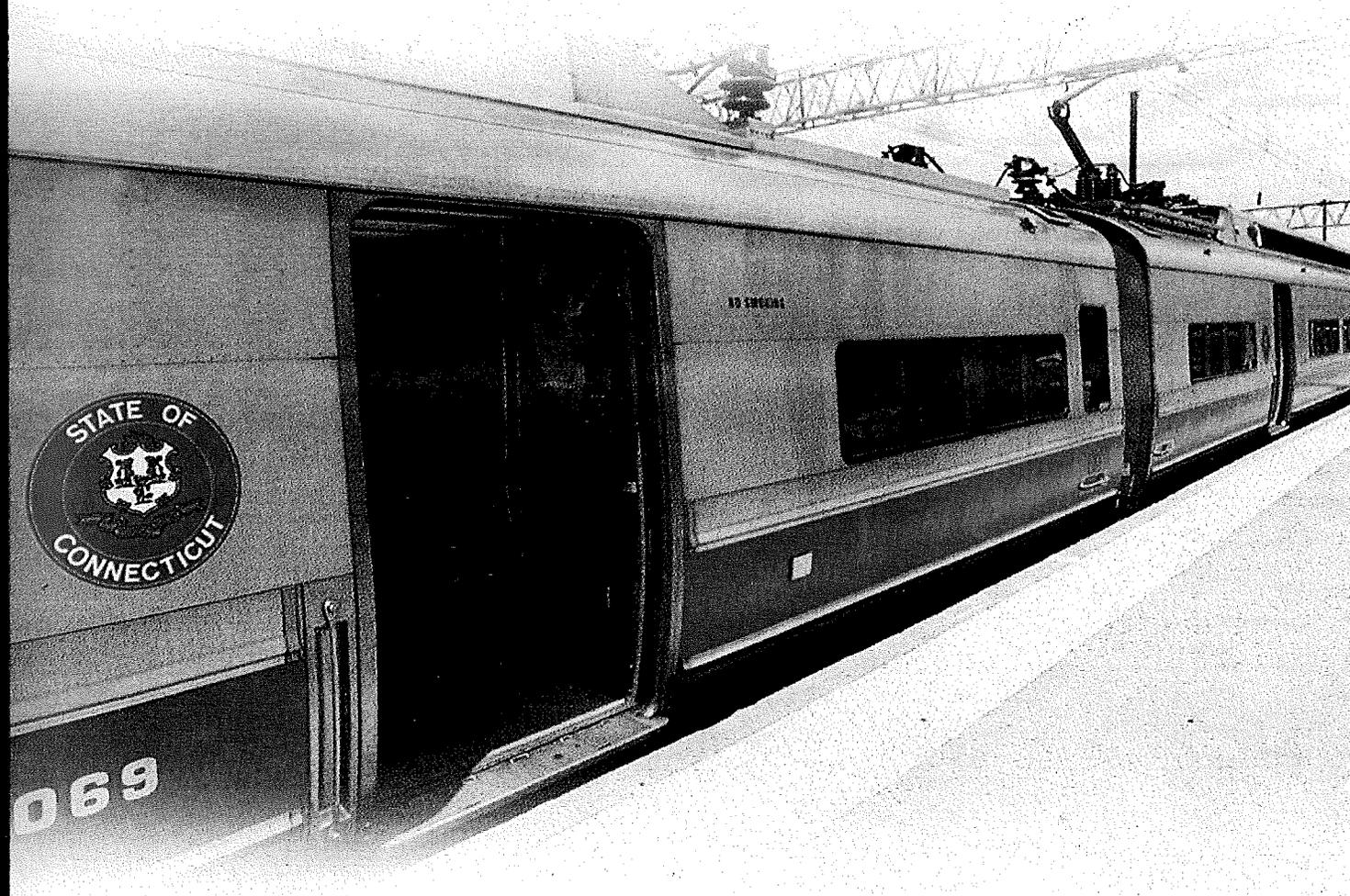


Analysis of the Amended and Restated Service Agreement for the Operation and Subsidization of the New Haven Rail Line

As called for in Public Act 00-129



PA00-129



STATE OF CONNECTICUT

DEPARTMENT OF TRANSPORTATION

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Office of the
Commissioner

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May 3, 2001

Hon. Biagio Ciotto
Hon. Jacqueline M. Cocco
Co-Chairpersons
Transportation Committee
Legislative Office Building
Hartford, Connecticut 06106

Dear Senator Ciotto and Representative Cocco:

Subject: Pubic Act No. 00-129

Pursuant to Section 2 of Public Act No. 00-129, "An Act Concerning Mass Transportation and the Metro-North Rail Operating Agreement", the Department of Transportation has conducted an analysis of the Amended and Restated Service Agreement (ARSA) between the Department, the Metropolitan Transportation Authority (MTA), and Metro-North Railroad (Metro-North) for the operation and subsidization of the New Haven Rail Line commuter service. As directed, the scope of this analysis included an examination of ridership, costs, service, scheduling, marketing, capital investment and other related issues.

The objective of the analysis was to develop recommendations for how the Department may better exercise its legal rights under ARSA to increase rail ridership while maintaining the affordability of fares for Connecticut commuters. It is acknowledged by the Department that increasing rail ridership on the New Haven Line is an effective element of an overall strategy to reduce highway congestion in southwestern Connecticut. It is also acknowledged that the greatest opportunity for increasing ridership on the New Haven Line is in targeting and capturing a greater share of the intrastate market in Connecticut. To accomplish this, an increase in the level of intrastate service on the New Haven Line is necessary.

ConnDOT and Metro-North have recently consummated lengthy budget discussions with the execution of a Memorandum of Understanding intended to clarify the process for developing an annual operating budget and to express a renewed spirit of cooperation between the agencies. While financial issues remain between ConnDOT and MTA/Metro-North, I am confident that our common goal of providing an even more efficient and cost-effective commuter rail service will lead to equitable resolution of these issues. It remains the expressed intention of ConnDOT and MTA/Metro-North to continue to cooperatively provide an attractive, affordable alternative to auto use for the residents of south central and southwestern Connecticut.

Very truly yours,

James F. Sullivan
Commissioner

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EXECUTIVE SUMMARY

STATEMENT OF PURPOSE

Section 2 of Public Act 00-129 directs the Commissioner of Transportation to conduct a comprehensive analysis of the Amended and Restated Service Agreement (ARSA) among the Connecticut Department of Transportation (ConnDOT), Metropolitan Transportation Authority (MTA), and Metro-North Commuter Railroad (Metro-North) for the operation and funding of the New Haven Rail Line. It is intended that this analysis produce recommendations for how ConnDOT may better exercise its legal rights under ARSA to increase rail ridership, while maintaining affordable rail fares for Connecticut commuters. In the formulation of such recommendations, the analysis is to consider existing ridership, costs, service, scheduling, marketing, capital investment and other related issues. Increasing ridership on the New Haven Rail Line is viewed by the Legislature as a part of an overall transportation strategy to reduce highway congestion in southwestern Connecticut.

NEW HAVEN LINE COMMUTER RAIL SERVICE

Since the mid-1960's, the states of Connecticut and New York have recognized that the New Haven Line commuter rail passenger service (the Service) is absolutely vital to the economy and quality of life in each state. Since 1983, ConnDOT and MTA/ Metro-North have worked together to create what has been recognized by those in the industry as the premier commuter railroad service in the United States. While ConnDOT and MTA/Metro-North have enjoyed periods of harmony and suffered periods of animosity and mistrust over the years, the agencies have recently executed a Memorandum of Understanding intended to reinvigorate and refocus their efforts to further improve the Service in a more cooperative and cost-effective manner. Though this Memorandum of Understanding in no way changes the terms or provisions of ARSA, it was created to clarify the annual Metro-North budget development process as outlined in ARSA. It is expected that the renewed spirit of cooperation exhibited by the Memorandum of Understanding will extend to other, if not all areas of ARSA administration.

Of late, the Service continues to exceed all ridership and revenue expectations. Ridership reached an all time high of 32.5 million in 2000, representing a 4.7% increase over 1999; an increase of 41% since 1984; and an increase of nearly 100% since 1970. In addition to marked growth in the morning peak period, Metro-North has provided ConnDOT with ticket sales data that demonstrates remarkable growth of intrastate ridership in Connecticut in the last five years. The data indicates that between 1995 and 2000, intrastate ridership in Connecticut has increased by 47%. There is agreement between ConnDOT and Metro-North that the opportunity exists to capture an even greater share of the intrastate travel market in Connecticut.

As of the October 29, 2000 timetable, the New Haven Rail Line consists of 250 weekday trains, 143 Saturday trains, and 132 Sunday trains. As of 1999, the Service generates revenues in excess of \$175 million and incurs operating expenses in excess of \$237 million, for a net operating deficit of approximately \$62 million. Under the current allocation of the net operating deficit, ConnDOT's share is approximately \$40 million annually. The number of passenger trips annually on the New Haven Line now exceeds 32 million. With an operating ratio (recovery of

expenses from the farebox) of nearly 70%; a subsidy per passenger of less than \$2.00; and an on-time performance consistently in a range above 96%, the high quality of service provided on the New Haven Line is indisputable.

FINDINGS

With respect to increasing intrastate ridership on the New Haven Line, there is no specific Article in ARSA that precludes ConnDOT from advancing a transportation strategy that calls for increasing the level of intrastate passenger while maintaining the affordability of fares. However, this is not to say that there are no impediments to implementing such a strategy. The lack of additional deficit funding and the lack capital funds needed for rolling stock and a vehicle maintenance and storage facility threaten existing and future service levels and reliability.

ARSA provides for the allocation of the main and branch line net operating deficits and, in Appendix C, establishes a basic Service level that can only be modified by mutual agreement. However, ARSA does not provide guidance for the allocation of costs associated with institution of main line intrastate service (in Connecticut or New York) above that which has historically existed in Appendix C. While ConnDOT has successfully negotiated some intrastate service improvements within the existing deficit model, MTA/Metro-North has suggested that additional intrastate service, operating wholly within the state of Connecticut, must either pay for itself or be treated as if it were a branch line service since it represents no benefit to the state of New York. This is not an unreasonable position by MTA/Metro-North and does not represent MTA/Metro-North's default from the terms and conditions of ARSA. Therefore, it should be assumed that the additional operating costs associated with significant expanded intrastate service in Connecticut would be borne solely by ConnDOT.

It follows then that the most significant impediment to increasing intrastate rail service is a lack of funding to offset the annual net operating deficit for the additional service. The second most significant impediment is the lack of capital funding necessary to provide the rail passenger equipment, with related maintenance facilities, and rail station parking necessary to support the service. The former is considered as a far greater concern in that it seriously threatens existing Service levels and reliability as well.

RECOMMENDATIONS

In compliance with Public Act 00-129 and to meet the goals of ConnDOT's evolving transportation strategy for relieving traffic congestion along the I-95 Corridor by enhancing commuter rail service, immediate recommendations have been developed. ConnDOT recommends:

That the Commissioner of Transportation and key managers on his staff work at maintaining an improved working relationship with their counterparts at MTA/Metro-North with the goal of ensuring ConnDOT's meaningful participation in the development of annual operating budgets and the establishment of future policies and strategies for the Service.

That ConnDOT and Metro-North continue ongoing negotiations to modify the manner in which specific costs are allocated to resolve current and future first step down allocation issues; to improve administrative practices; demonstrate value for subsidy; and eliminate wasteful practices and spending.

That ConnDOT exercise more fully all of the provisions and protections of ARSA, including arbitration, financial arbitration, and/or the renegotiation of specific Articles of ARSA with MTA and Metro-North.

That the Legislature authorize funds outside of existing appropriation levels for ConnDOT to expand intrastate rail passenger services and to acquire additional rail passenger equipment and to construct suitable storage and maintenance facilities for such equipment.

That Connecticut's Congressional delegation be made aware of the critical rail passenger equipment and maintenance facility shortage that the Service faces so that substantial Congressional earmarks can be sought for the acquisition of additional rail passenger equipment and the construction of suitable storage and maintenance facilities for such equipment.

That the Commissioner of Transportation be granted explicit legislative authority to award contracts on the basis of future guaranteed federal funding levels and the reasonable expectation that bond funds will be authorized by the Legislature to provide the required local share for federal grants.

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INTRODUCTION

The following narrative reviews the history of ConnDOT's collaborative effort with the MTA to continue and improve commuter rail operations on the New Haven Rail Line. This narrative also analyzes the individual Articles of ARSA and discusses certain difficulties that ConnDOT has encountered in the administration of ARSA. Finally, a summary of ConnDOT's efforts to attract new ridership both within and outside of the framework of ARSA and several recommendations to further the Legislature's overall transportation strategy have been provided.

BACKGROUND AND HISTORY

During the mid-1960s, after the second and final bankruptcy of the New York, New Haven and Hartford Railroad Company (the New Haven), the states of Connecticut and New York joined forces to continue the operation of the Service. In 1963, the Connecticut General Assembly created the Connecticut Transportation Authority (CTA) to represent Connecticut in negotiations dealing with the problems of the New Haven and the New Haven Line Commuter Service. In 1965 and 1967 the General Assembly expanded the powers of the CTA to include the buying and selling of rail properties and the financing of the commuter rail service. At that time, the Public Service Tax Fund was created as the funding source for this purpose.

In 1965 Governor Dempsey proposed a federally assisted demonstration project to support the Service with cash payments. The first subsidy agreement was for \$2.5 million and was effective July 1, 1965. It was executed among the Trustees of the New Haven and three subsidizers, the State of Connecticut, the State of New York, and a federal agency known at that time as Housing and Urban Development (HUD). The eighteen-month HUD demonstration grant funded two-thirds of the deficit subsidy while Connecticut and New York each provided one-sixth shares of the deficit.

Connecticut and New York jointly proposed another demonstration project for the modernization of the New Haven Line contingent upon federal financial assistance in 1966. The program included acquisition or lease of the right of way, new cars and capital improvements in both states. This capital project did not materialize until 1970, however. Simultaneously, the states assumed financial responsibility for the commuter service deficits with the Trustees of the New Haven operating the line as the states' agent.

In 1969, the General Assembly enacted the Connecticut - New York Railroad Passenger Compact (Sec. 13b-344 CGS) that provided for the continuation of essential, interstate railroad service. This statute authorized the CTA, individually and as a co-venturer with the MTA, to acquire railroad assets, repair and rehabilitate such assets, and operate the rail service or contract for the operation of part or all of the service. Also in 1969, the General Assembly replaced Connecticut's Highway Department with ConnDOT and incorporated the CTA into the new department.

Four agreements, collectively referred to as “the Service Agreement”, were executed to provide for the continuation of the New Haven Line Commuter Service in October, 1970. The principals involved in the agreements were CTA/ConnDOT, MTA, and the Trustees of the Penn Central Transportation Company (PCTC), successor to the New Haven since 1968 and also financially beleaguered. The Service Agreement, which became effective on January 1, 1971, provided for the continued operation of the Service by Penn Central under the joint oversight of the ConnDOT and MTA. ConnDOT and MTA funded the New Haven Line operating deficit equally under the terms and conditions of this agreement. Listed below are the titles of the four agreements and the participants in each:

- CTA Lease Agreement with purchase option (CTA/ConnDOT and PCTC)
- MTA Purchase and Lease Agreement (MTA and PCTC)
- Grand Central Terminal Joint Facilities Agreement (CTA/ConnDOT, MTA, and PCTC)
- Service Agreement (CTA/ConnDOT, MTA, and PCTC)

The bankruptcy of the Penn Central and seven other railroads in the Northeast and Midwest Region of the United States had the potential to cause severe economic hardship on both the Region and the nation. In response to this growing problem, Congress enacted the Regional Rail Reorganization Act of 1973 (3R Act) which created the Consolidated Rail Corporation (Conrail). The Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act) required Conrail to temporarily assume operation of the Service (as well as other commuter services) from Penn Central. Under the terms and conditions of the Service Agreement, Conrail began operations on the New Haven Line on April 1, 1976.

In 1981, Congress enacted the Northeast Rail Services Act (NERSA) which relieved Conrail of the obligation to provide railroad commuter service and allowed the sponsoring commuter agencies to operate the services themselves or to contract with a new agency (Commuter Services Corporation) created specifically for that purpose. On January 1, 1983 Conrail became a freight-only railroad carrier.

ConnDOT and MTA were left to choose a replacement for Conrail. MTA elected to create a subsidiary, the Metro-North Commuter Railroad Company, to operate its Harlem Line and Hudson Line Commuter Services, as well as its portion of the New Haven Line. ConnDOT agreed that Metro-North would also operate the Service in Connecticut. Under an Interim Service Agreement, Metro-North assumed New Haven Line operations on January 1, 1983. At this time, MTA raised questions regarding the equity of the 50-50 allocation of the annual Service operating deficit. It was agreed that the Interim Service Agreement would provide for a determination by an arbitration panel of the fair and equitable allocation of the net Service operating deficit between ConnDOT and MTA.

In June of 1985, after a lengthy arbitration procedure, ConnDOT and MTA/Metro-North signed the Amended and Restated Service Agreement (ARSA) for the continued operation of the New Haven Line. ARSA substantially changed the agencies' original cost-sharing agreement for the operating deficit and capital projects. It was concluded by an arbitration panel led by Archibald Cox that in the first year ConnDOT

would pay 60% of the total operating deficit. This percentage represented an uncalculated percentage for the net main line operating deficit, 53% of the New Haven Line's allocated share of the Grand Central Terminal's (GCT) operating deficit, and 100% of the operating deficit for the New Canaan, Danbury, and Waterbury branch lines. In subsequent years, ConnDOT's share of the total operating deficit would change to reflect the actual net main line operating deficit as calculated for the first year. That first year calculation for the net main line operating deficit was 56.29 %

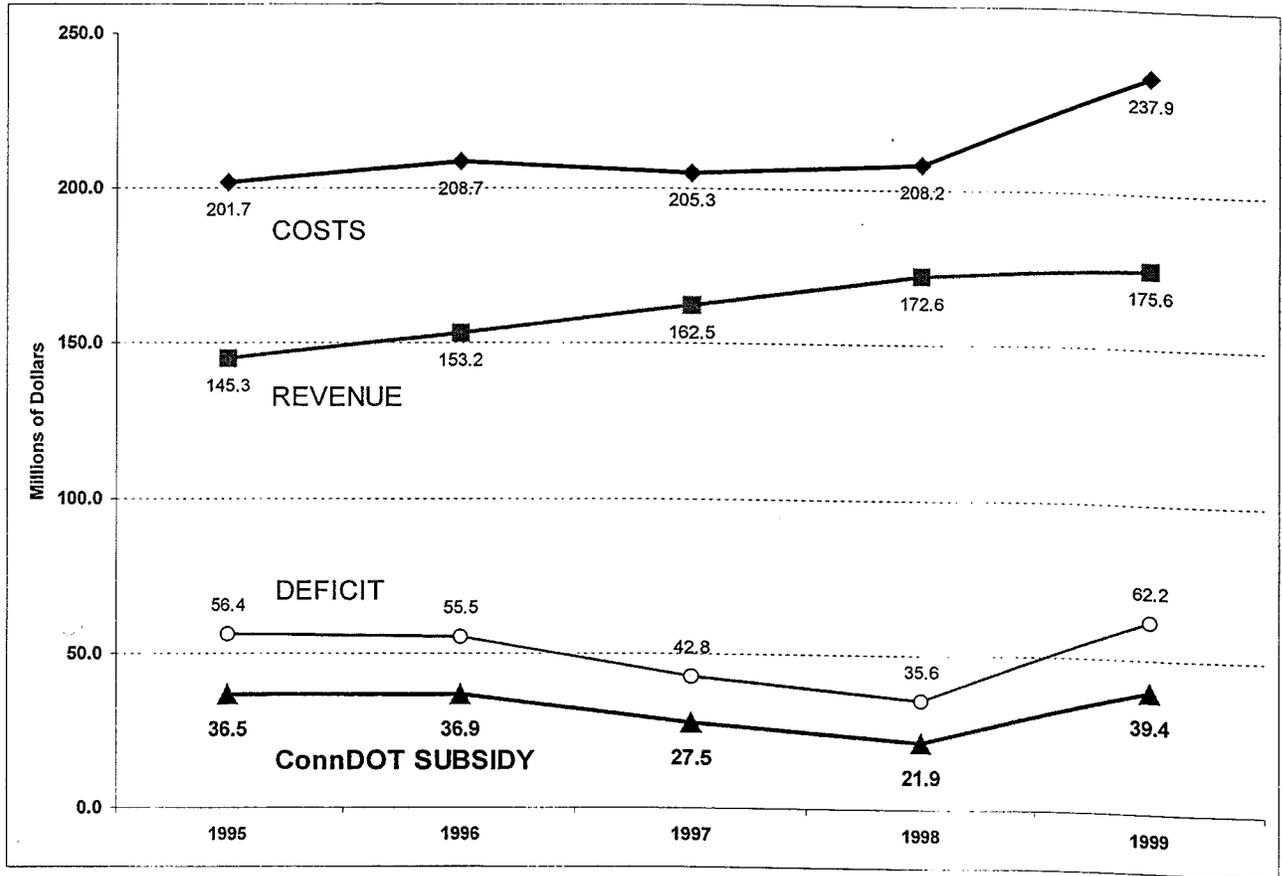
The selection of Metro-North as the New Haven Line operator would prove to be a watershed in the relationship between ConnDOT and MTA and in the administration of the New Haven Rail Line service. Prior to this, ConnDOT and MTA, on more or less equal footing, dealt with an independent third party that ostensibly favored neither subsidizer. Penn Central, and Conrail its successor, prepared annual budgets for the scrutiny of both ConnDOT and MTA and allocated costs equally between the parties. Metro-North, as a subsidiary of MTA, cannot be considered an independent operator since all of its corporate policies, labor negotiation parameters, and annual budget parameters are established by MTA.

During this time, ConnDOT was still paying an annual lease fee to the Trustees of the Penn Central under the provisions of the 1970 Service Agreement. However, the Service Agreement provided ConnDOT with the option to acquire the New Haven Line in the state of Connecticut for a fixed amount based on a 1969 appraisal. In October 1985, ConnDOT exercised this option and acquired the New Haven main line between New Haven and Greenwich and the three branch lines for approximately \$8.5 million.

One year before ARSA would automatically be renewed on January 1, 1995, ConnDOT notified Metro-North of its desire to renegotiate certain elements of ARSA in order to eliminate what ConnDOT perceived to be fundamental inequities. In particular, ConnDOT sought to renegotiate a differential for the fare structure, certain cost allocators, the disposition of administrative assets post-termination, GCT costs, and other cost allocating and accounting considerations. Since amicable resolutions to the issues raised by ConnDOT were not attainable, arbitration proceedings were begun. After what was again a lengthy arbitration, in 1998 ConnDOT was awarded the fare differential credit it sought, but was also forced to accept the arbitration panel's ruling that in the future ConnDOT would be allocated and pay 65% of the main line net operating deficit and continue to pay 100% of the branchline deficit.

In summary, effective January 1, 1983, 56.29% of the main line net operating deficit was allocated to and paid by ConnDOT, while 43.71% was allocated to and paid by MTA. One Hundred percent of the branch lines net operating deficit was allocated to and paid by ConnDOT. With respect to GCT, 53% of the New Haven Line's share of the GCT net operating deficit was allocated to and paid by ConnDOT, while 47% was allocated to and paid by MTA. As previously stated, a subsequent arbitration award in 1998, changed the allocation of the main line net operating deficit to 65% payable by ConnDOT and 35% payable by MTA. Table 1 provides a recent summary of the New Haven Line subsidy details.

**Table 1
New Haven Line Subsidy Details**



THE AMENDED AND RESTATED SERVICE AGREEMENT (ARSA)

As previously stated, the Service Agreement, that became effective on January 1, 1971, governed the New Haven Line operations and subsidization for both Penn Central and Conrail. However, with the departure of Conrail and the creation of Metro-North, a new era on the New Haven Line began. The beginning of this new era was marked by the execution, on December 31, 1982, of an amendment to the Service Agreement referred to as the Interim Service Agreement.

The Interim Service Agreement provided for the continuation of the Service under the operation of Metro-North and a determination by an arbitration panel of the “fair and equitable” allocation between ConnDOT and MTA of the net New Haven Line service operating deficit and capital costs. On September 7, 1984 the arbitration panel released an Arbitration Award that first changed the allocation of the net operating deficit and the relationship between ConnDOT and MTA. The parties agreed to certain other modifications to the Service Agreement in addition to those necessitated by the arbitration, and ARSA became effective as of June 21, 1985, retroactive to January 1, 1983.

With a minimum of editorializing, the following text briefly summarizes the Articles of ARSA. It does not attempt to account for the many different interpretations held with respect to the articles of ARSA, but rather it provides a general understanding of the framework under which the New Haven Line is operated and is subsidized.

Article One: Definitions

Article One of ARSA simply defines all the terms that have meaning that may be considered particular to the document.

Article Two: The Service and Its Operation

The Service is defined as all activities and functions, including maintenance and operations, associated with the train schedule included as ARSA Appendix C, which has been and may be modified from time to time in accordance with ARSA. Metro-North is assigned responsibility for the day to day operation of the Service, with the goal of providing "timely, efficient, clean and courteous service to the public on a continuing basis."

In the operation of the Service, Metro-North has the right to incur and charge to designated accounts all capital and operating expenses necessary to carry out its operating responsibilities consistent with the approved budget. With the prior consent of ConnDOT and MTA, Metro-North has the right to amend the main line Service schedule and to make temporary unilateral changes to the main line schedule. Both ConnDOT and MTA may propose amendments to the main line Service fares and such amendments shall be implemented by Metro-North once the proposed amendment is approved by both ConnDOT and MTA. ConnDOT retains the right to amend the Service schedule, consists (equipment used), and fares with respect to the branch line services, for which it pays 100 percent of the costs. From time to time ConnDOT has suggested and Metro-North has implemented main line Service schedule amendments, including the addition of trains. Since ARSA does not specifically address ConnDOT's authority to effect main line Service schedules, the allocation of costs associated with amendments to the main line Service schedule proposed by ConnDOT must be negotiated or perhaps arbitrated. All such schedule changes to date have been instituted in accordance with the approved deficit distribution formula in effect at the time the changes were instituted.

ARSA is silent with regard to ConnDOT's authority to extend Shore Line East revenue trains into the New Haven Line territory. At one time, MTA/Metro-North's unofficial position on this matter was that, MTA/Metro-North would have to be reimbursed for revenues lost, or diverted to Shore Line East trains operating in the territory. Also, while the unions representing Metro-North employees appear to support the extension of Shore Line East trains into the Service area, the issue of whether Metro-North or Amtrak employees "own" the work will likely arise. Discussions are ongoing with respect to these issues.

In accordance with ARSA, officials from ConnDOT and Metro-North meet monthly to review specific agenda items as may be requested by the parties. Meetings are conducted each month alternately in New Haven and New York.

Article Three: Allocation and Payment of Operating Deficits

Metro-North has developed a "deficit model" to calculate the annual Service deficit and apply the ConnDOT and MTA sharing percentages. ConnDOT's share is derivable from three primary pools of cost, which include the main line, the branch lines and Grand Central Terminal (GCT). As previously stated, in accordance with an arbitration award, 65% of the main line net operating deficit is allocated to and paid by ConnDOT, while 35% is allocated to and paid by MTA. One hundred percent of the net operating deficit for the branch lines is paid by ConnDOT and, based upon a decision made by ConnDOT in 1998, a fixed fee is paid for GCT.

The deficit model is a very complex calculator used to apply the definitions and interpretations of ARSA for the purpose of deriving the parties' respective deficit shares. There are a total of 21 allocators which are fractions, the numerators of which are units that relate to the New Haven Line service and the denominators of which are the same unit but related to the entire Metro-North system. Allocators are used as multipliers to assign costs to the New Haven Line.

Metro-North also uses an account coding system to compile costs. This coding system utilizes a 17-digit code made up of ledger accounts, management centers, cost centers and purpose codes. There is also a group code used to pool costs for special analyses. The coding system sorts and classifies Metro-North's records which are then used in the deficit model to determine the New Haven Line deficit.

With respect to monthly operating deficit billing and payments, a form of prepayment has been developed. On the first day of each month, Metro-North provides ConnDOT with a billing statement for the following month. For example, on January first Metro-North provides a billing statement for the month of February, based upon the operating portion of the approved budget. In addition to the budget amount for the month of February, the billing statement contains a statement of the actual expenses incurred two months prior, or in this example, the previous November. On February first, an electronic funds transfer (EFT) is made to Metro-North which provides funding for operations in the month a February, adjusted to reflect the difference between the amount previously paid and actual amount incurred in November. Continuing this example, if a budget payment of \$2.5 million were made for the month of November and the actual cost incurred proved to be \$2.3 million, then \$200,000 would be deducted from the EFT on February first. Similarly, the February payment would be increased if actual November costs exceeded the November prepayment amount.

Recognizing the need to ensure that costs incurred in good faith must be reimbursed and that each party has a say in what is eligible for reimbursement, ARSA requires that ConnDOT pay the billed amounts but provides a mechanism to resolve disputed costs. In the case of a disputed billing, ConnDOT must pay the amount in dispute and notify Metro-North of the disputed charge. The amount in dispute must then be held in escrow pending resolution of the dispute. ConnDOT must present all disputed items in writing with a copy

to MTA, with an explanation of the dispute. Metro-North must respond in writing to ConnDOT within two months of receiving notification of the dispute. In the event that the dispute is not resolved within one month after Metro-North's response, the dispute is submitted for resolution under an expedited financial arbitration procedure, which is explained latter in this section. Finally, ARSA states that neither ConnDOT nor its auditors may commence a financial dispute more than eighteen months following the delivery of the adjusted statement for the fiscal year in which the event giving rise to the dispute occurs. In the practical application of this provision ConnDOT and Metro-North have agreed that this time constraint be waived due to the complexity of outstanding audit issues from prior years. With its auditors, ConnDOT is working aggressively to resolve these issues.

Article Four: Classification and Acquisition of Capital Assets

The determination of what constitutes a capital asset, the cost of the capital asset, and the classification of a capital asset as a nonmoveable or moveable, and all decisions as to the location of the capital assets is made by Metro-North subject to the right of ConnDOT and MTA to submit the propriety of the decision to arbitration in the manner prescribed in ARSA. ConnDOT retains the right, at its election, to let, schedule or manage any capital project located solely within the state of Connecticut and to require that interstate projects be divided along state lines into two projects, whenever ConnDOT desires to let, schedule and manage the Connecticut portion of the work.

One hundred percent of the capital costs of non moveable capital assets located in New York are allocated to and paid by MTA, and one hundred percent of the capital costs of non moveable capital assets located in Connecticut are allocated to and paid by ConnDOT. Whenever a moveable capital asset, including administrative assets (administrative assets generally consist of computers, automotive vehicles, repair equipment, tools etc.), is purchased for use in the Service, Metro-North is responsible for making a determination with respect to the asset's "Service use". If the Service use of such asset will be primarily on a branch line then ConnDOT will be allocated and pay one hundred percent of the cost. If the Service use is determined to be primarily on the main line, then 65% of the cost is allocated to and paid by ConnDOT and 35% is allocated to and paid by MTA.

To allocate the cost of moveable assets purchased to serve the entire Metro-North system (Harlem and Hudson Lines included), an allocator is applied to the capital cost of that asset. In this case, the allocator is a fraction, the numerator of which is the total operating cost for the Service over a given period and the denominator of which is the total operating cost for the entire Metro-North system over that same period. No provision of ARSA precludes ConnDOT and MTA from varying their respective percentage allocations on a case by case basis with prior written agreement.

Generally, ConnDOT funds its share of administrative asset costs from its annual rail appropriations budget, while larger moveable assets (such as rail cars) and nonmoveable assets are funded with bonds authorized by the Legislature and formula funds received from the Federal Transit Administration. Payments to Metro-North for expenses incurred in carrying out capital projects are made in a manner similar to that described in the previous

section. At this time, only payments for administrative assets are made quarterly after expenses are actually incurred.

Article Five: Allocation and Payment of Capital Costs.

Article Five of ARSA directs how the costs of nonmoveable and moveable capital assets shall be allocated. One hundred percent of the capital costs of all nonmoveable capital assets located in the state of Connecticut are allocated to and paid by ConnDOT and 100% percent of all nonmoveable capital assets located in the state of New York are allocated to and paid by MTA. Whenever Metro-North purchases a moveable capital asset for use primarily on the New Haven Line, 65% of the cost of such asset will be paid by ConnDOT and 35% shall be paid by the MTA. The capital cost allocated to the New Haven Line for all moveable assets purchased to serve the entire Metro-North system, is determined by multiplying the cost of such asset by a fraction that represents the ratio of the New Haven Line's operating costs for a given period to the operating costs for the entire Metro-North system for the same period of time. Nothing in ARSA precludes ConnDOT and MTA from varying their respective percentage allocation, at any time and for any reason, by prior written agreement

Article Six: Service Finances and Budget Process.

ARSA provides that at any time after August 15th of each year, ConnDOT, MTA or Metro-North may request a meeting to discuss concerns and potential problems that the requesting party foresees in the preparation of the budget for the upcoming year. Prior to October 1st of each year, Metro-North is required to submit to ConnDOT and MTA a detailed annual budget for the Service, reflecting the anticipated Service revenues and Service costs for the upcoming year, including the costs of capital assets. Thereafter, ConnDOT, MTA and Metro-North are permitted to consult with respect to the proposed budget. During this consultation period, ConnDOT may seek to influence individual line items within the proposed budget.

To complete the process, on or before December 1st of each year ConnDOT must indicate to MTA and Metro-North its approval or disapproval of the proposed budget in total. At this time, ConnDOT does not have the authority to approve or disapprove specific elements of the budget. MTA approves or disapproves the proposed budget or any revisions to the budget resultant from consultations between Metro-North and ConnDOT, by formal action taken by the MTA Board of Directors on or before December 31st of each year.

Metro-North may request the modification of an approved budget at any time, and ConnDOT and MTA may by mutual agreement modify an approved budget at any time. Metro-North is only required to submit a modified budget to ConnDOT at such time as Metro-North believes that the actual operating expenses for the year will exceed the approved budget by ten percent. No provision of ARSA is deemed to prohibit Metro-North from charging costs incurred in good faith in fulfilling its obligations to operate the Service.

In the event that Metro-North's budget is not approved, Metro-North is permitted to budget and expend in accordance with the approved budget for the preceding year. Such increases as may be required by labor contracts and general increases in the costs of goods and services, as reflected in the Consumer Price Index, may be added.

Article Seven: Asset Ownership and Management.

ConnDOT and MTA agree that each party shall have all rights, title and interest in all present and future nonmoveable assets located in their respective state. Article Seven also provides for an asset management review to be performed jointly by ConnDOT and MTA. The objective of this review is to identify, attribute ownership of or other interest in, catalogue all capital assets used by the Service, and to establish a process by which the management and utilization of assets can be enhanced.

Article Eight: Labor

Nineteen separate bargaining units represent the nearly 5,000 contract employees of Metro-North. ARSA affords ConnDOT full rights of consultation in all stages of labor negotiations involving Metro-North and permits ConnDOT to have a representative sit in on all bargaining sessions with the unions. However, although it is not expressly stated in ARSA, most of the negotiating parameters followed by negotiators for Metro-North are set unilaterally by MTA since pattern bargaining is a practice followed within the MTA system and within Metro-North.

For example, MTA establishes a multi-year wage package that it will offer to all the agencies in its system, as well as the individual collective bargaining groups within each agency. Once an agency or sizable collective bargaining group(s) is signed to this package, MTA/Metro-North negotiators will contend that a pattern has been established and, therefore, a different wage package cannot be offered to another group.

Article Nine: Productivity Review.

In this section the parties agreed to undertake a joint comprehensive one-time review of the Service in an effort to improve its efficiency. The productivity analysis was intended to identify areas where service can be improved; costs reduced and revenues enhanced; and to develop a process to implement opportunities for improvement identified during the analysis. It was further agreed that any party could utilize the services of a consultant, at its own expense, to assist its staff.

Article Ten: Arbitration

Despite the philosophical agreement between the parties that every effort will be made to resolve disputes arising from differing interpretations of ARSA without resorting to arbitration, a detailed arbitration procedure and expedited financial arbitration procedure is provided. Any disagreement relating to the meaning of a provision of ARSA, or any alleged

breach of ARSA, may be submitted to arbitration by the parties. The following are steps to be followed when the arbitration provision is invoked:

- Either ConnDOT or MTA notifies the other of its intent to arbitrate. Such notice must include a detailed statement of the subject matter of the arbitration and the name of that party's designated arbitrator
- Within 15 days after such notification, the notified party must designate its own arbitrator.
- Within 15 days after the designation of a second arbitrator, the two arbitrators must designate a third arbitrator.
- If the two arbitrators fail to agree on a third arbitrator within 20 days, a third arbitrator will be appointed by the President of the American Arbitration Association at the request of ConnDOT and MTA.
- The arbitrators shall promptly proceed to receive such submissions and evidence from ConnDOT and MTA as deemed necessary.
- The Arbitrators will hear the matter after giving reasonable notice to both parties of the time and place for the hearing.
- The arbitrators shall promptly make their decision and award in writing and serve such decision to both parties.

The decision of the arbitrators is final, binding and conclusive and each party must pay its respective cost of any arbitration, with the joint costs to be paid in a proportion determined by the arbitrators.

Any dispute arising from the calculations of amounts to be paid by either ConnDOT or MTA, the classification of a capital asset, or the decision as to what constitutes a Service revenue or a Service cost can be resolved by an expedited financial arbitration procedure. Under this process a single arbitrator mutually acceptable to ConnDOT, MTA and Metro-North is selected. If, after 30 days, the parties can not agree upon an arbitrator, one may be appointed by the President of the American Arbitration Association. All disputes subject to this procedure must be submitted to hearing within 30 days and no practicing lawyers, including inside counsel are permitted to participate in the hearing unless the arbitrator requests or both parties agree.

In the case of a disputed amount, the amount in dispute is to be paid to Metro-North and held in an escrow account until the dispute is resolved. All decisions in the expedited financial arbitration procedure must be rendered within 30 days and are binding and conclusive. The cost of this manner of arbitration shall be as indicated above.

Article Eleven: Claims

All claims, damages, liabilities, or Service revenues brought by a third party under ARSA or with respect to the Service are deemed to be Service costs or Service revenues.

and are to be paid (in the case of Service costs) or received (in the case of Service revenues) by ConnDOT or MTA in proportion to the respective allocations.

In the event of a claim arising out of a collision or other accident involving equipment operated on behalf of the Service and equipment operated by Metro-North on behalf of the Harlem or Hudson Line services, the cost of claims and repairs shall be apportioned 50% to Service accounts and 50% to non-Service accounts. If such a collision or accident occurs as a result of equipment operated by Metro-North and any other carrier, Metro-North's liability shall be governed by the terms of the agreement, if any, with the carrier. The Service shall bear its proportionate share of such liability as such costs are allocable to the Service.

Article Eleven also provides Metro-North unilateral authority to select and direct counsel for litigation of claims arising out of the operation of the Service. However, if such a claim arises solely from branch line service, Metro-North shall confer with ConnDOT and the selection of counsel shall be subject to the consent of the State of Connecticut. The State of Connecticut has reserved the right to be represented by the Attorney General of the State of Connecticut or by counsel appointed by the Attorney General in any proceeding in which the State of Connecticut is a named party.

Article Twelve: Duration of the Agreement (Termination)

It was agreed that the initial seven year term of ARSA (1983-1990) shall be extended automatically for additional consecutive five year terms as each successive term expires. At least one year prior to the expiration of each term, ConnDOT or MTA may request to renegotiate the allocations. In the event that ConnDOT and MTA have not mutually agreed to allocations for the next renewal term eight months before the expiration of the existing term, they shall submit the question of fair and equitable allocations for the next renewal term to arbitration.

ConnDOT and MTA have the right to terminate ARSA by notifying the other parties in writing at least 18 months prior to the desired termination date. Any party also has the right to terminate ARSA 90 days after notifying the other party of that party's default under the terms and conditions of ARSA and that party's failure to remedy the default prior to the expiration of the ninety-day period. In the event of termination, and failing good faith negotiation, the fair and equitable allocation of moveable capital assets may be submitted to arbitration.

Article Thirteen: Miscellaneous.

Article Thirteen addresses and/or makes provisions for ten miscellaneous items such as formal filings related to ARSA; office space for ConnDOT at Metro-North's headquarters; force majeure; successors and assigns; past and future agreements; the State Connecticut's non-discrimination statutes and Executive Orders. It is in this Article where the State of Connecticut expressly waives sovereign immunity with respect to any claims or

proceedings commenced by MTA/Metro-North with respect to monies claimed to be due under the terms of ARSA or any arbitration award issued pursuant to ARSA.

Appendices

Six Appendices are integral parts of ARSA and the provisions set forth in these Appendices bind the parties to the same extent as if they had been set forth in their entirety in the main body of ARSA. The Appendices are modified from time to time as Service changes and fare structure changes warrant. The Appendices are:

- Appendix A: Uniform Accounting Principles for the Service
- Appendix B: Identification of Map of grand Central Terminal
- Appendix C: Service Schedule
- Appendix D: Service Consists
- Appendix E: Service Fares
- Appendix F: Identification of Branch Line Maps

WHERE THE PROBLEMS HAVE COME

There has been a perception that ARSA is a fundamentally flawed document and is skewed to the benefit of MTA/Metro-North. It has been suggested that ARSA is patently unfair to Connecticut based primarily upon the once equal but now unbalanced allocation of the Service's net operating deficit. But, as mentioned previously, the current allocation of the net operating deficit exists as a result of the binding awards of two arbitration panels and not as a result of ConnDOT's negotiation of ARSA.

In some respects, it can be said that ARSA lacks precision and can be subject to interpretation. While this is not a fatal flaw, it can also be said that ARSA also lacks the flexibility to simply correct this imprecision. For example, ARSA requires ConnDOT to share in all of Metro-North's direct, indirect, and administrative costs. This occurs in what is referred to as the first step down allocation of costs. In the first step down, all of Metro-North's direct and indirect costs are allocated to either the Harlem and Hudson Lines or to the New Haven Line. Direct costs are rather easily allocated. However, to allocate indirect costs, Metro-North utilizes a fully allocated cost allocation model in all costing situations. This model treats most costs as allowable and presumes the Service, and Connecticut's riders, benefit proportionately to the Harlem and Hudson Lines from all of Metro-North's activities.

ConnDOT has taken exception to that presumption, particularly, but not exclusively, with respect the activities of Metro-North's Legal Department, Property Management Office, Marketing, MTA Police and station administration and maintenance. In addition, ConnDOT has requested a more equitable allocation of DC power costs in what is referred to as the "common area", that is the area operated through by New Haven, Harlem and Hudson Line trains. MTA/Metro-North has agreed to discuss these matters with ConnDOT. A formal position paper is in preparation at ConnDOT and will be forwarded to

MTA/Metro-North shortly. This paper will represent the starting point for negotiation of these issues.

Another perceived shortcoming of ARSA is its reliance on Generally Accepted Accounting Principles (GAAP). It has long been ConnDOT's position that ARSA incorporate standards that provide a more detailed allocation of costs and revenues such as those used by the federal government. It is generally accepted that GAAP focuses on external reporting requirements and provides little guidance on internal cost and revenue allocation. ConnDOT has suggested that the implementation of cost accounting standards or principles, such as those promulgated by the Cost Accounting Standards Board of the federal government, would eliminate many of the problems that have arisen from the first step down allocation procedures. While it remains to be seen whether such a modification to ARSA would result in a greater or lesser allocated share of the net operating deficit for ConnDOT, it would certainly enhance consistency and fairness.

Despite the fact that ARSA provides a process for the arbitrating non-financial disputes as well as an expedited financial arbitration procedure, these processes are often time-consuming, costly, and have the potential to create animosity among the parties. The point can be made that ARSA lacks a fair and timely mechanism to resolve financial disputes that cannot be resolved through negotiation. Even the expedited financial arbitration procedure can take up to 150 days to resolve a dispute. For these reasons, ConnDOT has been reluctant to utilize the arbitration procedures that ARSA provides. Nevertheless, the expedited financial arbitration procedure is a protection of ARSA that ConnDOT must consider in the future.

Facing an ever-escalating Metro-North annual operating budget and a more static annual revenue appropriation from which to fund its share of the net operating deficit, ConnDOT has been frustrated by its inability to exert control in the budget process. It has been assumed by many that much of this frustration stems from restrictions and inequities associated with ARSA. However, it must be acknowledged that ARSA does provide mechanisms to potentially enhance ConnDOT's influence in the budget review process. A Memorandum of Understanding recently executed by the parties re-emphasizes these mechanisms and reaffirms the parties' interest in preserving and enhancing this vital service by reestablishing a meaningful process to develop a mutually acceptable annual budget for the Service.

In the past, two distinct factors have undermined ConnDOT's effectiveness in the budget process. First, Metro-North had not provided a proposed Service budget for ConnDOT's review, but rather provided a Metro-North system budget that provided only summaries of components of the Service budget. From time to time, ConnDOT has had difficulty in reviewing the proposed budget and identifying a causal or beneficial relationship between activities and the delivery of the Service. Article six, section 6.04 (b) requires that on or before October 1, Metro-North submit to the MTA and ConnDOT detailed annual budgets for the Service. The aforementioned Memorandum of Understanding restates the intent of the parties to more closely follow the provisions of ARSA in establishing annual budgets for the Service.

Secondly, MTA/Metro-North's annual calendar year budget process does not conform well to ConnDOT's biennial budget process. MTA/Metro-North issues a draft calendar year budget each October 1st for the upcoming calendar year, while ConnDOT prepares a budget for a two fiscal year period which begins twelve months after that budget is prepared. This fundamental, temporal disjoint at times has created difficulties for ConnDOT when Metro-North's projected operating revenues or costs vary from actuals, or administrative assets project schedules slide. Nevertheless, ConnDOT and Metro-North have mutually agreed to clarify the budget process as set forth in ARSA to ensure timely and coordinated budget development.

CONNDOT'S ROLE IN THE ADMINISTRATION OF ARSA

As might be expected in any relationship of comparable length, ConnDOT has enjoyed periods of harmony and has suffered periods of animosity and mistrust in its relationship with MTA/Metro-North. Many of the ups and downs in the relationship can be directly attributable to the changing personalities and managerial philosophies that have guided the respective agencies and their interpretation of the letter and intent of ARSA. Just as the nature of the agencies' relationship has fluctuated over time, so to has the effectiveness of ConnDOT's administration of the Service Agreement and ARSA, usually in direct proportion to the availability of financial and human resources.

In 1971, when ConnDOT formally began its oversight of the New Haven Line commuter service, five individuals were assigned full-time in the Bureau of Rail and Motor Carrier Services (known today as the Bureau of Public Transportation) to monitor Penn Central's day to day operation of the railroad and administer a number of capital improvement grants received from the Urban Mass Transportation Administration (known today as the Federal Transit Administration, FTA). Administrative assistance in reviewing and processing monthly operating deficit payments was received in a part-time capacity from two additional individuals assigned to the Bureau of Administration. In these early days of ConnDOT's involvement railroad invoices were paid on time, but with little analysis or oversight of the first step down to the New Haven Line; federal grants were procured, often faster than projects could be implemented; and construction projects were administered, usually through a force account agreement with the operating railroad attended with little if any oversight by ConnDOT.

Over the years, ConnDOT's role and level of involvement has evolved to a point where today, there are 113 individuals assigned to the Bureau of Public Transportation. Of this number approximately two-thirds are involved in some capacity in providing operational planning, capital planning, engineering, construction management, marketing or administrative support in ConnDOT's oversight of the New Haven Line. In addition, engineering and construction management support is received from the Department's Bureau of Engineering and Highway Operations. For its legal interpretations and guidance in administering ARSA, ConnDOT currently utilizes the part-time services of an Assistant Attorney General on assignment to the Department of Transportation. With respect to financial matters, ConnDOT has a multi-year agreement with a competitively selected

accounting firm to provide ongoing audit assistance of the annual operating deficit, as well as other miscellaneous audits and financial analyses.

Despite this dramatic evolution, ConnDOT's role in overseeing the New Haven Rail Line commuter service has really changed very little at its core from 1971 to today. Though ConnDOT's objectives with respect to the New Haven Line may never have been articulated or reduced to writing, a basic transportation policy and financial objectives have always existed and continue to evolve. Simply stated, ConnDOT's evolving New Haven Line transportation policy has been to develop alternatives to congested highways; increase intrastate mobility; and increase access to jobs and labor pools. Its financial objectives have been to demonstrate value for subsidies and eliminate wasteful spending.

To these ends, ConnDOT's role in the administration of ARSA can be summarized, again simplistically, in the following tasks:

- Monitor the operational and financial effectiveness of Metro-North.
- Review and approve the annual New Haven Line operating and capital budgets.
- Review, process, and audit monthly deficit billings and payments.
- Develop and maintain fare policy and fare structure for the Connecticut portion of the New Haven Line and coordinate revisions with Metro-North and MTA.
- Develop periodic schedule changes with Metro-North.
- Develop annual Five-Year New Haven Line Capital Plan updates with Metro-North.
- Procure and administer federal funds to effect New Haven Line capital improvements.
- Conduct and/or administer planning and engineering studies.
- Coordinate and/or administer capital improvement projects for New Haven Line facilities and structures in Connecticut.

ConnDOT has exercised its right of oversight of the deficit model from 1992 through 1999 in particular. During this period over \$17 million of costs were questioned and Metro-North subsequently reduced ConnDOT's deficit share by \$15 million, with the remaining questionable costs being negotiated. Nevertheless, ConnDOT's effectiveness in carrying out its role and the extent to which the aforementioned tasks are addressed has been and clearly remains a function of the financial and human resources available.

TARGETING AND CAPTURING A NEW MARKET

There is little disagreement that for the first 25 years of ConnDOT's involvement in the operation of the New Haven Line the Service has been "New York-centric"; that is, centered around trips destined for Manhattan. In fact, ConnDOT's original enabling legislation, which authorized the Connecticut-New York Rail Passenger Compact, expressly referred to the preservation and improvement of service between New Haven and the city of New York. Even today, 90% of the trips on the New Haven Line begin or end at GCT.

However, in recent years a fast-growing, intrastate and reverse commute market in Connecticut has emerged and has given rise to Connecticut's new transportation strategy.

Worsening traffic congestion and its potential impact on the ability to move people and goods in the I-95 corridor resulted in a legislative awareness that immediate action was needed to address mobility issues. Special Act 97-13 directed the Commissioner of Transportation to analyze the transportation needs along the I-95 corridor from Branford, Connecticut to the New York state line and develop revised travel demands from 1987 to 1997 and forecast this demand to the year 2007. In addition, the Department is directed to develop a plan with the goal of reducing highway commuter demand during peak periods from the 1997 base level by five percent over a period of five years.

In compliance with this mandate, ConnDOT produced a report entitled the Southwest Corridor Update (Update) in February 1998. The Update recommended that ConnDOT develop a "commuter as customer" philosophy and recommended a series of strategies to provide the commuter with a range of transportation choices. Further, the Update initially established the five percent goal and referred to the target goal as a diversion of 8,600 commuters from I-95, Route 15, and Route 1. As a means of meeting this goal, a series of alternative strategies were developed. Prominent among the strategies was increasing the use of the region's rail system.

Without question, the Service has been exceeding all ridership and revenue expectations. Ridership reached an all time high of 32.5 million in 2000, representing a 4.7 % increase over 1999; an increase of 41% since 1984 and an increase of nearly 100% since 1970. Morning peak ridership in Connecticut on the New Haven Line has increased by over 950 riders in the past year and 2,213 riders since the base year of 1997. This number represents a 9.9% growth in morning peak ridership between 1997 and 2000. Metro-North has provided ConnDOT with ticket sales data that demonstrates remarkable growth of intrastate ridership in Connecticut. Reports indicate that between 1995 and 2000 intrastate ridership has increased by 47%, with 26% percent of this growth occurring between 1997 and 2000. **Tables 2 and 3** illustrate this growth.

Table 2
Average Monthly Connecticut Intrastate Rides
New Haven Line Service

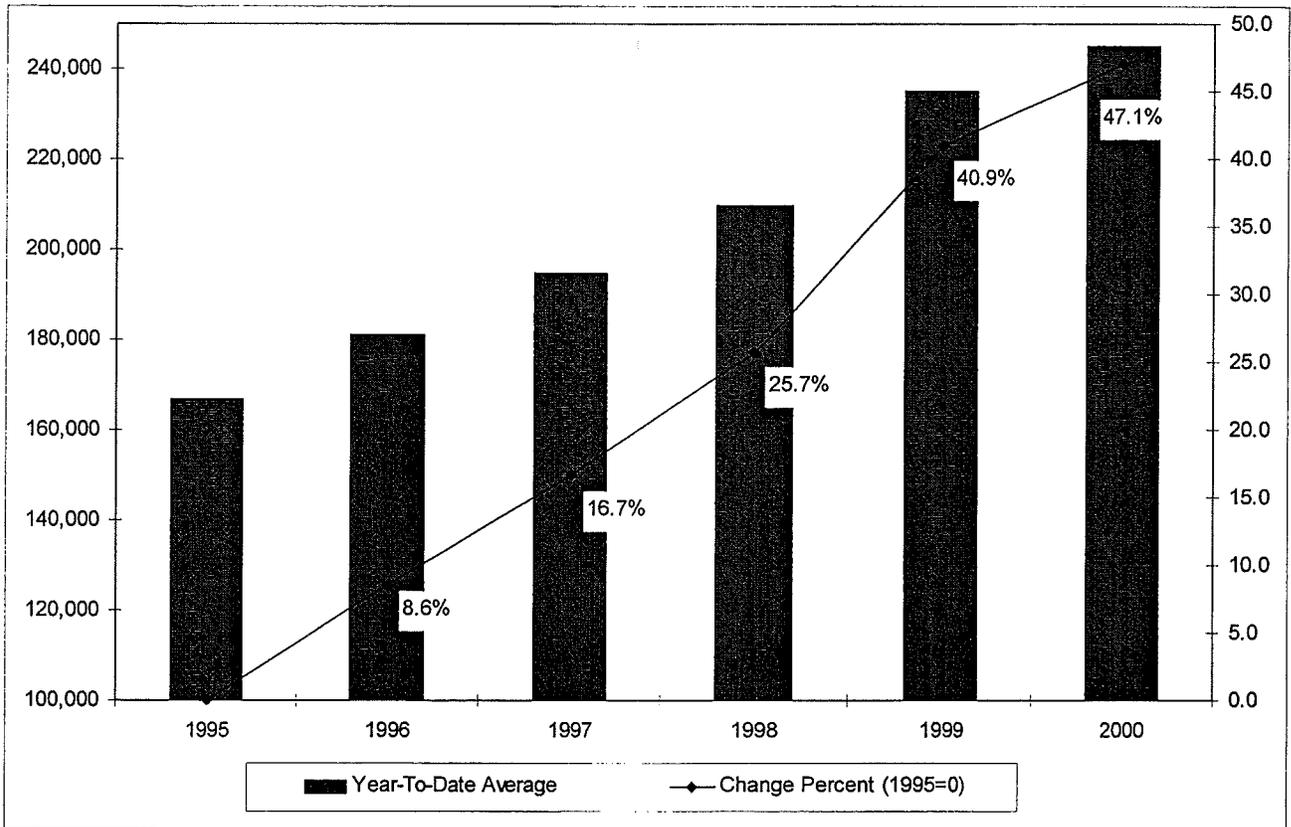
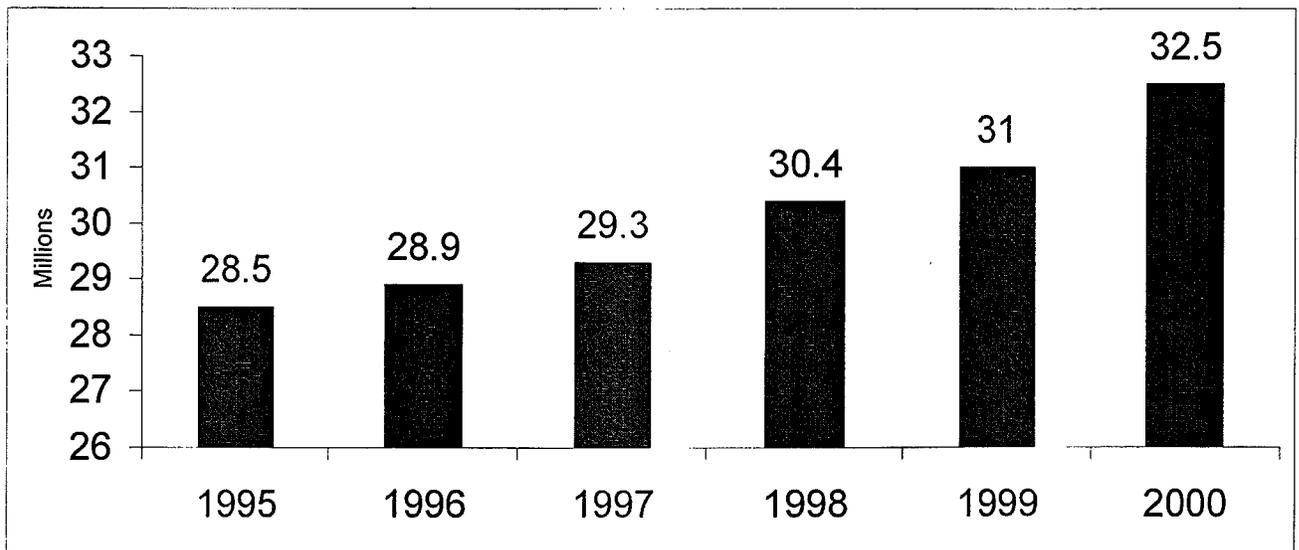


Table 3
Annual Ridership
New Haven Line Service



Clearly many factors are involved in preserving the existing ridership and attracting new riders. The service must be safe, reliable, on-time, affordable and must provide adequate, affordable parking. The significant ridership growth in the past five years is due in large part to service and parking improvements and the expansion of intermodal service connections along the line. In particular, more frequent service for intrastate commuters; parking expansion in Bridgeport, including a new garage and free surface parking lot; an innovative parking and shuttle bus operation in cooperation with the New Haven Coliseum Authority; and a privately subsidized CTTransit public shuttle from Stamford station to the Westvaco corporate offices, have all contributed to the attraction of new riders.

In the past seven years, ConnDOT and Metro-North have jointly implemented a number of targeted fare initiatives to attract new ridership in the intermediate commutation market to the major employment centers of southwestern Fairfield county. These initiatives were specifically directed at both the intrastate Connecticut market and the reverse commutation market out of the Bronx and lower Westchester County. Both these markets presented, and continue to present, unique opportunities to generate growth in ridership through innovative fare modifications. This was especially so because the New Haven Line's existing market share was low compared to the dominant share of the automobile and the existing intermediate fare structure was high compared to the estimated cost of commuting by auto. Data collected in 1990 showed that the Service captured approximately 5% of the intrastate market share from the east end of the New Haven Line to key employment centers in along the New Haven Line. According to Metro-North, over the last several years this market share has grown to approximately 12% to 15%. The market share potential is currently estimated at 20%, thus offering excellent opportunity for continued intrastate market share growth.

While targeted fare reductions in 1993, 1994, and 1997 produced ridership gains of 10% to 30% within the targeted markets, the Bridgeport fare reduction implemented in 1998 resulted in ridership increases to/from Bridgeport of up to 40% in the first two years. This increase represents over 500 additional daily riders, most of whom were new riders, as opposed to those who may have been diverted from other stations. Commutation ridership between Bridgeport and Manhattan increased by over 130%, while commutation ridership to/from intermediate stations increased by almost 60%.

What constitutes an affordable fare is clearly a subjective matter, especially when, according to recent survey data, the approximate annual household income for 79.8% of all Connecticut commuters to GCT is greater than \$100,000. Nevertheless, as a frame of reference, it can be stated that the New Haven Line fare structure in general, and monthly commutation tickets in particular, has kept pace with the Consumer Price Index (CPI). As it is commonly understood, CPI represents changes in prices for all goods and services purchased for consumption by urban households. When the cost of a monthly New Haven Line commutation ticket is factored into a CPI inflation calculator for any given year since 1984, the buying power of that cost generally remains within single digit percentages of what it would be in 2001. As permitted under ARSA, ConnDOT will continue to negotiate innovative fare strategies with Metro-North to attract new ridership, while still maintaining a favorable relationship with the CPI.

Sufficient parking for rail commuters is also a key element in attracting new ridership. ConnDOT has initiated a study of the existing New Haven Rail Line rail station parking and governance to determine if these facilities are currently managed and maintained in the most efficient and cost-effective way. ConnDOT has also entered into an agreement with the South Western Regional Planning Agency (SWRPA) to study rail station parking alternatives in Fairfield County and with the South Central Regional Council of Governments (SCRCOG) to study the feasibility of a major regional train station between New Haven and Milford. Suitable sites in both Orange and West Haven have been identified for a new station, though funding has not.

Finally, ConnDOT is progressing parking initiatives in New Haven, Stamford, and Fairfield to add 1000, 900 and 1200 new spaces respectively. With respect to New Haven, ConnDOT solicited and received innovative "design, build, operate and maintain" proposals to provide an additional parking structure at New Haven station adjacent to the existing parking structure. Negotiations to implement the favored proposal with a minimal outlay of public funds have been arduous, but the concept at this time remains viable. At Stamford, an expansion of the existing parking structure is currently underway utilizing a combination of state and federal funds.

A unique public/private partnership has been formed among ConnDOT, the Town of Fairfield and a private developer to effect a new passenger station and commuter rail parking in Fairfield. This new station, which will be operated in addition to the existing Fairfield and Southport stations, will be constructed on a portion of an abandoned industrial site of approximately 35 acres owned by the developer. Additionally, the developer plans to construct up to 1.4 million square feet of office development and associated retail development, that may include a hotel.

ConnDOT, with federal assistance, will fund a new four lane bridge over the railroad to access the site, high level boarding platforms, public roadway improvements and extensive environmental remediation. A station and 1200 surface parking spaces for rail commuters will be funded by the Town and the developer. As the development materializes, it is envisioned that the surface parking facility will be converted to a parking structure. In any event, 1200 spaces will be available for rail commuters at all times.

Just as ConnDOT will continue to negotiate innovative fare and schedule strategies within the framework of ARSA, ConnDOT will also pursue all avenues to increase the availability of parking for rail commuters and will continue to encourage public/private partnerships for this purpose outside of ARSA.

Marketing

When Metro-North was first contracted to operate the Service in 1983, there was no formal marketing department within Metro-North or ConnDOT, though some marketing functions were undertaken within the planning units of both organizations.

However, by the late 1980s, Metro-North and ConnDOT agreed that there was a need to market railroad services, and the Marketing Department at Metro-North was created.

Since the inception of the Metro-North Marketing Department, railroad ridership has grown along with the scope of the Marketing Department's activities. The Department now encompasses the marketing of parking programs, connecting services, ticketing/pricing, promotions and special events. Market research is also conducted through this Department in the form of annual and quarterly customer satisfaction surveys, market share analysis, tracking studies and customer expectations research.

ConnDOT has taken an increasingly active role in the Connecticut portion of Metro-North's marketing activities as well. Shortly after Metro-North's Marketing Department was formed, ConnDOT limited its involvement to only reviewing Metro-North's activities to ensure that an acceptable level of marketing services was being provided to Connecticut in relation to the amount being billed. ConnDOT established its own Transit Marketing Unit in 1997 to work closely with Metro-North's Marketing Department and to integrate its activities with other transit operator's activities within the state (Amtrak, CTTRANSIT, Transit District services).

The role of ConnDOT's Transit Marketing Unit has expanded greatly since 1997. The Unit gives final approval for all Metro-North marketing activities that utilize Connecticut media and ensures that ConnDOT's role in the Connecticut portion of the service is well represented in all in-state communications. ConnDOT's Transit Marketing Unit is working with Metro-North to ensure that the most effective marketing strategy possible is developed to reach Connecticut markets with the greatest opportunity for ridership growth. For calendar year 2001, ConnDOT reviewed Metro-North's draft marketing plan and made comments with regard to the Connecticut portion of their work program. These comments were received favorably by Metro-North and incorporated into their 2001 Marketing Plan.

In October, 2000, ConnDOT initiated a contract with the advertising, marketing, and public relations agency FJCandN, Inc. of Salt Lake City, Utah. This agency was hired to assist in the marketing of rail services and other public transportation services in Connecticut. They will develop a brand for public transportation throughout Connecticut. This brand will be incorporated into all marketing materials from ConnDOT, including Metro-North's marketing for the New Haven Line.

Capital Investment

With respect to commuter rail capital improvements, the mission of ConnDOT is to bring existing infrastructure and rolling stock to a state-of-good-repair, maintain them at that level, replace existing facilities and equipment as expected life cycles dictate, and size its rolling stock fleet and support facilities in a manner necessary to accommodate current and future ridership needs.

In support of the aforementioned mission statement, the Intermodal Capital Planning and Programming Unit within the Bureau of Public Transportation maintains a fiscally constrained Capital Project Management Plan that programs all of the state and federal funds that are expected to be available during a rolling 20 year horizon. A Capital Projects Review Meeting is conducted monthly at which time investment priorities are reviewed in light of changing needs.

As called for in Article Six, Section 6.08 of the ARSA, ConnDOT and Metro-North have developed a five year capital plan for the New Haven Line. The plan, which is updated annually, identifies the acquisition and/or construction of all moveable and nonmoveable capital assets, whether located in Connecticut or New York. This plan contains all of the projects identified in the ConnDOT's Capital Project Management Plan, however the five year plan is not fiscally constrained. Projects of lesser priority, for which no funding source has been identified, are also included.

ConnDOT began its capital investment in the New Haven Line in 1970. ConnDOT and MTA each placed an order with General Electric for 72 M-2 type rail cars. ConnDOT added 100 cars to its 72 car order at a cost of \$65 million soon after. MTA paid 50% of the non-federal cost for 100 car add-on order and assumed ownership of 50 of those cars. Through the 1970's and early 1980's, ConnDOT administered contracts to effect the construction of high level platforms at all main line stations; construction of an M-2 car maintenance facility in New Haven; conversion of the main line electric traction system to 60 cycle to facilitate the retirement of the coal burning Cos Cob power plant; a modernization of the main line signal system to allow reverse operations; and annual track modernization programs to replace ties and rail.

Since 1985, ConnDOT has invested over \$1 billion of state and federal formula and discretionary funds in New Haven Line capital improvement projects. With the exception of limited assistance received from the Federal Railroad Administration and Amtrak for certain projects, all federal assistance for New Haven Rail Line capital improvements is received from the Federal Transit Administration. **Table 4** shows the major ConnDOT-funded capital projects by category completed between 1985 and 2000, those currently underway, and those programmed within the next five years:

**Table 4
New Haven Line Capital Improvement Projects**

Improvement Type	Completed	Underway	Programmed	TOTAL
	1985-2000		2001-2006	
Moveable Bridge Rehabilitations	\$46.2	\$0.0	\$12.0	\$58.2
Moveable Bridge Replacements	\$140.0	\$2.0	\$10.0	\$152.0
Fixed Bridge Replacements	\$20.2	\$23.8	\$81.0	\$125.0
Fixed Bridge Repairs	\$22.7	\$2.8	\$22.8	\$48.3
Track Rehabilitation	\$112.6	\$141.5	\$29.2	\$283.3
Signal & Power	\$16.7	\$84.2	\$202.0	\$302.9
Shop & Yard	\$74.1	\$64.0	\$35.2	\$173.3
Stations/Parking	\$28.9	\$155.5	\$78.0	\$261.1
Acquisition of ROW	\$8.1	\$0.0	\$0.0	\$8.1
Rolling Stock	\$196.4	\$36.0	\$68.0	\$276.4
TOTALS	\$665.9	\$509.8	\$538.2	\$1,688.6

THE CHALLENGES

More than ever before, forecasting future Service budgets in the preparation of a biennial State budget and managing an annual rail appropriations budget so as to maintain existing service levels and reliability in the face of an escalating deficit share and related Service costs is becoming a true challenge for ConnDOT. It follows, therefore, that the most significant challenge to implementing a transportation strategy that will divert a meaningful number commuters to the Service is appropriating the amount necessary to fund the deficit for additional intrastate trains, regardless of whether that sum represents 65% or 100% of the total cost. The second most significant challenge that ConnDOT faces in implementing such a strategy is identifying the resources necessary to address a critical shortage of passenger equipment and the storage and maintenance facilities necessary to support this equipment.

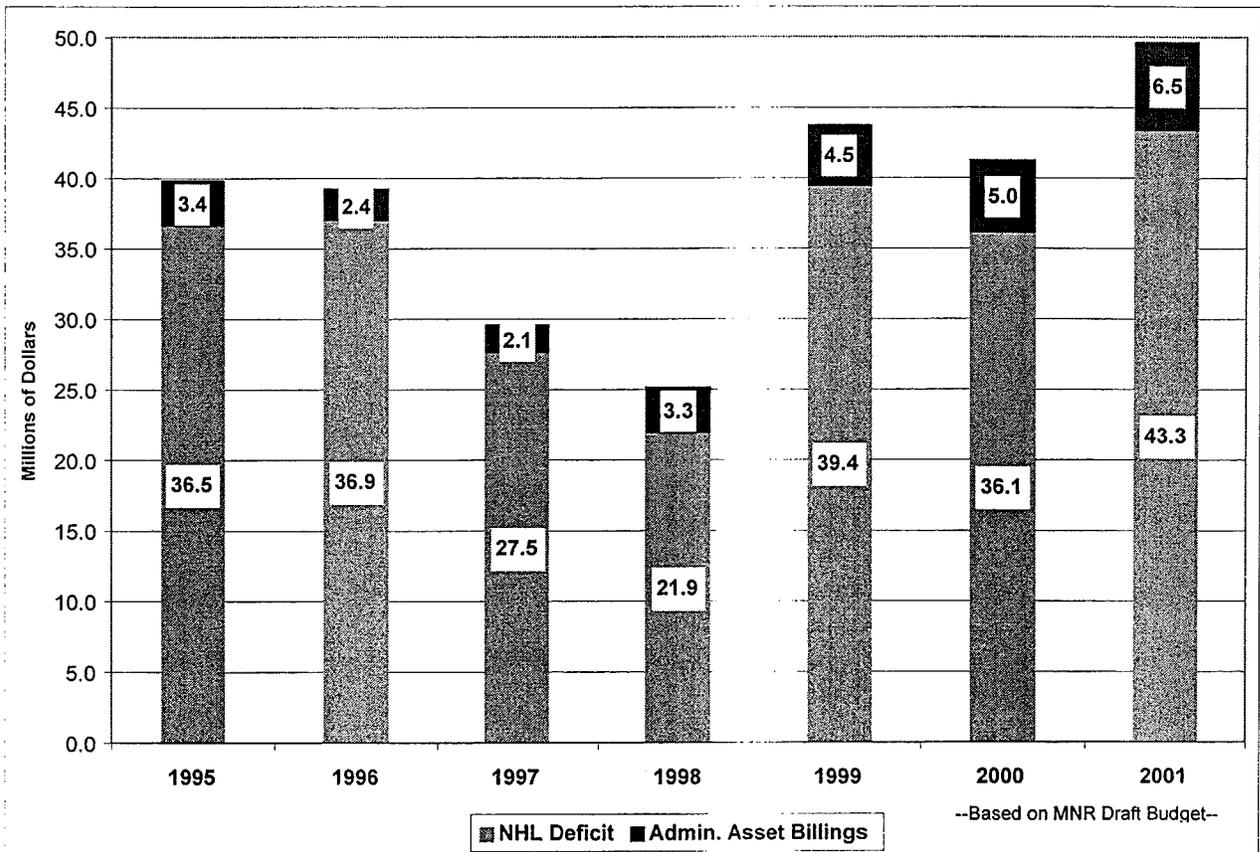
ConnDOT funds its share of the annual New Haven Line deficit, its share of the annual New Haven Line administrative assets cost, the Shore Line East commuter rail operating deficit, claims (anticipated and unforeseen), and miscellaneous rail freight activities from an annual rail appropriation, the balance of which lapses at the end of each fiscal year. The ongoing challenge that ConnDOT faces in managing its rail appropriation budget within the current MTA/Metro-North annual budget process was described in detail previously. However, to this point, the difficulty resultant from ConnDOT's participation in the annual cost of New Haven Line administrative assets has not been discussed.

Administrative assets are moveable capital assets which are used to perform administrative functions with respect to the Service, including but not limited to computers, train control systems, power control systems, automatic ticket selling and fare collection systems, and highway vehicles. In each year's draft capital budget, Metro-North provides ConnDOT with an administrative asset project listing for which it intends to incur costs in the coming year. Estimated total costs and projected cash drawdowns are included with this listing. ConnDOT concurs with this listing, in whole or part, and budgets approximately \$3

to \$4 million annually from its rail appropriation for this purpose. In recent years, however, this amount has spiked to over \$5 million as a result of special projects undertaken. At the present time, payments to Metro-North for administrative assets are the only form of payment made to Metro-North in advance.

Historically, Metro-North has not incurred administrative asset charges in a manner consistent with the projected cash drawdowns they provide. Costs are invariably incurred at much slower rate than projected. ConnDOT has often been left at the end of its fiscal year with the prospect of lapsing rail appropriation funds budgeted for administrative asset projects that have not been completed. ConnDOT must then budget a balance for those incomplete administrative asset projects in the upcoming year, in addition to new administrative asset projects introduced for that year. Nevertheless, as long as administrative asset estimates varied favorably, ConnDOT was able to manage its ever-increasing deficit share. **Table 5** shows a brief history of ConnDOT's New Haven Line deficit and administrative asset billings.

Table 5
ConnDOT Subsidy of the New Haven Line
Deficit and Administrative Billings



This balancing of rail appropriation funds has reached a far more critical stage in recent years, however. In the past two fiscal years, ConnDOT budgeted a significant amount of rail appropriation funds to pay for the acquisition and installation ticket vending machines

at various New Haven Line rail stations and to overhaul M-2 rail cars. The implementation of each of these projects was significantly delayed and payments to Metro-North were not made as expected on these projects.

This circumstance, which may have been considered disastrous in prior years, proved to be somewhat fortuitous in that ConnDOT's share of the operating deficit in these years rose significantly. Rail appropriation funds that would have been lapsed were used to pay ConnDOT's share of the deficit. It is likely that ConnDOT's deficit share will continue to rise, and just as likely that as soon as the next fiscal year, significant charges for the aforementioned projects will be presented. In the convergence of these forces, ConnDOT will be faced with a severe rail appropriation shortfall. Despite the fact that managing administrative assets may be the greatest variable in the budget process, the difficulty does not stem directly from a specific Article of ARSA and may potentially be corrected through the renegotiation of current practices by both parties.

ConnDOT's Public Transportation bond authorization is also facing a new and somewhat unique crisis as well. As shown in **Table 6**, since state fiscal year 1998, ConnDOT's annual Public Transportation bond authorization has remained at \$34 million. In each of these years, the federal transit funds available to ConnDOT (and requiring a 20% match by ConnDOT) have increased significantly. Due in large part to federal regulations that permit highway funds to be used for transit purposes and an increase in the amount of earmarks that Connecticut's Congressional delegation has secured for transit projects, over \$117 million in federal funds were available for transit projects in federal fiscal year 2001. This amount required a state match of over \$29 million. As the bond authorization level approaches the amount needed just to match the federal funds that are available, less and less of these funds will be available for ConnDOT's non-federally participating projects.

Table 6
Federal Authorization Levels

Authorizations	FFY 1998	FFY 1999	FFY 2000	FFY 2001
Sect 9/Sect5307 Capital	\$34,699,987	\$39,028,906	\$47,481,832	\$49,349,914
Sect 9/Sect5307 Enhancement	\$199,160	\$226,924	\$269,649	\$278,569
Sect 9/Sect5307 Total	\$34,899,147	\$39,255,830	\$47,751,481	\$49,628,483
Sect 3/Sect 5309 (Rail)	\$32,379,650	\$33,739,745	\$35,804,354	\$36,386,919
Sect 3/Sect 5309 (Bus)	\$596,259	\$798,943	\$1,093,013	\$1,297,716
Sect 5309 Earmarks	\$1,172,636	\$6,699,375	\$8,622,392	\$1,733,051
HPP Funds	\$2,577,630	\$3,514,950	\$4,443,262	\$4,217,940
CMAQ Funds	\$22,801,000	\$0	\$0	\$24,000,000
Total Federal	\$94,426,322	\$84,008,843	\$97,714,502	\$117,264,109
Amount Required for State Match	\$23,606,581	\$21,002,211	\$24,428,626	\$29,316,027

The point to be made is that if ConnDOT's Public Transportation bond authorization remains static or does not have the flexibility to meet requirements that vary from year to

year, a point may soon be reached when ConnDOT has insufficient funds available to garner all of the federal funds available to it. For the purpose of comparison, it should be noted that only 35% of MTA/Metro-North's capital funds are derived from federal sources, while ConnDOT is now approaching an 80% reliance on federal funds.

Regarding the availability of equipment, ConnDOT currently owns 121 M-2 type rail cars, 34 M-4 type rail cars, and 30 M-6 type rail cars, for a total of 185 electric multiple unit rail cars (EMUs). These EMUs, in addition to the EMUs owned by the MTA, are used daily in the Service. Of the 67 rail passenger coaches and 18 locomotives owned by ConnDOT, 30 coaches and 10 locomotives are also used in the Service. The balance of coaches and locomotives is used daily in ConnDOT's Shore Line East commuter rail service. Four new locomotives and 10 rail coaches for branchline service are currently on order and will be delivered in 2001 and 2002 respectively.

ConnDOT has retained the services of a consultant to perform a New Haven Line Fleet Configuration Analysis. This analysis, scheduled for completion in the spring of 2001, will assist ConnDOT and MTA/Metro-North in establishing a rolling stock management philosophy, number and type of vehicles, for the next thirty years (thirty years being the anticipated useful life of the next generation of New Haven Line rolling stock, be it EMUs, locomotive hauled coaches, or a combination of the two). A recommendation for a mixed fleet of EMUs and locomotive hauled coaches is anticipated.

At this time, locomotives cost approximately \$4.5 million per unit and can be procured with minimal design activity in 18 to 24 months. Push/pull coaches for use with locomotives cost approximately \$1.3 million and can also be procured with minimal design in 18 to 24 months. Next generation EMUs, on the other hand, will cost \$4.5 per unit, will require extensive specification development (1 to 2 years), and will take 3 to 4 years to manufacture. Despite the fact that 374 passenger cars are used to provide the Service today, it is estimated that by the year 2030, well over 500 passenger cars may be required to replace the existing fleet and account for future growth. Currently, based upon anticipated state and federal funding levels, only about \$200 million over four years can be programmed for the M-2 fleet replacement, beginning in state fiscal year 2008.

Since ConnDOT's M-2 fleet of 121 electric M-2 type rail cars is now nearly 30 years old, an increasing rate of component failure is occurring. Equipment failures have exacerbated the seat shortage created by dramatically increasing passenger loadings and created an untenable maintenance cycle. Greater passenger loadings require that the equipment spend more time in revenue service, which limits the opportunities for normal preventive maintenance, which leads to more frequent failures and reduces the life expectancy of the vehicle. The current spare ratio on the New Haven Line is approximately 17%, which is below the 20% average of most comparable commuter railroad operations.

Given the failure rate of the M-2 fleet and the fact that significant, though insufficient funds for fleet replacement cannot be programmed until 2008, ConnDOT and MTA/Metro-North have developed an M-2 Critical System Component Replacement program designed to extend the useful life of the M-2 fleet for 12 to 15 years. Though

extending the life of the M-2 fleet will provide the time to develop a specification for the next generation EMU and protect service levels during a 3 to 4 year lead time for the delivery of new EMUs, cycling M-2 pairs out of service to undergo the overhaul will certainly worsen the current equipment shortage and consume significant financial resources. It is estimated that the M-2 overhaul will take 4 to 5 years to complete and that ConnDOT's share (65%) will be between \$50 and \$70 million.

With ridership increasing and M-2 cars soon to be cycled out of service for overhaul (and M-4 and M-6 cars likely to follow), ConnDOT and MTA/Metro-North have identified an immediate need for 10 locomotives and 60 push/pull coaches for the New Haven Line. This interim fleet expansion is necessary to maintain the existing level and reliability of service, as well as implement additional intrastate strategies. ConnDOT's share of such an acquisition would be approximately \$89 million, none of which can currently be programmed because of the need to complete essential infrastructure improvements and the M-2 car overhaul project. If funds were made available, however, it is possible that both coaches and locomotives could be delivered in calendar year 2003.

An essential component of fleet expansion is the provision of expanded vehicle storage and vehicle maintenance capabilities. The New Haven Line has maintenance of equipment facilities in Stamford and New Haven. The facility in New Haven is used to perform periodic inspections and to perform running/intermediate repairs that require less than three days to complete. At the Stamford maintenance of equipment facility inspections and running/intermediate repairs are also performed. Currently vehicles are stored and cleaned overnight in both Stamford and New Haven. Vehicle storage and maintenance operations at these facilities are becoming severely limited and planning for an additional facility has begun. Ideally, the effective in-service date for a new vehicle maintenance and storage facility would coincide with any significant fleet expansion. However, given a 12 to 18 month design requirement and a 24 to 30 month construction duration, an additional facility could not be operational for at least 4 to 5 years.

In accordance with ARSA, ConnDOT is responsible for 100% of the cost for nonmoveable capital assets located in Connecticut, and therefore, would be responsible for the construction of a new maintenance of an equipment and storage facility if the facility is located in Connecticut. However, it must be remembered that there is nothing that precludes the parties from negotiating an allocation of costs different from that called for in ARSA or a deficit credit, if, for example, the parties agreed that each would benefit equally from the nonmoveable capital asset. The estimated cost for such a facility is \$250 million, though a suitable site and sufficient funding have yet to be identified.

Despite the aforementioned successes that ConnDOT has had with initiating commuter rail parking expansions, providing sufficient parking for rail commuters remains a formidable challenge. Besides the numerous other priorities competing for limited capital funds, finding locations along the New Haven Line that are suitable for parking expansion has proven difficult. The New Haven Line traverses a densely settled section of the state where real estate is at premium and coveted for its tax value by the municipalities. In some instances where parcels suitable for rail expansion do exist, municipalities have found

proposed parking structures to be inconsistent with the aesthetic values they have sought to create and/or preserve. Again, this challenge is unrelated to ARSA and requires a greater understanding by all of the municipalities in the region of the need for and value of expanded parking for rail commuters. Facing this particular challenge also requires continued diligence on the part of ConnDOT in developing additional innovative public/private partnerships.

CONCLUSION AND RECOMMENDATIONS

In Public Act 00-129, Section 2, the Legislature directed that a comprehensive analysis of ARSA be performed to determine if there are terms and conditions within the agreement that impede ConnDOT's ability to implement a transportation strategy that calls for increased rail ridership, while maintaining the affordability of the service. Public Act 00-129 also seeks recommendations as to how ConnDOT may better exercise its rights under ARSA to implement the aforementioned strategy.

Simply stated, there is no specific Article in ARSA that precludes ConnDOT from advancing a transportation strategy that calls for increasing the level of intrastate passenger service on the New Haven Rail Line while maintaining the affordability of fares. However, this is not to say that there are no impediments to implementing such a strategy. A lack of additional deficit funding and the capital funds needed for rolling stock and a vehicle maintenance and storage facility may threaten existing and future service levels and reliability.

ARSA provides for the allocation of the main line net operating deficit and, in Appendix C, establishes a basic Service level that can only be modified by mutual agreement. However, ARSA does not provide guidance for the allocation of costs associated with institution of main line intrastate service above that which has historically existed in Appendix C. While ConnDOT has successfully negotiated some intrastate service improvements within the existing deficit model, the MTA/Metro-North position is that any new Connecticut intrastate service must either pay for itself or be treated as if it were a branch line service, since it represents no benefit to the state of New York. This is not an unreasonable position by MTA/Metro-North and does not represent MTA/Metro-North's default from the terms and conditions of ARSA. Therefore, it should be assumed that the additional operating costs associated with significant expanded intrastate service in Connecticut would be borne solely by ConnDOT.

The two most significant impediments to increasing intrastate rail service remain a lack of funding to offset the annual net operating deficit for the additional service and the lack of capital funding necessary to provide the rail passenger equipment, equipment storage and maintenance facilities, and rail station parking necessary to support the service. The latter must be considered a far greater concern in that it seriously threatens existing Service levels.

In compliance with Public Act 00-129 and to meet the goals of ConnDOT's evolving transportation strategy for relieving traffic congestion along the I-95 Corridor by enhancing commuter rail service, immediate recommendations have been developed. ConnDOT recommends:

That the Commissioner of Transportation and key managers on his staff work at maintaining an improved working relationship with their counterparts at MTA with the goal of ensuring ConnDOT's meaningful participation in the development of annual operating budgets and the establishment of future policies and strategies for the Service.

That ConnDOT and Metro-North continue ongoing negotiations to modify the manner in which specific costs are allocated to resolve current and future first step down allocation issues; to improve administrative practices; demonstrate value for subsidy; and eliminate wasteful practices and spending.

That ConnDOT exercise more fully all of the provisions and protections of ARSA, including arbitration, financial arbitration, and/or the renegotiation of specific Articles of ARSA with MTA and Metro-North.

That the Legislature authorize funds outside of existing appropriation levels for ConnDOT to expand intrastate rail passenger services and to acquire additional rail passenger equipment and to construct suitable storage and maintenance facilities for such equipment.

That Connecticut's Congressional delegation be made aware of the critical rail passenger equipment shortage that the Service faces so that substantial Congressional earmarks can be sought for the acquisition of additional rail passenger equipment and the construction of suitable storage and maintenance facilities for such equipment.

That the Commissioner of Transportation be granted explicit legislative authority to award contracts on the basis of future guaranteed federal funding levels and the reasonable expectation that bond funds will be authorized by the Legislature to match such federal levels.

APPENDIX A
First Arbitrator's Award, September 7, 1984

In the Matter of Arbitration Between

CONNECTICUT DEPARTMENT OF TRANSPORTATION

and

THE METROPOLITAN TRANSPORTATION AUTHORITY

APPEARANCES:

SCHATZ, SCHATZ, RIBICOFF & KOTKIN (By Mark S. Shipman, Esq., Michael L. Widland, Esq., and Lewis G. Schwartz, Esq.), Two Landmark Square, Stamford, Connecticut 06901, for CDOT

DAVIS, POLK & WARDWELL (By Lewis B. Kaden, Esq., Abigail Jones, Esq., and Mark E. Segall, Esq.), One Chase Manhattan Plaza, New York, NY 10005, for the MTA.

OPINION

For many years the New York, New Haven and Hartford Railroad operated commuter trains from Connecticut into New York. Later, Penn Central Railroad succeeded the New Haven. In 1970, after it had become clear that commuter service could not continue without public subsidies, Metropolitan Transportation Authority (MTA), Connecticut Transportation Authority (the predecessor of Connecticut Department of Transportation (CDOT), and Penn Central entered into a formal Service Agreement implementing a basic arrangement first worked out in 1965 between Governors Rockefeller and Dempsey. Penn Central undertook to operate the NHL commuter service. MTA agreed to bear 50 percent of the deficit, to pay for 50 percent of the outlay for new rolling stock, and to pay for fixed capital improvements within New York.

CDOT agreed to bear the other 50 percent of the deficit and outlay for rolling stock, and to make capital outlays for fixed improvements in Connecticut. MTA and CDOT would operate as a joint partnership, each with a voice in and veto over decisions concerning fares, service, and other matters not delegated to Penn Central.

Conrail succeeded Penn Central and operated the NHL commuter trains until December 31, 1982, when Congress by enactment of the Northeast Rail Service Act relieved Conrail of the duty. Connecticut and New York were then forced to choose among several courses: (a) to operate the NHL commuter service themselves, either as a single unit jointly or separately in parts, one for New York and the other for Connecticut commuters; (b) to contract for operation by Amtrak Commuter Service, another federal corporation; or (c) to abandon the NHL commuter service in whole or in part. MTA chose to operate the NHL directly. CDOT acquiesced. Accordingly, MTA and CDOT entered into a new agreement dated December 31, 1982, calling for operation by Metro-North Commuter Railroad Co., a MTA subsidiary, under the old Service Agreement and the joint partnership arrangement that had prevailed since 1967, except for ultimate financial responsibility.

Under the Service Agreement the NHL deficit had mounted from approximately \$5,000,000 in 1966 to roughly \$67,000,000 in 1982 and a projected \$64,000,000 for 1983. During the 1982 negotiations MTA refused any longer to bear 50 percent of the deficit or to continue to pay its former share of

the cost of capital costs. CDOT resisted any change. The parties then agreed to have a panel of three arbitrators decide what would be - -

The fair and equitable allocation between MTA and CDOT of (i) net service operating revenue or deficit and (ii) service capital costs

having regard to specific factors listed in the agreement and "such other factors as the Panel determines to be appropriate and relevant."

Eugene Keilin, Esq. of New York City and James A. Wade, Esq. of Hartford, Connecticut were named to the Arbitration Panel by MTA and CDOT respectively. Archibald Cox, Esq. of Massachusetts was chosen to be the third member of the Panel.

After appropriate notice the Arbitration panel held hearings and received evidence and argument on December 7, 8, 9, and 15, 1983 and on February 2, 1984. The Panel was aided by further submissions by the parties during its consideration of the case in executive sessions.

While executive sessions were proceeding, CDOT and MTA conferred extensively in an effort to resolve by Agreement other issues between them falling outside the scope of the submission to arbitration but vitally affecting the operation of the NHL commuter service and the size of the resulting deficit. The resolution of those outside issues is a matter of great public importance. Without some joint agreement between MTA and CDOT the service rendered to New York and Connecticut commuters could not possibly have achieved its full potential. The Service would remain under an overhanging threat of termination. It is to the credit of New York and Connecticut officials that they did reach agreement upon

the outside issues. That agreement is an important part of the context shaping our Opinion and Award.

The case before us is now ripe for decision.

I. THE OPERATING DEFICIT

Six factors falling into two groups shape our award apportioning the net service operating deficit.

A. STATISTICAL EVIDENCE

1. Residents of Connecticut enjoy at least 66 percent and perhaps 75 percent of all the transportation services furnished by NHL. MTA calculates that 75.8 percent of the passenger miles traveled on NHL are traveled between points in Connecticut and points in New York. The CDOT estimates are not far different. MTA would reduce the figure to 66 percent to allow for New York residents commuting to and from work in Connecticut.

Whichever figure is used, one must remember that it is in the furnishing of such services - - at least two-thirds of which go to Connecticut residents - - that the deficit is incurred.

2. The expenses fairly allocable to the transportation of Connecticut residents, after subtracting the fares received from them and all other revenues fairly allocable to their portion of the service, account for no less than 66 percent of the overall deficit.

The Arbitration Panel heard widely divergent expert testimony concerning the proper division of total expenses and of individual cost accounts into the costs of transporting Connecticut and New York residents. The witnesses

differed not only in their statistical methods but in their judgments concerning the allocators to be used in apportioning individual cost accounts or groups of accounts. We have reviewed the testimony, voluminous statistics, and arguments on both sides, and made our own analyses. Given the irreducible scope for judgment, there is no single demonstrably correct figure. We conclude, however, that under all the circumstances, \$97,916,000 or 68.0 percent of the budgets overall NHL expenses for 1983 is fairly attributable to the carriage of Connecticut residents. Subtracting a proper share of the revenues leaves \$42,129,000 or 66 percent of the budgeted 1983 deficit fairly traceable to the carriage of Connecticut residents.

B. EQUITIES AND THE GOOD OF THE SERVICE

While the concerns measurable by statistical evidence concerning costs and benefits support the contention of MTA that Connecticut should pay two-thirds of the deficit. Other additional factors demonstrate that under all the circumstances of this particular case New York should bear a somewhat large share than if the allocation were made by cost accounting alone.

3. Because New York City is the hub of the Greater New York Metropolitan area, New York probably receives a more nearly equal share of the other, incommensurable benefits of continued NHL commuter service.

The existence of the NHL commuter service confers upon New York and Connecticut many benefits over and above the value of the transportation furnished to their respective residents. The benefits received by Connecticut include the salaries and other compensation taken home by

Connecticut commuters. Economists can estimate these and can then extrapolate estimates of the effect upon property values and economic activities in Connecticut. The benefits to New York are harder to measure, but no one can doubt the importance to the economy of New York of this method of getting into the City executives, professional men and women and other skilled and talented individuals. New York officials repeatedly stressed this fact in seeking federal Government assistance to preserve the NHL commuter service. Connecticut commuters, while in the City, generate economic activity on a large scale. While no one can foresee all the consequences of discontinuance of the NHL service forced New York and Connecticut to provide alternate transportation and to meet the demand for increased commuter services from and to other residential areas. Because of property values as well as the volume of traffic, New York would incur the relatively greater costs. Furthermore, New York would be at risk of losing major corporate and professional activity to cities and town outside the State.

4. In 1965 Governor Dempsey of Connecticut and Governor Rockefeller of New York agreed on a 50/50 split of the deficit of the NHL commuter service.

The Dempsey-Rockefeller agreement was not for a fixed period. The passage of time, the vast increases in annual deficits, and other changes of circumstance affect its weight, but the agreement for equal division remains persuasive evidence of how the two highest officials of New York and Connecticut viewed the equities and practicalities under the circumstances then

existing, not all of which have changed. Furthermore, the Rockefeller-Dempsey agreement generated public expectations that cannot be wholly overlooked.

5. MTA and CDOT have reached a new basic agreement for the continued operation and management of the NHL commuter service by Metro-North, an MTA subsidiary, with important participation by CDOT and ultimate check protecting Connecticut against abuses.

The agreement between MTA and CDOT reached while this case was under submission is important for four reasons:

First, the agreement substitutes a spirit of cooperation for the friction and danger of a breakup of the service that plagued the past. For example, in that agreement CDOT and MTA have come to terms regarding participation in a productivity, asset management, and budget review; access to information; labor relations; and dispute resolution. It is, therefore, important that our award nourish the new spirit by taking into account the same equities and practicalities that the parties deemed important in their negotiations.

Second, although Metro-North has a duty to operate the NHL commuter service for the benefit of both parties and the public the NHL serves, the combination of nearly all the major commuter services in and into New York City under a New York authority has very substantial value to New York.

Third, MTA and CDOT agreed that because the New Canaan, Danbury, and Waterbury branch lines offer service only to Connecticut commuters, CDOT shall have control, under an agreed procedure, over fares, schedules and costs. We think this severance entirely appropriate and that a like division should be

made in allocating past as well as future deficits so that CDOT pays 100 percent of the net operating deficit of the branch lines.

Fourth, MTA and CDOT also agreed that the allocation to NHL of a share of the cost of operating the join facilities below Woodlawn should be based upon actual costs.

Breaking out the branch lines leads us to the further conclusion that the NHL share of the operating deficit of Grand Central Terminal should be broken out of the other figures, and allocated separately in proportion to the numbers of New York and Connecticut passengers who use the Terminal upon going into the City.

What we have said above leads to three conclusions concerning the allocation of the annual operating deficits.

1. CDOT, for the reason stated above, should pay 100 percent of the branch line operating deficits defined to include all costs and revenues of providing services to passengers boarding or deboarding at stations on the branch lines.

2. CDOT, for the reason stated above, should pay 53 percent and MTA should pay 47 percent of the NHL share of the net operating deficit of the Grand Central Terminal; i.e., of the costs and revenues associated with the use and maintenance of the Grand Central Terminal building, excluding the operations area.

3. CDOT must also pay a percentage share of the deficit resulting

from the maintenance and operation of the mail line (i.e., of the NHL other than the branch lines and the Grand Central Terminal building).

Because the record in this case was closed before the parties agreed that CDOT would take over the control of the branch lines and that the cost of operating the joint facilities below Woodlawn should be based upon actual costs, the evidence and arguments presented to us did not separate out the main line deficit and did not directly address its percentage division as such. It is both possible and practicable, however, to provide upon the present record a formula from which the fair and equitable percentage share of MTA and CDOT can be exactly calculated without difficulty and also without suffering the delay and expense of reopening the record.

Weighing the six factors mentioned earlier in this opinion in the context of the agreement reached during this proceeding, we conclude that CDOT's fair and equitable share of the 1983 NHL deficit is 60 percent. The figure is for one year and one year only. There will be no comparable over-all deficit once CDOT takes over the operation of the branch lines. We have also found that CDOT should pay 100 percent of the branch lines deficit and 53 percent of the NHL share of the Grand Central Building deficit not only for 1983 but for future years. Given these findings, CDOT's fair and equitable dollar share of the main line deficit can be calculated, once the actual 1983 deficit is ascertained, by subtracting from Connecticut's dollar share of the over-all deficit Connecticut's dollar shares of the branch lines and GCT deficits. The total main line deficit can be ascertained by parallel calculation. From those figures Connecticut's dollar

share of the 1983 main line deficit can easily be converted into the fair and equitable percentage. Connecticut should then pay exactly the same percentage of main line deficits in future years. The figure is likely to be close to 58 percent.

In sum, under our award - -

1. CDOT will control the branch lines and pay the deficit;
2. CDOT will pay 53 percent and MTA will pay 47 percent of the NHL share of the net operating deficit of the Grand Central Terminal building; and
3. CDOT will pay an estimated 58 percent and MTA an estimated 42 percent of the net operating deficit of the main line, the exact shares being calculated according to a formula set out in the award.

We find the above allocation just and reasonable in considerable part because of the context of the parties newly-concluded settlement of non-economic issues and their desire to work more cooperatively together for at least a five-year term. If either party seeks a reexamination of their mutual engagements at the end of that term, this opinion and award should not be regarded as a precedent either for or against a different allocation more closely tied to the statistically measurable costs and benefits of the service.

II. CAPITAL OUTLAYS

The continued operation of the NHL commuter service requires substantial capital outlays. Metro-North's five-year capital budget calls for the expenditure of \$393.4 million; its twenty year budget for an expenditure of \$766.3 million. Both figures are tentative because CDOT's agreement is required, but the Metro-North

estimates seem to give fair indication of the order of magnitude. Under the Rockefeller-Dempsey agreement carried forward through December 31, 1982, capital outlays for rolling stock were to be made by Connecticut and New York in equal shares while each State paid for other, fixed improvements within its territorial jurisdiction.

MTA's initial submission to the Arbitration Panel called for dividing the burden of capital expenditures in the same proportions as the net operating deficit, i.e., roughly two-thirds would be assigned to Connecticut and only one-third to New York. CDOT argued for continuation of the pre-1983 50/50 division of the cost of rolling stock and for each State to continue to pay the capital assets to be located within its jurisdiction.

MTA and CDOT have now agreed that the New Canaan, Danbury, and Waterbury branches are essentially the responsibility of CDOT and that CDOT should make the relevant decisions even though Metro-North performs the operations. We think it follows that CDOT should pay 100 percent of the cost of acquiring all capital assets for the branch lines, including not only fixed assets but rolling stock and other movable equipment.

New York and Connecticut share the benefits of new capital assets added to existing plant in roughly the same proportions as they share the benefits and generate the costs of operations. In the long run and on an over-all basis the carriage of their respective residents probably generates about the same proportion of the expenses for plant and durable equipment as it does of operation costs, even though some single capital items would have to be

allocated in widely different shares according to their nature, location and extent of use. Nevertheless, we find it unwise in policy and infeasible in practice to divide the burden of fixed capital outlays in the same proportions as we divided the operating deficit. Even though the negotiations mentioned above give promise of future harmony, the fact that partnership is subject to termination upon eighteen months notice makes it undesirable to risk creating a situation in which CDOT would have a claim to ownership of an undivided share of property fixed in New York and MTA or Metro-North would have a similar claim to property fixed in Connecticut. Neither State can own property in another jurisdiction with the same attributes of sovereignty as it holds property within its own territory. Furthermore, the legislatures of both New York and Connecticut would each be reluctant to appropriate funds for the purchase of property to be located in another State. Accordingly, we shall award that fixed capital assets in Connecticut be paid for by Connecticut.

That disposition, considered in isolation, might seem somewhat unfair to New York because Connecticut travelers receive benefit from some capital assets fixed in New York while New York passengers receive relatively little, if any benefit from capital assets fixed in Connecticut. Any unfairness can be cured, however, by a slight adjustment in allocating the cost of non-fixed assets.

Sharing the cost of non-fixed assets, including rolling stock, other moveable equipment and machinery, automated fare systems, and other computer equipment does not present the same difficulties as fixed capital assets. The greatest outlays will be for rolling stock, which will be found at times

in New York and at other times in Connecticut. Other moveable equipment and machinery and also computer equipment can be and sometimes is moved from one place to another. We think it fair and equitable, based upon this discussion and the factors listed in connection with the operating deficit, that the responsibility for non-fixed assets used for the main lines should be shared in the same proportions as the main line deficit, subject to a small adjustment to offset the benefit that Connecticut will receive from fixed capital assets located in New York. The adjustment should bring Connecticut's share to 64 percent.

As is true with respect to the operating deficit, the capital cost portion of this opinion and award should not be regarded as precedent in any future reexamination after the expiration of the term of the parties' non-economic settlement.

AWARD

Upon consideration of the evidence and argument presented by the parties, the entire record in the case, and the factors listed in Section 3 (c) of the Submission, and in reliance upon the five factors identified above, we determine and award that to achieve a fair and equitable allocation - -

1. Connecticut Department of Transportation shall pay 100 percent of the net annual operating deficits of the New Canaan, Danbury, and Waterbury branch lines, commencing as of January 1, 1983. The "net operating deficit" of a branch line includes all costs and revenues of providing services to passengers boarding or deboarding at a station exclusively on a branch line.

2. Commencing as of January 1, 1983 Connecticut Department of Transportation shall pay 53 percent and Metropolitan Transportation Authority shall pay 47 percent of the NHL share of the net annual

operating deficits of the Grand Central Terminal building, excluding the operations area.

3. Commencing as of January 1, 1983 Connecticut Department of Transportation shall pay a percentage of the net annual operating deficits of the NHL main line calculated in the following manner:

Ascertain the 1983 main line operating deficit by subtracting from the 1983 over-all NHL operating deficit the 1983 operating deficits for the branch lines and the Grand Central Terminal building. Ascertain Connecticut Department of Transportation's dollar share of the 1983 main line operating deficit by subtracting from 60 percent of the 1983 over-all NHL deficit Connecticut Department of Transportation's dollar share of the 1983 branch line and GCT deficits calculated in accordance with paragraphs 1 and 2. Calculate the percentage that Connecticut Department of Transportation's dollar share is of the total 1983 main line operating deficit. Connecticut Department of Transportation shall pay that dollar share of the 1983 main line operating deficit and same percentage share of future main line operating deficits regardless of changes in dollar amounts. Metropolitan Transportation Authority shall pay the remaining share. The main line is that portion of the New Haven Line other than the New Canaan, Danbury, and Waterbury branches and the Grand Central Terminal building as defined in paragraph 2.

4. Connecticut Department of Transportation shall pay 100 percent of the cost of acquiring all capital assets for the New Canaan, Danbury, and Waterbury branch lines commencing as of January 1, 1983.

5. Metropolitan Transportation Authority shall continue to pay the cost of acquiring all fixed capital assets located within the State of Connecticut.

6. Connecticut Department of Transportation shall continue to pay the cost of acquiring all fixed capital assets located within the State of Connecticut.

7. Connecticut Department of Transportation shall pay 63 percent of the cost and Metropolitan Transportation Authority shall pay 37 percent of the cost of acquiring all non-fixed assets other than those covered by paragraph 4, including rolling stock, other moveable equipment and machinery, and automated fare systems, and other computer equipment, where the decision to purchase was mutually agreed upon Metropolitan Transportation Authority and Connecticut Department of Transportation, commencing as of January 1, 1983.

Signed and issued September 7, 1984

EUGENE KEILIN

JAMES A. WADE

ARCHIBALD COX

APPENDIX B

Second Arbitrator's Award, September 8, 1998

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September 11, 1998

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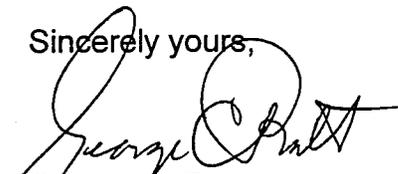
Gentlemen:

Enclosed is the final award in this arbitrated dispute. You will note that the award has been signed by Arbitrator Keilin and myself. Arbitrator Schuck has dissented in a separate opinion, which is also enclosed.

One final matter. Each of the arbitrators has accumulated a large volume of paper in this matter. Usually at the end of an arbitration the parties want the arbitrators to destroy all papers they have been supplied by the parties. Unless I hear from either of you to the contrary by Sept. 30, 1998, I will assume that we, too, should destroy the papers.

It has been a great pleasure working with you.

Sincerely yours,



George C. Pratt

CC:

Prof. Peter Schuck
Eugene J. Keilin

----- X
In the Matter of the Arbitration Between
CONNECTICUT DEPARTMENT OF TRANSPORTATION
- and -
METROPOLITAN TRANSPORTATION AUTHORITY

Pursuant to the Amended and Restated Service
Agreement Dated as of June 21, 1985, Regarding
Certain Allocations Therein.
----- X

ARBITRATORS' AWARD

Before:

Eugene J. Keilin, Esq.

Prof. Peter Schuck

Hon. George C. Pratt

Arbitrators

Acting under Section 12.03 of the Amended and Restated Service Agreement ("ASA") dated as of June 21, 1985, and entered into among the State of Connecticut, by the Department of Transportation ("CDOT"), the Metropolitan Transit Authority ("MTA") and Metro North Commuter Railroad Company ("Metro North"), CDOT on December 29, 1993, notified the MTA and Metro North that it wished to resolve certain issues relating to their joint operation of the New Haven Line ("NHL") of Metro North Railroad. Following up on that notice, CDOT on April 28, 1994, gave formal notice of its

intent to arbitrate six enumerated claims relating to the operation and deficit allocation of the railroad.

While they entered into discussions about the issues, the parties stayed the arbitration. Eventually the issues were reduced to determining what would be fair and equitable allocations of the net operating deficits for the Main Line, the Connecticut Branch Lines, and Grand Central Terminal, and of the capital cost of the moveable capital assets. As contemplated by the ASA, these allocations need to be made for the 5-year renewal term of the ASA beginning Jan. 1, 1995.

After extensive preparation, the parties presented evidence relating to these issues at hearings conducted on 16 days over an 8-month period beginning January 16, 1997, at which the panel received written and oral testimony from 22 witnesses and received in evidence 122 exhibits. After the parties submitted post-hearing briefs and reply briefs, the panel heard final arguments on Oct. 28, 1997. Later, the panel requested and received additional evidence and argument with respect to certain of the issues. The matter was finally submitted to the panel for decision on April 15, 1998.

The issues presented to the panel are difficult and complex. Counsel on both sides have ably and enthusiastically presented the pertinent evidence and arguments relevant to technical, economic, and philosophical aspects of this dispute. Much of the opinion evidence is conflicting. On some of the issues the panel has been unable to reach unanimous agreement. What is set forth below represents, with respect to each allocation, the agreement of at least a majority of the panel. Since no practical purpose would be served, we have made no effort to relate the decisions on particular issues or sub-issues to the views of individual members of the panel.

I GENERAL CONSIDERATIONS

Arbitration derives its authority from agreement. Under an earlier agreement between the parties there was an arbitration resulting in an award released on September 7, 1984, which was intended to cover the allocations for a 7-year period ending January 1, 1990. Following that award the parties entered into the ASA, which is still in effect and which is the authorizing agreement for this proceeding. Section 12.03 of the ASA provides, in part:

In the event that MTA and CDOT have not mutually agreed to allocations for the next renewal term eight months before the expiration of the existing term, they shall submit the question of fair and equitable allocations for the next renewal term to arbitration. ASA § 12.03 (emphasis added).

The term "allocations" is defined as "MTA's and CDOT's respective shares of the operating deficits and Capital Costs * * * as set forth in Articles Three and Five hereof." ASA § 1.01.

There are some basic considerations on which the parties agree:

- 1) The renewal term begins as of January 1, 1995. The allocations established by this award will be retroactive to that date and will apply until December 31, 1999.
- 2) The NHL (NHL) has 26 main-line stations, 8 (31%) in New York and 18 (69%) in Connecticut. It has 337.8 miles of track, 103.7 (31%) in New York and 234.1 (69%) in Connecticut. 55% of its riders are allocated to Connecticut and 45% to New York. Being farther from Grand Central Station in Manhattan, the primary destination of the vast majority of commuters, Connecticut riders travel longer distances than New York riders; as a result,

68% of the passenger miles are attributable to Connecticut and 32% to New York.

- 3) Since 1984 use of the railroad has increased significantly. The total number of trains has increased by 188 or 14%, from 1299 per week to 1487 per week. 15 of the new trains (8%) serve New York only; 157 (84%) serve Connecticut only; and 16 (9%) serve both states.
- 4) Of the total number of weekly trains (1487), 125 (8%) serve New York only; 858 (58%) serve Connecticut only, and 504 (34%) serve both states.
- 5) Since the first arbitration, both usage of the NHL and the service provided have increased; simultaneously, the size of the deficit has decreased. From 1984 to 1995 revenues increased 57% in actual dollars -- from \$93 million to \$146 million. At the same time expenses increased only 33% -- from \$152 million to \$203 million. The resulting deficit decreased by 3.4% -- from \$59 million to \$57 million. The fare operating ratio (total revenue from fares / total operating costs) has increased from 50% to 75%.
- 6) While Connecticut and New York now charge different fares, in both states the fare for a given trip consists of a minimum amount plus an increment based on distance traveled. Thus a fare is a function, in part, of miles traveled, and the total fare paid increases with distance.
- 7) The cost of operating a train also increases with the distance traveled. On a per-mile basis, however, both the individual fare and the cost of running the train decrease as the distance increases.

- 8) Connecticut pays no management fee to Metro North for operating the NHL, a feature that is built into the ASA.

The ASA divides the NHL operating deficit into three parts, to which the following indicated percentages were assigned to CDOT by the ASA, which adopted the figures determined in the 1984 award: Main line 56.32%; Branch lines 100%; and Grand Central Terminal (GCT) 53%. CDOT contends that these percentages are no longer "fair and equitable" and should be reduced substantially. It is these allocations, plus a problem as to capital costs, to which this award is directed.

CDOT has also presented an issue arising from the fact that over the years since 1991 Connecticut has followed a program of periodically increasing fares for passengers who either begin or end their trips in Connecticut, while New York has essentially maintained level fares for passengers traveling solely within New York State. This has resulted in a fare differential which CDOT contends unfairly burdens its residents. Before addressing the specific allocations called for by this arbitration (Parts III - VI), we first consider the fare differential issue (Part II). Our final award is summarized in Part VII.

II FARE DIFFERENTIAL ISSUE.

CDOT claims that some adjustment is essential to correct the inequity created by the differential in fares. MTA originally opposed any adjustment for the fare differential, but it has now abandoned that position in favor of a variable adjustment that would accommodate unilateral fare changes by either party. CDOT proposed a single allocation for the entire five-year period based on the 1994 fare structure. MTA's

proposed variable credit was based on what would have happened if New York had matched CDOT's fare increases.

After careful consideration, we have determined that in order to fairly and equitably allocate the Main Line deficit some accommodation must be made for the fare differential. Although an adjustment might arguably conflict with the definitions and some concepts in the ASA, we are satisfied that the adjustment is necessary if we are to comply with the ASA's command that our allocation of the deficit must be "fair and equitable".

The adjustment should be a variable one that can be applied to each year's Main Line deficit and that can change with changes in fares; it should not be a single figure that would cover the entire five-year period. It should recognize the principle that each state may allocate its share of responsibility for operating the NHL among riders and taxpayers in any way it chooses.

The fare differential adjustment to be applied for each year of the current renewal term shall follow this formula:

- a) Actual deficit. Begin with the Main Line actual deficit.
- b) Determine adjusted deficit. Determine an adjusted deficit based on revenues calculated as if the Connecticut fare structure were the same as the New York fare structure.
- c) Allocate adjusted deficit. Allocate the adjusted deficit (b) in accordance with the percentage factors determined in Part III of this award.

- d) Fare credit. Calculate the total fare credit by subtracting the actual deficit (a) from the adjusted deficit (b).
- e) Allocate fare credit. Allocate the total fare credit (d) 85% to Connecticut and 15% to New York.
- f) Final deficit shares. Deduct each state's allocated fare credit (e) from its allocated share of the adjusted deficit (c). The results will be the final Main Line deficit shares for the two states.

The formula is based on an assumption that Connecticut's fare structure is higher than New York's. It is highly unlikely that the situation will change in the foreseeable future. The allocation percentages for the fare credit in item e) is based on the fact that there are many New Yorkers who travel between New York and Connecticut and who therefore must pay Connecticut fares. For purposes of calculating a fare differential CDOT has accepted New York's contention that 14.51% of the Connecticut fares should be attributed to New York riders.

III MAIN LINE DEFICIT.

Appendix A, Section II, of the ASA defines the "Main Line Net Operating Deficit" as follows:

Main Line Net Operating Deficit calculated as set forth herein, shall represent the net operating deficit (revenues net of the expenses) of the Service, excluding the (i) Grand Central Terminal Net Operating Deficit and the (ii) Branch Line Net Operating Deficit. See also ASA §1.01 at p. 8.

The ASA then describes in considerable detail what items shall be classified as revenues and as expenses.

Of the three deficits under consideration, the Main Line's is by far the largest. For example, for the year 1995, the Main Line deficit was approximately \$37 million, the Branch Line deficit was approximately \$9 million, and the Grand Central Terminal deficit was approximately \$10 million. Understandably, therefore, the bulk of the time at the hearing was devoted to the many considerations that might affect the Main Line deficit. Working with the same underlying data, expert witnesses reached widely varying estimates of what the proper allocation should be. Opinions ranged from a 40 % to a 73% allocation to Connecticut.

After considering all of the material submitted, the opinions of the experts, and the arguments of counsel, we have determined that a fair and equitable allocation of the Main Line deficit is 65% to Connecticut and 35% to New York, before application of the Fare Differential adjustment that is described in Part II of this award.

MTA contends that Connecticut's share of the Main Line deficit should be higher. It focuses on passenger miles, the larger number of Connecticut riders particularly during rush hours, the longer distances they travel, the higher per-mile fares paid by New York riders, and a number of other factors. CDOT contends that Connecticut's share of the Main Line deficit should be much lower, and its position is grounded heavily in the claimed larger revenues generated by the Connecticut riders. However, much of the revenue-enhancing distortion relied on by Connecticut has been compensated for by the Fare Differential adjustment we have made as described in Part II above.

We have found unpersuasive Connecticut's claim of inefficiencies in the operation of the NHL, the economic analysis that was constructed on the unrealistic assumption of a termination of the NHL's operations, and Connecticut's occasional application of a marginal-cost approach. Nor are we persuaded that a fair and equitable allocation of the deficits of this integrated system could be determined by a fragmented, train-by-train analysis of costs and revenues. Such a process becomes so complicated that its credibility inevitably succumbs to its own errors, inconsistencies, and arguable assumptions.

Considering all the evidence before us, including the opinions of the experts, as well as the arguments of counsel, and viewing the Main Line as an operating whole, we conclude that the fair and equitable allocation of the Main Line deficit for the five years in the current renewal period is 65% to Connecticut and 35% to New York, subject, of course, to the Fare Differential adjustment described in Part II.

IV BRANCH LINE DEFICIT.

Appendix A, Section IV of the ASA defines the "Branch Line Net Operating Deficit" as follows:

The Branch Line Net Operating Deficit calculated as set forth herein shall be the Branch Line revenue as defined below less the Branch Line costs as defined below. See also ASA §1.01 at pp. 5-6.

Branch Line revenue is to be determined essentially on a revenue passenger mile basis, based on the carriage of passengers from a station on a branch line to the nearest passenger station on the Main Line. Some of the Branch Line costs are to be

allocated directly to the Branch Lines; others that involve trains running on both the Branch and Main Lines are to be allocated on a car-mile basis.

The Branch Lines serve only Connecticut residents. Section §3.02 of the ASA allocated 100% of the Branch Line deficit to Connecticut. That allocation remains fair and equitable.

CDOT has argued that all of the Branch Line costs are charged to Connecticut, but that it is credited with only a portion of the Branch Line revenues. It contends that there has been a sharp increase in ridership on the Branch Lines with the result that the Branch Line expresses that travel to and from Grand Central Terminal are heavily loaded and therefore profitable trains. CDOT also claims that it does not have the full control over Branch Line operations that it initially expected. CDOT concludes that Connecticut should be credited with all the revenues from these trains, including the expresses. CDOT also suggests that we abandon the concept of a separate deficit calculation for the Branch Lines and either adopt a single deficit allocation for all the train operations combined, or at least adopt the same percentage for both the Branch Lines and the Main Line.

Seeing no persuasive reason to depart from the formula for the Branch Line deficit that is established in the ASA, we have rejected these arguments. Adopting a single allocator is too great a departure from the ASA. A single allocator for the Branch Lines and the Main Line could not be grounded in any realistic evaluation of the two operations, because they are so different. Except for integrating its Branch Line schedule with the operations on the Main Line, adjustments that are required because of the needs of other Connecticut

passengers, CDOT has virtually complete control over the Branch Line operations. Even with the Branch Line expresses, 25% of their passengers are picked up or discharged at Main Line stations in Connecticut.

As to CDOT's alternative claim to all the revenues of the Branch Line expresses, we favor instead the implicit recognition in the ASA that to the extent that a Branch Line train operates on the Main Line, both its costs and revenues should be allocated between the Branch and Main Lines on the basis of distances traveled on the two lines. CDOT's contention that it pays all the costs of Branch Line trains fails of analysis when the cost definitions of Appendix A, Section IV are considered. For example, propulsion fuel and power costs are computed on the basis of "car miles traveled on the Branch Lines" (emphasis supplied). To the extent that passenger and other equipment are not used primarily on the Branch Line, their costs of repair and maintenance are computed on the basis of "revenue car miles traveled on the Branch Lines" (emphasis supplied). Other similar allocators are included to differentiate Branch Line costs from Main Line costs with respect to yard costs, train-crew costs, Main Line station costs, and the costs of maintaining trackage, right of way, and interlockers with the Main Line.

Thus, the Branch Line costs as defined in the ASA relate closely to operations of trains while they are on or serving the Branch Lines. The other costs associated with moving those trains into Grand Central Terminal are assigned to the Main Line deficit. Consequently, there is no unfairness in apportioning the revenues of the Branch Line expresses based on the relative distances traveled by passengers on the Branch and

Main Lines, respectively. Nor is it unfair to require Connecticut to pay 100% of the deficit resulting from the revenues and costs thus allocated to the Branch Lines.

V GRAND CENTRAL TERMINAL DEFICIT

Grand Central Terminal ("GCT") presents a different set of considerations. It serves as the southerly terminus of the NHL, and the vast majority of passengers who use the line either enter or exit at GCT. GCT also serves as the terminal for two other lines of Metro North – the Harlem and Hudson Lines. In addition, it is an important part of the New York City Transit System, providing an express stop on the Lexington Avenue subway line and a terminal for the Shuttle Trains to Times Square.

Appendix A, Section III of the ASA defines the GCT Net Operating Deficit, including how revenues and costs should be calculated and allocated between the NHL and other operations using its facilities (No issue is raised as to this part of the allocation). The NHL portion of the deficit is allocated on the basis of Connecticut ridership and New York ridership. The parties agree that for the current term of the agreement the ridership proportions are 54.3% Connecticut and 45.7% New York.

With respect to the GCT deficit, CDOT advances three principal arguments:

1. There is no GCT deficit.
2. Other users of the terminal should be considered.
3. MTA's renovations of GCT must be considered.

The first two arguments are readily disposed of; the third requires more detailed discussion.

1. There is no GCT deficit.

New York City is required by statute, New York Public Authorities Law §1277, enacted in 1965, to pay to the MTA an amount equal to the costs of operating GCT. This is part of a program established by the New York State legislature to require local governments to help defray the costs of station maintenance on the commuter railroads. CDOT contends that since the MTA already receives money equal to the operating costs of GCT, there can be no "deficit", and that any sum allocated to Connecticut under the ASA amounts to "double counting".

CDOT's argument stumbles on the terms of the ASA, which post-dated §1277 by 20 years and which carefully defines the GCT net operating deficit. See ASA §1.01 at p. 7, and Appendix A, Section III. The revenue portion lists specifically what is to be included, and significantly absent from the list are any §1277 payments, even though included are revenues from some other sources that do not appear to be inherently related to GCT's railroad operations – e.g., store rentals, and steam and electricity charges.

In short, under § 1277 New York City is required to pay to the MTA a subsidy that is measured by the total cost of running GCT. That annual payment is of a different nature than the revenues contemplated by the ASA to be included in calculating the GCT deficit to be shared between New York and Connecticut. The payment amounts to a New York City taxpayers' subsidy to the MTA that just happens to be measured by GCT's operating costs. Thus, contrary to CDOT's contention, under the provisions of the ASA, when properly construed, there is a GCT deficit.

2. Other users of the terminal should be considered.

CDOT argues that the allocation should be based on total customer usage of GCT, including the subway riders -- a change that would reduce CDOT's share of the deficit to less than 10% of the total. This change, however, would also run counter to the intent of the ASA. Since the adoption of the ASA, there has been no significant change in the nature or proportion of subway riders using GCT, and the allocation agreed to at that time should continue, based on ridership on the NHL, which currently is 54.3% Connecticut and 45.7% New York.

3. MTA's renovations of GCT must be considered.

The MTA has undertaken two major reconstruction projects at GCT. One of them, the North End Access project, will provide additional street access at the north end of the underground platforms. This involved the construction of a large complex of passageways, staircases, escalators, elevators, street entrances and ventilation facilities, at an approximate capital cost of \$99 million. The project will have no discernible effect on revenues, but when it is completed in 1999 it will create additional operating costs of an estimated \$2.8 million for customer service, cleaning, utilities, maintenance, police, and elevator maintenance. Use of the North End Access will equally benefit Connecticut and New York riders of the NHL.

The second major reconstruction project, called the Retail Revitalization project, is a bold attempt by the MTA to restore GCT as an historical landmark and to transform it into an upscale urban mall. This involves substantial work in and around the Grand Concourse. Construction actually began on January 1, 1996. Beginning with that year, rentals and other income dropped significantly, causing a substantial increase in the

NHL portion of the GCT deficit. Since 1983 the revenues from GCT have declined, while the expenses have increased steadily.

CDOT contends that the sharp drop in revenues, which stems largely from the closing of stores and shops during the reconstruction period, requires an adjustment in the allocation of the GCT deficit. MTA's initial view was that once completed, the Retail Revitalization would produce significantly increased rentals that would substantially reduce future GCT deficits. CDOT protested, however, that it had no say in whether or not the Retail Revitalization project should have been undertaken, and that there was nothing in the ASA that was intended to require Connecticut to participate as a partner in a real estate speculation. At the final argument in this arbitration, CDOT indicated that it preferred a different allocation of the deficit to an opportunity to share in future benefits from the Retail Revitalization project.

During its deliberations, the panel tentatively agreed that Connecticut should not be required to participate involuntarily in the Retail Revitalization project, and it informed the parties that it was considering adopting a "base" deficit to be used for allocations of the GCT deficit during this renewal period. To help in its decision, the panel invited further views from the parties. In its response, Connecticut seemed to retreat from its earlier position that it wanted nothing to do with possible future revenues from the Retail Revitalization project, when it argued that future expenses resulting from the two renovation projects should not be allocated at this time because those expenses are "only speculative at this time and * * * the panel appears to be considering a methodology that would preclude CDOT from receiving any benefits from revenue

increases that may result from the renovation." CDOT's Supplemental Memorandum at 18 (emphasis added).

CDOT's position on the Retail Revitalization portion of the renovation projects is thus not clear. MTA has indicated its willingness to, in effect, let CDOT out of the Retail Revitalization portion by excluding both the related revenues and expenses from the GCT deficit calculations. But CDOT must make up its mind; it would not be fair to wait until the success or failure of the Retail Revitalization program is apparent and then decide whether to share in the deficit or profit.

Our determination on this issue, therefore, gives CDOT a choice. If CDOT notifies the MTA by October 15, 1998, that it wishes the GCT deficit calculation for the current renewal period to include the Retail Revitalization portion of the renovations, then the fair and equitable allocation of the GCT deficit will be to continue calculating the deficit according to the current practices, and to allocate the NHL portion of that deficit 54.3% to Connecticut and 45.7% to New York.

If CDOT does NOT notify the MTA by October 15, 1998, of its desire to include the Retail Revitalization portion of the renovations in the deficits for this renewal term, then the fair and equitable allocation of the GCT deficits for the term will be at the same percentages, but the base figure, ideally, should be calculated so as to exclude any effects on revenues and expenses attributable to the Retail Revitalization portion of the renovations, but to include, beginning with the opening of the new North End Access facilities, any additional expenses attributable to the maintenance and operation of those facilities.

Separate identification of the additional expenses from the North End Access facilities is relatively easy. Separate identification of the financial consequences of the Retail Revitalization project, however, would be extremely difficult, if not impossible. Therefore, our determination of the GCT deficit to be allocated will proceed on the basis of a base figure for the first year of the renewal term, to be modified by later adjustments.

The parties do not agree, however, on the base figure. CDOT suggests that we adopt the amount of the deficit in 1988, the year before the first announcement of the GCT renovation project, adjusted to 1995 constant dollars, or \$9,215,786. MTA suggests that we use the amount of the 1995 deficit, \$10,456,000, because actual construction of the renovations did not begin until 1996, when the sharp drop in rentals occurred. CDOT, however, demonstrates that there were earlier losses of revenue caused by the initial planning, publicity, and preparation for construction of the Retail Revitalization project.

We conclude that the fair and equitable solution is to use the sum of \$9,750,000 as the base figure for the year 1995. For the remaining four years, the NHL portion of the GCT deficit shall equal the base figure adjusted annually by any changes in the Consumer Price Index, and, once the North End Access facilities have been opened, by the NHL's share of the additional expenses attributable to the maintenance and operation of those facilities.

VI CAPITAL ASSETS

Section 12.03 of the ASA provides that in the absence of agreement for a renewal term the parties shall submit to arbitration the "allocations", which in §1.01 at p. 5 are defined to include MTA's and CDOT's respective shares of the operating deficits (discussed in Parts II through V, above) and "Capital Costs" as set forth in Article Five of the ASA. "Capital Costs" in turn are defined with reference to Nonmoveable Capital Assets, ASA §5.01, and Moveable Capital Assets, ASA §5.02. There is no issue as to allocating the costs of Nonmoveable Capital Assets; they are paid for by the jurisdiction in which they are located. For the panel, therefore, the only allocation of capital costs to be made relates to Moveable Capital Assets, a category that includes both rolling stock and administrative assets such as maintenance equipment, vehicles, information systems, ticket machines, and similar kinds of system-wide capital assets.

Allocating the cost of rolling stock has not proved to be a problem in the past. If the cars are to be used on the Branch Lines, Connecticut has paid for it. If they are for use on the Main Line or for joint use, the ASA allocated 63% of its cost to Connecticut and 37% New York. In practice, the parties have realistically modified that allocation so that any particular car will be owned by either Connecticut or New York, and no car is jointly owned.

Many of the administrative assets serve the entire Metro North system, but again the parties have readily resolved any allocation problems arising out of shared use. They have divided the costs between the NHL and the Harlem and Hudson Lines based on their relative operating expenses. The NHL's share has then been allocated in accordance with the 63% -- 37% ratio established by the ASA.

In general, the parties assume that continuing the foregoing approach toward capital assets would be fair and equitable, and the panel agrees. The parties disagree, however, over what allocating percentages should be applied to the moveable capital assets. (Rolling stock is not an issue because none has been purchased so far during the current renewal term, and no purchases are contemplated.)

As to administrative assets, MTA argues for a continuation of the method described in the 1984 arbitration opinion and that was embodied in the ASA. According to the MTA that method focuses on the respective shares of the Main Line deficit, with a percentage increase added to Connecticut's share "to account for MTA's exclusive funding of the fixed assets of the railroad in NY." CDOT argues that the 63% -- 37% allocation in the ASA was a negotiated figure and that the explanation in the 1984 opinion is merely a rationalization for the negotiated result. CDOT also contends, with considerable justification, that it is time to abandon any adjustment based on fixed assets in New York that are used by Connecticut riders. Extensive fixed assets have also been created by Connecticut for the benefit of the entire operation, including car storage facilities, maintenance shops, and inspection facilities. Since 1983 Connecticut has spent or committed over \$1 billion for fixed assets that service riders from both states and the railroad as a whole. It projects an additional \$58 million to be similarly spent during the remainder of the current term. MTA has spent comparable amounts in New York, but when they are allocated between the Hudson and Harlem Lines and the NHL, the NHL's share reduces the MTA amount (excluding all retail Retail Revitalization costs at GCT) to approximately \$600 million for the period from 1982 through 1999.

The 1984 award, the ASA, CDOT, and MTA all recognize, in one form or another, that the costs of moveable capital assets should be allocated in approximately the same proportions as the Main Line deficit, except of course for the rolling stock that is to be used on Connecticut's Branch Lines. The panel agrees, and therefore determines that the fair and equitable percentage to be applied in allocating moveable capital assets is 65% to Connecticut and 35 % to New York, the same as the allocation of the Main Line deficit before applying the Fare Differential adjustment.

VII SUMMARY OF AWARD

For the renewal term beginning January 1, 1995, and ending December 31, 1999, the fair and equitable allocations are as follows:

A. Main Line deficit: 65% to Connecticut and 35% to New York, subject to the Fare Differential adjustment to be calculated and applied as described in Part II.

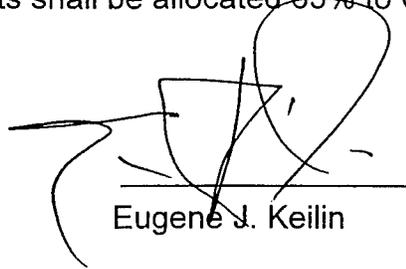
B. Branch Line deficit: 100% to Connecticut.

C. Grand Central Terminal Deficit: 54.3% to Connecticut and 43.7% to New York. The base to which the percentages shall apply shall be determined as follows:

1. If CDOT elects to participate in the GCT Retail Revitalization project, the base shall be the GCT deficit calculated in accordance with the principles established by past practice, including the Retail Revitalization revenues and expenses.
2. If CDOT does not elect to participate in the GCT Retail Revitalization project, the base shall be \$9,750,000 for 1995, which shall be modified for subsequent years by (a) any change in the Consumer Price Index, and (b) including, beginning with the opening of the new North End Access facilities, NHL's share of any additional expenses attributable to the maintenance and operation of those facilities.

D. Capital Assets:

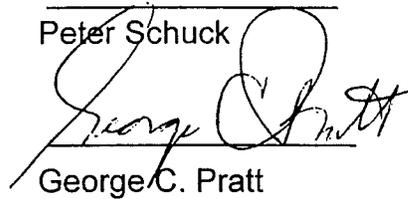
1. Costs of fixed capital assets will continue to be paid according to their location. See ASA §5.01.
2. Except for assets used "primarily on the Branch Lines", see ASA §5.02(a), and assets purchased under ASA §3.03(c), costs of moveable capital assets shall be allocated 65% to Connecticut and 35% to New York.



Eugene J. Keilin

Dated: September 8, 1998

Peter Schuck



George C. Pratt

APPENDIX C

Dissent by Arbitrator Peter H. Schuck, September 3, 1998

Dissent by Arbitrator Peter H. Schuck
September 3, 1998

My principal difference with the Panel majority's Award and written decision pertains to the allocation of the Main Line ("ML") deficit and to the allocation of the moveable capital assets costs, which mimics the Main Line deficit allocation. By letter dated June 22, 1998, which summarized my earlier communications, I conveyed these views to the majority. It has rejected them, necessitating this dissent.

The arbitration was convened in order to preserve the decades-long relationship between Connecticut and New York in the operation of the New Haven Line ("NHL") and to place it on a fairer, more efficient footing. The majority's Award, however, is so one-sided that it may in fact force Connecticut to terminate that relationship and to find a new operator for the Connecticut service on the NHL. It is difficult to characterize as "fair and equitable" an allocation that seems all too likely to precipitate a divorce. This is particularly true when the existing allocation is one that the parties manifestly considered "fair and equitable" at the time that this arbitration was sought.

The financial consequences of the ML allocation are great. Each percentage point is worth almost \$400,000 a year on the ML allocation alone, not counting its effect on the moveable capital assets allocation that is derived from it. The majority's award increases Connecticut's share of the ML deficit from 56.3% to

65%, which represents an increase of more than 15% above its current share. This decision will require Connecticut to pay to the Metropolitan Transportation Authority ("MTA") more than \$3 million merely to cover the years 1995-1998, not to mention the future increased payments necessitated by this much larger share.

In order to justify a transfer of funds from Connecticut to MTA of this relationship-threatening magnitude, the Panel must explain what conditions have changed so radically since the 1984 Award established the current allocation. It has manifestly failed to do so. Although the financial data on the costs and revenues of the predominantly Connecticut and predominantly New York services are subject to differing interpretations, the record establishes to my satisfaction that the Connecticut service has contributed disproportionately to the reduction of the Main Line deficit since the 1984 Award -- a period during which Connecticut's usage, as measured by its percentage of passenger-miles, did not change.

MTA's own documents indicate the source of this contribution to deficit reduction: the Connecticut service consists of trains that generally run longer distances carrying more passengers per car, on infrastructure that is cheaper to operate and maintain, and at a higher fare structure (the new Award properly eliminates the financial effect of this last difference) than the New York service. And although there was a conflict of testimony as to the net financial effect of the greater distance traveled by the Connecticut trains, I am persuaded that it was deficit reducing,

any affirmative case that Connecticut's share should be increased. "Considering all the evidence" (Award, p. 9) hardly constitutes an explanation or justification. It is simply a conclusory mantra, an ipse dixit that conceals the fact that the parties' experts did not provide the Panel with a defensible number, and the Panel was therefore obliged to come up with its own. Indeed, the fact that the majority's 65% figure deviates both from Connecticut's passenger-mile share (68%) and from MTA's proposed 73% Connecticut share indicates that the majority has not followed MTA's methodology either, which leaves us to guess at how the majority came up with its 65% figure.

What, then, is the correct figure? Undeniably, this is very hard to say. The reason it is so hard to say is provided by the majority when it observes that "[w]orking with the same underlying data, expert witnesses reached widely varying estimates of what the proper allocation should be. Opinions ranged from a 40% to a 73% allocation to Connecticut." (Award, p. 8) Perhaps that is the nature of railroad economics in a system like the NHL. The real question, then, becomes this: what is the Panel supposed to do when both parties' experts present it with numbers and rationales that are so extreme and doubtful that they are both unacceptable in themselves and incapable of being reconciled or compromised as between them?

There is no easy or entirely satisfactory answer to this question, but legal tradition and common sense provide us with a workable one. It is that the status quo, which the parties

not increasing.

Given these conditions, what can possibly justify increasing Connecticut's deficit share at all, much less by 15%? The Panel majority says only that the new Award's fare differential adjustment will compensate for "much of the revenue-enhancing distortion relied on by Connecticut." (Award, p. 8) But this adjustment is merely designed to eliminate MTA's incentive to lag its fare increases behind Connecticut's, as it began doing in the 1990s, long after the 1984 Award was issued. The adjustment cannot explain the majority's decision to increase Connecticut's share of the deficit above the current share, which was decided by the 1984 Award at a time when the now-resolved fare differential issue did not even exist.

The decision to increase Connecticut's share to 65%, then, must stand on its own if it is to stand at all. It does not. The majority does not indicate which changed conditions, if any, have occurred since 1984 to justify raising Connecticut's share above the current 56.3%, much less why such changed conditions - whichever they are - justify a 65% share when Connecticut's usage remains unchanged since 1984 and when its service has evidently reduced the deficit since then. All the majority tells us is that it is not persuaded either by Connecticut's claim that MTA is an inefficient operator of the service or by Connecticut's proposed methodology. (Award, p. 9) But even assuming arguendo that the majority is correct in rejecting Connecticut's positions on inefficiency and methodology, it has utterly failed to make

negotiated in 1984 and which they have have lived with without serious disagreement ever since,¹ should constitute the default allocation. I would therefore retain the current 56.3% share, on the theory that neither party has met its burden of adducing compelling reasons, rooted in post-1984 changed circumstances, to depart from it.

As it happens, this 56.3% figure also approximates Connecticut's share of NHL passengers, which is 55%.² (Award, p. 3) If we are obliged to use rough justice, rather than the parties' expert methodologies, to come up with a number, this share-of-passenger figure seems more defensible than the passenger-mile criterion that the MTA made the core of its case. The problem with the passenger-miles criterion, as discussed above, is that passenger-miles, in Connecticut's higher load service, works to reduce the deficit, not increase it. It is perverse for the majority to penalize Connecticut (by increasing its share) for precisely that aspect of its service which serves both parties by increasing ridership and reducing the deficit.³

¹ It is important to remember what is easily forgotten but what the record (Hearing Exh. 4) makes perfectly clear: the casus belli of this arbitration was not the deficit allocation but the differential fare structures that had developed over time, an issue that has now been resolved. Some other issues were mentioned but the deficit allocation was not one of them.

² This is no coincidence; the 1984 negotiations and resulting Award surely took this passenger share into account.

³ I also note that, perhaps coincidentally, the 56.3% status quo share happens to lie exactly midway between the two extreme positions of 40% and 73% proposed by the parties' experts.

This has been a protracted, complex, and bitterly-contested arbitration. In the case of the ML allocation, the Panel has been asked to locate a single point in a vast, dense, and unfamiliar policy space while receiving less help from the technical experts than we might have expected in light of the impressive skills that they and the lawyers exhibited throughout this proceeding. Under these circumstances, it is surely too much to expect that the Panel would converge on the "right" figure, as no single, objectively determined, technically correct "right" figure exists. At best, there is a larger domain within it must be found.

Nevertheless, I believe that the majority's largely unexplained allocation lies outside this domain. The wiser and fairer course would have been to return to our starting place -- the allocation on which the parties long ago agreed and with which they have lived ever since. So far as the record reveals, they did not regard this allocation as unfair, nor did they either propose or expect to alter it, when they convened this arbitration. This is compelling evidence, in my view, that the existing allocation continues to be "fair and equitable."

APPENDIX D

Grand Central Terminal Determination, November 13, 1998

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November 13, 1998

**BY FACSIMILE (212) 479-6275
AND BY HAND**

William H. O'Brien, Esq.
Kronish, Lieb, Weiner & Hellman
1114 Avenue of the Americas
New York, NY 10105

Dear Bill:

Under the terms of the Arbitration Award in the matter of the Connecticut Department of Transportation (CDOT) and Metropolitan Transportation Authority (MTA), CDOT elects the option that establishes a base year deficit for GCT in 1995 at \$9,750,000, as the New Haven Line share of the GCT deficit, of which Connecticut's share, at 54.3%, will be \$5,294,250. It is CDOT's understanding that the base figure, and its proportionate share, will then be inflated by the annual increase in the Cost of Living (CPI) for the New York region.

CDOT understands the base figure is to include any and all expenses related to the operation of Grand Central Terminal with one exception: the opening, budgeted for 1999, of the North End Access (NEA). It is CDOT's understanding that the additional costs associated with the opening and initial operation of the NEA will be added, in the year the NEA opens, to the base figure. Then the combined figure will be increased, from that point forward, by the CPI. CDOT further understands Metro North has created a new cost center for capturing only NEA costs regardless of which Cost and Management Center Metro North uses.

William H. O'Brien, Esq.

November 13, 1998

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This decision is also based on a mutual agreement between CDOT and Metro North concerning the cost allocation of police for the various components of the Metro North Line made necessary by MTA merging the Metro North Police into the MTA Police. MTA has advised CDOT they are developing a proposal for capturing actual costs in the future. It is CDOT's understanding that Metro North/MTA is to finalize that proposal and present it to CDOT for its review and approval.

Very truly yours,

A handwritten signature in black ink, appearing to read "MLW", written over the closing phrase "Very truly yours,".

Michael L. Widland

MLW:dv

cc: Harry P. Harris, Bureau Chief, Bureau of Public Transportation

APPENDIX E
Memorandum of Understanding, April 24, 2001

Memorandum of Understanding
Between The
Connecticut Department of Transportation and
The Metro-North Commuter Railroad Company

Whereas, the Connecticut Department of Transportation (CDOT) and the Metro-North Commuter Railroad Company (Metro-North) have entered into an Amended and Restated Service Agreement for the operation of the New Haven Line rail passenger service, and

Whereas, the New Haven Line commuter rail passenger service is economically vital to the State of Connecticut and the State New York, and

Whereas, the New Haven Line commuter rail passenger service is currently operated in an efficient and effective manner and provides a quality service to its customers, and

Whereas, the parties to this Memorandum of Understanding desire to ensure that the New Haven Line commuter rail passenger service continues to provide quality service to its customers in an efficient and effective manner, the parties hereto mutually agree to the following:

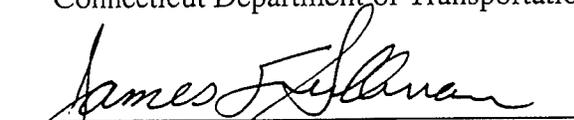
1. In accordance with the provisions of Section 6.05(a) of the Amended and Restated Service Agreement and to facilitate effective development of a calendar year budget, CDOT and Metro-North shall include in the agenda for the quarterly financial review meetings, among other things appropriate for those meetings, discussion of budget projections then being prepared for the following calendar year and discussion of any potential problems or concerns that either party foresees for that budget year.
2. In accordance with the provisions of Section 6.04(b) of the Amended and Restated Service Agreement, prior to October 1st of each year, Metro-North shall submit to CDOT the detailed annual budget request for the Service for the following calendar year, in such a manner as to clearly identify each proposed change, increase or decrease in the budget and the direct New Haven Line effect of each proposed change associated with the operation of the New Haven Line service and Metro-North.
3. Between October 1st of each year and December 1st of each year, CDOT and Metro-North shall consult on all budget issues and work cooperatively to resolve any differences.
4. In accordance with the provisions of Section 6.04(b) of the Amended and Restated Service Agreement, CDOT shall, on or before December 1st of each year, notify Metro-North of its approval of the budget or notify Metro-North that it disapproves the budget. Any disapproval notification from CDOT (which shall not be unreasonably made) shall include an identification of the specific areas of concern and provide recommended actions to modify the budget, so that it may be approved by CDOT. Metro-North and CDOT shall immediately enter into negotiations to resolve the budget issues.

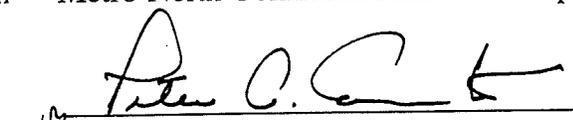
5. In accordance with the provisions of Section 6.04(d) of the Amended and Restated Service Agreement, if the negotiations, referenced in item 4 above, have not resulted in CDOT's approval of the budget by December 31st, then Metro-North shall be permitted to budget and expend in accordance with the budget for the preceding year, plus such increases as may be required by (i) labor contracts, (ii) general increases in the costs of goods and services, as reflected in the consumer price index published for the New York Metropolitan Region, and (iii) service improvements made at the request of CDOT to the extent not covered by the preceding year's budget. Metro-North shall be required to operate within the confines of the budget for the preceding year, as adjusted to reflect the three items stated above and CDOT shall be required to pay its share of the operating deficit in accordance with the provisions of the Amended and Restated Service Agreement. In any event, however, Metro-North may charge to the New Haven Line service, as provided in Section 6.04(c) of the Amended and Restated Service Agreement, costs it incurs in good faith (which shall not be unreasonably made) in fulfilling its obligations to operate the Service as then constituted. Metro-North and CDOT shall continue to aggressively negotiate a resolution of the budget issue as expeditiously as possible. Once both parties approve the budget, any necessary billing adjustments shall be made in accordance with the Amended and Restated Service Agreement.

The parties hereto enter into this Memorandum of Understanding to clarify the budget development process and to ensure timely and effective coordinated action on the budget. Nothing contained herein modifies or changes in any way the terms and provisions of the Amended and Restated Service Agreement.

Connecticut Department of Transportation

Metro-North Commuter Railroad Company


James F. Sullivan
Commissioner


Peter A. Cannito
President

4-12-01
Date

4/24/01
Date