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SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SAN DIEGO

KEN KAHAN, Plaintiff, vs. CARRIZO GORGE RAILWAY, INC., Defendant	Case No.: 37-2012-00095975-CU-BT-CTL DECLARATION OF KAREN LANDERS (GENERAL COUNSEL FOR SAN DIEGO METROPOLITAN TRANSIT SYSTEM) IN OPPOSITION TO PRELIMINARY INJUNCTION Hearing Date: June 8, 2012 Hearing Time: 10:30 a.m. Dept: 68 Judge: Hon. Judith F. Hayes

Declaration of Karen Landers in Opposition to Preliminary Injunction

1. I am employed as General Counsel for San Diego Metropolitan Transit System (MTS) and its related entities (San Diego Transit Corp, San Diego Trolley, Inc., and San Diego & Arizona Eastern Railway Co.) (collectively referred to as "MTS"). I also supervise the MTS Land Management Department, which oversees real estate assets owned by MTS. The statements set forth herein are based on my personal knowledge, or information available to me in my position as General Counsel.

2. MTS is a public transit development board created by statute. (Pub. Util. Code, § 120050 *et seq.*) MTS is the sole member of the San Diego & Arizona Eastern Railway Co., a Nevada non-profit corporation (SD&AE). MTS purchased SD&AE and its real estate assets from Southern Pacific Transportation Company in 1979. The purchase was prompted, in part, by MTS's opposition to Southern Pacific's petition to abandon the "Desert Line", which consists of approximately 70 miles of railroad tracks extending from the US-Mexico border at Division, California, to Plaster City, California. Operations on the Desert Line were suspended because of severe storm damage suffered in 1976. MTS opposed the abandonment of the Desert Line on the basis that "restoration of SD&AE's storm-damaged lines, and resumption of full railroad freight services by SD&AE, are necessary and desirable for the use and benefit of San Diego County, California, its economy, its business, and its residents."

3. Between 1979 and 1984, operations on the Desert Line stopped and started as a result of various natural disasters, including fires and floods. Notwithstanding these difficulties, the Interstate Commerce Commission denied an application by SD&AE's freight operator (Kyle

Railways) to abandon or discontinue service on the Desert Line. (ICC Decision No. AB-16 (Sub-No. 1) dated April 25, 1984.)

4. In 1984, MTS entered into an operating agreement for SD&AE's freight railroad assets with San Diego & Imperial Valley Railway Company (SD&IV) ("1984 Operating Agreement"). The 1984 Operating Agreement gives SD&IV the exclusive right to operate freight on the SD&AE right-of-way, including the Desert Line. The 1984 Operating Agreement includes 5 ten-year terms through March 8, 2034. SD&IV has the right to unilaterally exercise each option period.

5. Between 1985 and 1992, fire damaged two additional tunnels and two bridges. Because of the high cost of repairs, not all repairs were completed. In 1994, costs to repair the Desert Line were estimated at approximately $17 million (including service upgrades after operations restored). In 1996, a San Diego Association of Governments study estimated the project cost at $24 million to $105 million, depending on the project scope.

6. In 2002, MTS consented to an assignment by SD&IV to Carrizo Gorge Railway Inc. (CZRY) of its rights to operate the Desert Line ("CZRY Operating Agreement"). The term of the CZRY Operating Agreement coincides with the 1984 Operating Agreement but is subject to SD&IV's reasonable discretion, and SD&AE/MTS consent, to extend the CZRY Operating Agreement for each new ten-year term. The current term for each agreement ends on March 8, 2014.

7. The 2002 CZRY Operating Agreement was entered into based on CZRY's intent to "reopen the Desert Line by reconstructing the line to accommodate freight service." (CZRY Operating Agreement, page 2.) MTS agreed to SD&IV's assignment of the Desert Line operating

rights to CZRY to allow "CZRY the ability to reinstate the line and provided common carrier service over the line." (CZRY Operating Agreement, page 2.)

8. Since CZRY took over the Desert Line in 2002, very little freight activity has taken place. In 2007, a study was prepared concerning the state of repair for the Desert Line bridges. The study concluded that the condition of the infrastructure was significantly more deteriorated than previously known. Costs to bring the Desert Line into a state of good repair were informally estimated at more than $100 million. The tunnels along the Desert Line have not been inspected or repair costs estimated.

9. As a result of the bridge study, and a lack of funds to commence the full set of repairs needed, CZRY agreed to an embargo and no freight activity has occurred on the line since early 2009.

10. It is MTS's understanding that CZRY has been engaged in various shareholder and creditor disputes since approximately 2005. These disputes have impacted performance under the CZRY Operating Agreement and created uncertainty for MTS as to who was in control at CZRY.

11. In early 2011, MTS was provided with a copy of a January 3, 2011 court order in *Sweetwood v. CZRY* (SDSC Case No. 37-2008-00092295-CU-WM-CTL), which established the shares and votes held by each CZRY shareholder and a statement that "The Court believes that its ruling resolves issues of control, such that further interference of the type complained of in the motion is not likely to occur, obviating the need for injunctive relief." On the basis of this court order, which appeared to resolve the ongoing shareholder disputes and questions of

control, MTS began working with Sheila LeMire and Pacific Imperial Holdings, LLC (PIH) as the representative in control of CZRY.

12. In February or March 2012, MTS was made aware that CZRY had formally assigned its rights under the CZRY Operating Agreement to Pacific Imperial Railroad (PIR) through a series of loans, assignments, and other agreements between CZRY, its shareholders, and creditors:

a. January 5, 2011, Assignment, Assumption, and Settlement Agreement between CZRY, Pacific Imperial Holdings, LLC (PIH), Pacific Imperial Industries, LLC (PII), and Sheila Lemire. (Transfer of operating and trackage rights to PII).

b. November 1, 2011, Assignment Agreement between PII and PIR. (Transfer of operating and trackage rights to PIR.)

c. January 7, 2012, Amendment to CZRY Operating Agreement (formally assigning CZRY Operating Agreement to PIR) -- SD&IV, SD&AE, and MTS consent required.

13. MTS was generally aware that these transactions were occurring. During the course of 2011, MTS was informed that PIH and some associated entities, PII and PIR, were developing a proposal to repair the Desert Line and resume freight operations as originally contemplated by the CZRY Operating Agreement. MTS encouraged PII to develop its proposal, since this action was the first substantive progress towards re-opening the Desert Line for freight service that had occurred since CZRY took over the Desert Line.

14. Since the costs to bring the Desert Line bridges into a state of good repair has been informally estimated by MTS staff to be approximately $100 million, MTS recognizes that

very few entities have the ability to finance the repairs necessary. Based on MTS's limited knowledge of the shareholder and creditor disputes that have been filed against CZRY, it does not appear that CZRY has the assets or collateral available to finance a project of this size and scope.

15. In contrast to CZRY's lack of financing, the entity proposed to succeed CZRY in the CZRY Operating Agreement, PIR, appears to have the ability to finance a project of this nature. MTS has met with PIR and its bankers and confirmed that the project is moving forward and that PIR appears able to obtain the financing needed. This financing will be secured by assets controlled by PIR and not associated with CZRY.

16. In or about March 2012, MTS was informed that additional progress on PIR obtaining funds to finance the repairs could not proceed to the next step until SD&AE and MTS formally acknowledged the transfer of the operating rights to PIR.

17. On April 10, 2012, the SD&AE Board met and authorized staff to consent to the assignment of the CZRY Operating Agreement to PIR. This authorization was conditioned upon staff confirming that PIR was authorized to do business in the State of California. Staff subsequently obtained confirmation from the Secretary of State to this effect.

18. On or about April 30, 2012, I was informed that the *Kahan* action was filed and a temporary restraining order granted related to the CZRY Operating Agreement. On May 1, 2012, I spoke with the Department 68 court clerk to confirm if a restraining order had been granted. At that time, I was informed that no order had been entered and that the next hearing was scheduled for June 15, 2012. I was informed that during the April 25, 2012 ex parte hearing, the Court had ordered the parties to meet and confer concerning the scope of

the temporary restraining order the Court agreed to grant at the hearing. On May 2, 2012, I obtained a copy of the April 25, 2012 hearing transcript from the court reporter.

19. Upon reviewing the transcript and moving papers from the April 25, 2012 ex parte hearing, I noted that MTS was not a named party and the moving papers requested an order restraining CZRY from taking any action. The action being proposed for MTS, consent to the assignment of the CZRY Operating Agreement, was the last step that needed to be taken to finalize this transaction. CZRY had already taken all action required when it signed the documents listed in Paragraph 12.

20. On May 17, 2012, at 9:00 am, the MTS Board met to authorize the assignment of the CZRY Operating Agreement to PIR. At approximately 8:41 am on May 17, 2012, I was provided via email with a May 3, 2012 court order that allegedly prevented MTS from taking any action on the assignment. Upon reviewing the court order, I concluded that it did not, and could not, assert any jurisdiction over MTS. However, given the required elements for granting a temporary restraining order, the court order appears to raise questions regarding the validity of the assignment document that MTS was consenting to. On this basis, the MTS Board authorized staff to consent to the assignment of the CZRY Operating Agreement, contingent upon the outcome of the June 8, 2012 preliminary injunction hearing scheduled before this Court.

21. MTS is concerned that granting the preliminary injunction proposed will unreasonably delay and/or terminate the proposed development and associated financing for this project. MTS has been incredibly patient in allowing CZRY and its shareholders to resolve their differences and return their attention to performing under the CZRY Operating

Agreement. However, during this time, the Desert Line has fallen into greater disrepair and no freight activity has taken place. MTS does not have any confidence that the CZRY shareholders, on their own, have the capacity to repair the Desert Line and resume freight operations.

22. MTS has informed PIR and CZRY that unless a new agreement to invest in all necessary repairs and restart freight operations on the Desert Line is in place by March 8, 2014, then MTS will not agree to extend the CZRY Operating Agreement beyond its expiration date.

23. Since 2007, MTS has received less than $10,000 in revenue as a result of giving CZRY the exclusive operating rights to the Desert Line. This is an insignificant amount compared to a railroad under normal freight operations. Therefore, for every year that CZRY has been unable or incapable of repairing the Desert Line and resuming freight operations, MTS has lost out on significant revenue.

24. In addition, based on the continued disfunction between CZRY and its shareholders, if this current shareholder dispute substantially delays or terminates the current proposed development, then MTS is prepared to review its options to immediately terminate the CZRY Operating Agreement for default (failure to diligently pursue and obtain funding to reopen the Desert Line). If CZRY or its successor-in-interest is unable to fulfill its obligations under the CZRY Operating Agreement, then it is not in MTS or the public's interest to allow them to continue in an exclusive operating rights position. Instead, MTS will take steps to publicly bid operation of the line, with a requirement that any proposer provide evidence of the ability to finance and a plan to develop the Desert Line within the next two to five years.

25. Based on the foregoing, MTS opposes the Kahan request for a preliminary injunction. The TRO language that prohibits CZRY "from implementing the provisions of the"

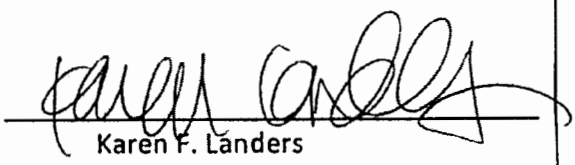
assignment agreement has been described to MTS as preventing assignment of the CZRY Operating Agreement to PIR, at least until some further action is taken by CZRY at an undetermined time. Any significant delay in formally recognizing the assignment to PIR will harm MTS by delaying and compromising performance of the CZRY Operating Agreement.

26. Because they do not have the capacity to finance the necessary repairs, the CZRY Operating Agreement does not have any value if it remains in the hands of the current CZRY shareholders. The CZRY Operating Agreement only has value in the hands of an entity that can finance the repairs.

27. To the extent there is a "bonus value" associated with CZRY's limited right to assign the agreement to an entity that can perform, it appears that this value can be calculated and compensated for with a money damages judgment between the minority and majority shareholders, if warranted on the merits. Upon my review of the assignment request, it appeared that this value and exchange of compensation was already calculated in the cancellation of debts and other actions that were set forth in the January 5, 2011 Assignment, Assumption & Settlement Agreement.

28. Granting a preliminary injunction in this case will only further drive CZRY into default under the CZRY Operating Agreement, while at the same time prejudicing MTS by delaying its ability to see the Desert Line restored for freight operations. MTS will be forced to either declare CZRY in default and take on the litigation risks associated with such a step, or delay all progress on this project until the agreement naturally expires on March 8, 2014. Such an outcome is not in the public interest and places too much burden on MTS, who is not a party to this shareholder dispute.

I declare the foregoing to be true and correct, under penalty of perjury, under the laws of the State of California. Executed on May 30, 2012 in San Diego, California.



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