NCRA covered by NWP's

indemnification, the indemnity claim shall be passed on by NCRA to NWP, and shall not be treated as a Third Party Claim.

G. Third Party Claims

1. Notice of Third Party Claim

- (a) **Notice of Third Party Claim.** If any third party makes any claim or brings any action, suit or proceeding against an Indemnitee (a "Third Party Claim") with respect to which an Indemnitor may have liability, the Indemnitee must promptly notify the Indemnitor in writing of the Third Party Claim and deliver to the Indemnitor a copy of the claim, process, and all legal pleadings with respect to the Third Party Claim.
- (b) **Indemnitor Assumption of Defense.** If an Indemnitor wishes to assume the defense of the Third Party Claim, it shall do so by sending notice of the assumption to the Indemnitee. The Indemnitor's assumption of the defense acknowledges its obligation to indemnify. Promptly after sending the notice, the Indemnitor shall choose and retain independent legal counsel of reputable standing. After sending the notice, the Indemnitor is entitled to contest, pay, settle or compromise the Third Party Claim as it determines subject to the provisions of subsection (e) below.
- (c) **Indemnitee's Right to Undertake Defense.** Despite the provisions of subsection (b) and Indemnitee is entitled:
 - (1) to participate in the defense of a Third Party Claim; and
 - (2) to defend a Third Party Claim with counsel of its own choosing and without the participation of the Indemnitor if:
 - (a) the Indemnitor fails or refuses to defend the Third Party Claim on or before the 20th day after the Indemnitee has given written notice to the Indemnitor of the Third Party Claim; or

- (b) representation of the Indemnitor and the Indemnatee by the same counsel would in the opinion of that counsel, constitute a conflict of interest.
- (d) **Litigation Expenses.** The Indemnitor shall pay for the Litigation Expenses incurred by the Indemnatee to and including the date the Indemnitor assumes the defense of the Third Party Claim. Upon the Indemnitor's assumption of the defense of the Third Party Claim, the Indemnitor's obligation ceases for any Litigation Expenses the Indemnatee subsequently incurs in connection with the defense of the Third Party Claim, unless the Indemnatee has retained counsel in accord with the provisions of subsection c(2) supra.
- (e) **Compromise and Settlement of Third Party Claims**
 - (1) **General Rule.** If an Indemnitor assumes the defense of a Third Party Claim, it may not effect any compromise or settlement of the Third Party Claim without the consent of the Indemnatee, and the Indemnatee has no liability with respect to any compromise of any Third Party Claim effected without its consent.
 - (2) **Exceptions to the General Rule.** Despite the provision of subsection e(1) supra relating to the general rule an Indemnitor may effect a compromise or settlement of any Third Party Claim without an Indemnatee's consent if:
 - (a) There is no finding or admission of any violation of law or any violation of the rights of any person and no effect on any other claim that may be made against the Indemnatee; and
 - (b) The sole relief provided is monetary damages that are paid in full by the Indemnitor; and
 - (c) The compromise or settlement includes, as an unconditional term, the claimant's or the plaintiff's release of the Indemnatee, in form and substance satisfactory to the Indemnatee, from all liability in respect of the Third Party Claim.

H. Third Party Beneficiaries

The Affiliates of NCRA are third party beneficiaries of this Agreement in accordance with its terms. Any modifications of this Agreement executed by the signatories is binding upon such Affiliates, and any action taken or consent given by NCRA on its own behalf is binding upon the Affiliates for the purposes of this Agreement. This Agreement is not intended to nor may it be deemed to, create any rights of enforcement in any person who is neither a signatory to this Agreement nor an Affiliate of NCRA.

I. Insurance

1. NWP shall, at its sole cost and expense, procure the following kinds of insurance effective on Commencement Date and promptly pay when due all premiums for that insurance. Upon the failure of NWP to maintain insurance as provided herein, NCRA shall have the right after giving NWP ten (10) days written notice to obtain insurance and NWP shall promptly reimburse NCRA for that expense. The following minimum insurance coverage shall be kept in force during the term of this Agreement:

- (a) Comprehensive Freight Railroad Liability insurance including contractual liability providing bodily injury, including death, personal injury and property damage coverage with a combined single limit of at least Twenty-five Million Dollars (\$25,000,000) for each incident and a general aggregate limit of at least Twenty-five Million Dollars (\$25,000,000). (The Parties agree that NWP has objected to the \$25 million limit as being unreasonably high, and that NCRA and NWP will jointly seek a \$5 million limit in their SMART negotiations.) This insurance shall contain Broad Form Liability covering the indemnity provisions contained in this Agreement, severability of interests and name NCRA and SMART as additional insured with respect to liabilities arising out of NWP's obligation to NCRA in this Agreement. If coverage is purchased on a 'claims made' basis it shall provide for at least a three (3) year extended reporting or discovery period, which shall be invoked should insurance covering the term of this Agreement be cancelled unless replaced with a policy containing the same retroactive date as the policy being replaced.

- (b) Federal Employer's Liability Act insurance with a waiver of subrogation.
2. NCRA (or its Third Party Operator) shall, at its sole cost and expense, procure the following kinds of insurance to be effective on the later of either (i) the Commencement Date or (ii) the date Permitted or other Passenger Services begin:
- (a) Comprehensive Passenger Railroad Liability insurance including contractual liability providing bodily injury, including death, personal injury and property damage coverage with a combined single limit of at least twenty-five million dollars (\$25,000,000) for each incident and a general aggregate limit of at least twenty-five million dollars (\$25,000,000). NCRA (or its Third Party Operator) shall promptly pay when due all premiums for that insurance. Upon the failure of NCRA (or its Third Party Operator) to maintain insurance as provided herein, NWP shall have the right after giving NCRA ten (10) days written notice to obtain insurance and NCRA shall promptly reimburse NWP for that expense. This insurance shall contain Broad Form Liability covering the indemnity provisions contained in this Agreement relating to NCRA Passenger Service, severability of interests and name SMART, and NWP as additional insureds with respect to liabilities arising out of this Agreement as it relates to NCRA Passenger Service. If coverage is purchased on a "claims made" basis, it shall provide for at least a three (3) year extended reporting or discovery period, which shall be invoked should insurance covering the term of this Agreement be cancelled unless replaced with a policy containing the same retroactive date as the policy being replaced.
 - (b) Federal Employer's Liability Act Insurance with a waiver of subrogation.

XVI. Reopener Clause Following SMART Negotiation

- A. The parties contemplate that NCRA will undertake negotiations for revisions of the Operating Agreement over the course of the next year that address including without limitation, the following issues:

1. Assumption by NCRA of responsibility for the Lombard Segment by SMART transfer to NCRA of ownership of the Lombard Segment;
2. Modification of the Permitted Passenger Service restrictions that apply to NCRA Passenger Service in Section 3.01 of the Operating Agreement;
3. Agreement by SMART to utilize the higher of the engineering standards promulgated by either SMART or NCRA on the Easement Premises;
4. Deletion of the word "unreasonably" in Section 1.02(e) of the Operating Agreement and agreement that any approvals will not interfere with the Freight Easement;
5. Clarification of the responsibility for the costs of rehabilitation and capital improvements and the maintenance of grade crossing warning systems on the Easement Premises;
6. Deletion of the requirements for annual payments in Section IV of the Operating Agreement;
7. Reduction of the \$25 million liability insurance limit specified in Section 10.02 of the Operating Agreement to a \$5.0 million liability insurance limit so long as no rail passenger train service is operated by NCRA or its licensees, agents or contractors on the Easement Premises;
8. Inclusion of NWP as a party to the Coordination Agreement referred to in Section 3.09 and Schedule 3.10;
9. Payment by SMART of any real property taxes and bonded or special assessments upon the Leased Premises;
10. Modification of the provisions relating to the termination of the Operating Agreement, providing for the provision being triggered by NCRA having obtained regulatory approval for termination of its common carrier authority;
11. Making by SMART of any necessary approvals to terminate any remaining California Northern trackage rights between Lombard and Schellville.

- B.** Without affecting any obligations of this Agreement and upon the conclusion of such negotiations, NCRA shall notify NWP and the parties shall thereafter negotiate in good faith to amend this Agreement to conform to the Operating Agreement as revised.

XVII. Accounting and Reporting

- A.** NCRA and its agents shall have the right at any time following NWP's receipt of not less than forty-eight (48) hours notice prior to inspect NWP's books, records, or any other reports or supporting documents or materials necessary to determine compliance with any provisions of this Agreement. Such inspection shall be conducted during normal business hours. NWP shall make its facilities available to NCRA's inspectors to permit such inspection without undue interference with NWP's operations. Any direct expense arising from the inspection shall be borne by NCRA.
- B.** NWP shall have its financial statements audited by an independent certified public accountant on or before the third month following the close of the calendar year and shall provide a copy of such independently audited financial statement delivered to NCRA within thirty (30) days of its receipt. To the extent that this Agreement creates or conditions a right upon financial expenditure or percentage of income, such right shall be referable to the financial statement, independently audited as contemplated herein, and such portion thereof as is separately delineated or defined therein.
- C.** NWP shall maintain for a minimum of three (3) years its books, records and any other reports, or supporting documents or materials necessary to determine compliance with this Agreement
- D.** At the time of providing the financial statement as required in B above, NWP shall in good faith forecast the amount to be deposited in the Lease Fund for the following twelve (12) month period and the following thirty-six (36) month period.

- E. It is understood that as a condition to eligibility for NWP participation in any public funding pursuant to the Capital Projects provision of this Agreement NWP may be required to participate in a pre-qualification audit conducted by CalTrans, or its designee.

XVIII. Right of First Refusal

During the term of this Agreement, if at any time NCRA or its successor public agency shall decide to sell all or any portion of the NWP Line to a third party, NWP shall have a continuing right of first refusal to purchase such Premises.

Within 90 days after receipt of written notice from NCRA that NCRA intends to offer all or any portion of the Premises to a third party for cash (or cash equivalents, such as a promissory note secured by a deed of trust), NWP may exercise this right of first refusal by delivering written notice to NCRA that it agrees to acquire the specified portion of the Premises for the same price for cash, or at NWP's option, for the cash equivalents specified in the notice, if any, and upon the same terms and conditions as NCRA has specified in its notice to NWP. If NWP has not exercised its right of first refusal for a proposed transaction, and NCRA decides to reduce the purchase price for such transaction by more than 10%, NCRA shall first provide NWP with notice of the intended price reduction and with a renewed opportunity to exercise its right of first refusal for such portion of the Premises. NWP shall have a continuing right of first refusal extending throughout the full term of this Agreement.

XIX. Notices

- A. Requirement of a Writing Delivered by Permissible Means.** Any party giving or making any notice, request, demand or other communication, (each, a "Notice") pursuant to this Agreement, or otherwise as required by law or regulation shall:

1. Give the Notice in writing;
2. Cause the Notice to be signed by an officer authorized to give notice;
and

3. Use one of the following methods of delivery, each of which for the purposes of this section is a writing:

- (a) Personal Delivery;
- (b) Registered or Certified Mail, in each case, return requested and postage prepaid;
- (c) Facsimile; or
- (d) E-mail.

B. Addressees and Addresses. Each party giving a Notice shall address the Notice to the appropriate person at the receiving party ("the Addressee") at the address listed below, or to another Addressee or at another address designated by a party in a Notice pursuant to this Section.

1. North Coast Railroad Authority

Ukiah, California 95482

Attention: Executive Director

Facsimile No.: (707) 463-3282

Telephone No. (for verification purposes only): (707) 463-3280

E-Mail: ncra.mstogner@sbcglobal.net

With a copy to:

Christopher J. Neary

110 South Main Street, Suite C

Willits, California 95490

Facsimile No. (707) 459-3018

Telephone No. (for verification purposes only): (707) 459-5551

E-mail: cjneary@pacific.net

2. Northwestern Pacific Railroad Company

C/O The Woodside Consulting Group, Inc.

385 Sherman Avenue, Suite 1

Palo Alto, California 94306-1840

Facsimile No.: (650) 289-9856

Telephone No. (for verification purposes only): (650) 289-9850

E-Mail: jhw@woodsideconsulting.com

With a copy to:

Douglas H. Bosco

37 Old Courthouse Square, Suite 200

Santa Rosa, California 95404

Facsimile No.:

Telephone No. (for verification purposes only): (707: 525-8999
Email: dbosco@boscolaw.com

C. Effectiveness of a Notice. Unless provided elsewhere in this Agreement, a Notice is effective only if the party giving or making the Notice has complied with subsections (a) and (b) and if the Addressee has received the Notice. A Notice is deemed to have been received as follows:

1. If a Notice is delivered in Person, or sent by Registered or Certified Mail, or nationally recognized overnight courier, upon receipt as indicated by the date of the signed receipt.
2. If a Notice is sent by facsimile, upon receipt by the party giving the Notice of an acknowledgement or transmission report generated by the machine from which the facsimile was sent indicating that the facsimile was sent in its entirety to the Addressee's facsimile.
3. If a Notice is sent by E-mail, upon written confirmation of receipt.
4. If a Notice is sent by any means and all necessary party recipients confirm or acknowledge receipt in writing.
5. If any Notice is received after 5:00 P.M., or on a day that is not a Business Day, then the Notice is deemed received at 9:00 A.M. on the next Business Day.

XX. Modification Of Agreement

- A. This Agreement may be modified by amendment, supplement, termination, or discharge by a written agreement signed by the parties. As a condition precedent to the effectiveness of each modification, each party must deliver to the other a certified copy of the resolution of its board of directors authorizing the modification.

XXI. Waivers

- A. The parties may not waive any provision of this Agreement, except pursuant to a writing executed by the party against whom any amendment or waiver is sought to be enforced.

B. No failure or delay in:

1. Exercising any right or remedy or
2. Requiring the satisfaction of any condition under this Agreement, and not course of dealing between the parties operates as a waiver or estoppel of any right, remedy or condition.
3. A waiver made in writing on one occasion is effective only in that instance and only for the purpose that it is given and is not to be construed as a wavier on any future occasion or against any other Person.
4. To the extent any course of dealing, act, omission, failure, or delay in exercising any right or remedy under this Agreement constitutes the election of an inconsistent right or remedy, that election does not
 - (a) constitute a waiver of any right or remedy; or
 - (b) limit or prevent the subsequent enforcement of any contract provision.
5. No single or partial exercise of any right or remedy under this Agreement precludes the simultaneous or subsequent exercise of any other right or remedy.
6. The rights and remedies of the parties set forth in this Agreement are not exclusive of, but are cumulative to, any rights or remedies now or subsequently existing at law, in equity, or by statute.

C. Severability

1. If any provision of the Agreement is determined to be invalid, illegal or unenforceable, the remaining provisions of this Agreement remain in full force, if both the economic and legal substance of the transactions that this Agreement contemplates are not affected in any manner materially adverse to any party.

D. Integration and Merger

1. This Agreement constitutes the final agreement between the parties. It is the complete and exclusive expression of the parties' agreement on the matters contained in this Agreement. All prior and contemporaneous negotiations and agreements between the parties on the matters contained in this Agreement may not be explained, supplemented or qualified through evidence of trade usage, course of performance, or a prior course of dealings. In entering into this Agreement, neither Party has relied upon any statement, representation, warranty, or agreement of the other Party, their agents or contractors, except those expressly identified in the Agreement.

E. Counterparts

1. The parties may execute this Agreement in multiple counterparts, each of which constitutes an original, and all of which, collectively, constitute only one agreement. The signatures of all parties need not appear on the same counterpart, and delivery of an executed counterpart signature page by facsimile is as effective as executing and delivering this Agreement in the presence of the other parties to this Agreement. This Agreement is effective upon delivery of one executed counterpart form each party to the other. In proving this Agreement, a party must produce or account for the executed counterpart of the party to be charged.

XXII. Number

- A. Any reference in this Agreement to the singular includes the plural where appropriate.

XXIII. Captions

- A. The headings of sections in this Agreement are provided for convenience only and do not affect this Agreement's construction or interpretation.

XXIV. Presumption of Consideration

- A. For the exercise of any option in this agreement the mutual covenants of this agreement at the time of its making shall be deemed to be sufficient consideration for the exercise of any option whenever made in accordance with the terms of this agreement.

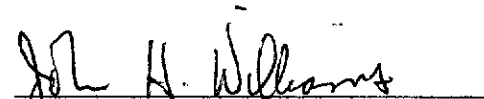
XXV. Severability

- A. In the event that any provision of this Agreement is void, voidable, or unenforceable, such provision of this Agreement shall be severed from the agreement and remaining provisions of the Agreement shall remain in full force and effect.

NORTH COAST RAILROAD
AUTHORITY, a public agency


ALLAN HEMPHILL
Chairman of the Board of Directors

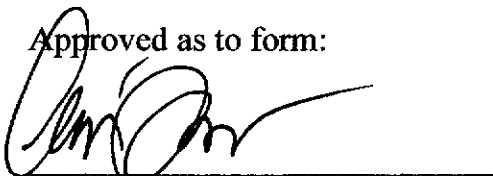
NORTHWESTERN PACIFIC
RAILROAD COMPANY, a
California corporation


JOHN WILLIAMS
President

Attest:


MITCH STOGBER
Secretary to the Board of Directors

Approved as to form:


CHRISTOPHER J. NEARY
General Counsel