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UPDATE OF OLR REPORT 2005-R-0345 REGARDING THE METRO NORTH CONTRACT ANALYSIS

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ISSUE

Update of OLR Report 2005-R-0345.

SUMMARY

This report is the second update of a 2001 report (2001-R-0514) that provided a bullet-point summary of the *Analysis of the Amended and Restated Service Agreement (ARSA) for the Operation and Subsidization of the New Haven Rail Line,* required by PA 00-129.

This report reproduces the bullet point information of 2001-R-0514 as originally presented. As with the 2005 update (2005-R-0345), we asked the Department of Transportation (DOT) to review the previous report point-by-point and provide any comments it deemed appropriate to provide either revised or more recent information.

For any point of information for which DOT provided revised or updated information, we have added that information below the original bullet point with the notation "2005 Update" or "2014 Update," as appropriate.

This report is divided into two sections. DOT has updated the information in Part I, but did not update Part II. We agreed to this in the interest of timeliness. The sections that were not updated included information on, among other items, new rail cars, train stations, parking, and the New Haven Rail Yard. Please let us know if you would like us to follow up with DOT for updates in those areas, or if there is other information from those sections you would like DOT to address. For this report, DOT also added a section on "General ARSA Provisions."

PART I

DOT has updated some of the following sections.

SERVICE AND CONTRACT HISTORY

Contract History

- Subsidized rail service from New Haven to New York City has existed since a demonstration project was begun under a federal Housing and Urban Development grant in 1965.
- Four service agreements were executed in 1970 that provided for continuation of the service under the joint oversight of the DOT and Metropolitan Transportation Authority (MTA). The Penn Central Railroad and, later, Conrail (its successor) operated the service under the agreements.
- Under these agreements, DOT and MTA funded the operating deficit on a 50/50 basis.
- Federal law relieved Conrail of its obligations to provide rail commuter service in 1981.
- MTA elected to create a subsidiary, the Metro-North Commuter Railroad, to operate its Harlem and Hudson commuter lines and its portion of the New Haven line. DOT agreed to have it operate the service in Connecticut.
- Metro-North assumed operating responsibility under an interim service agreement in January 1983.
- At this time, MTA raised questions about the 50/50 deficit allocation distribution and it was agreed that the interim service agreement would provide for an arbitration panel to determine a fair and equitable deficit allocation.
- In June 1985, after a lengthy arbitration proceeding, DOT and MTA/Metro North signed an Amended and Restated Service Agreement (ARSA) for continued operation based on the arbitrators' ruling.

- In the first year, DOT paid 60% of the total operating deficit. This represented an uncalculated percentage of the net main line operating deficit, 53% of the New Haven line's allocated share of the Grand Central Terminal's operating deficit, and 100% of the deficit for the three Connecticut branch lines (New Canaan, Danbury, and Waterbury).

- In subsequent years, DOT's share would change to reflect actual net main line operating deficit as calculated in the first year, which turned out to be 56.29%.

- Prior to MTA's creation of Metro North, DOT and MTA dealt with an independent third party (Penn Central/Conrail) on a "more or less equal footing," with the third party ostensibly favoring neither subsidizer. Annual budgets were prepared for both parties' scrutiny and costs were allocated equally between the parties.

- DOT does not consider Metro-North to be an independent operator since all of its corporate policies, labor negotiation parameters, and annual budget parameters are established by the MTA.

- During this period, DOT was still paying an annual lease fee to the Penn Central Trustees. In October 1985, DOT exercised an option under the service agreement to purchase the line between New Haven and Greenwich for $8.5 million.

- A year before the ARSA would have automatically renewed on January 1, 1995, DOT notified Metro-North that it wanted to renegotiate certain elements of the agreement to eliminate what it perceived as fundamental inequities. The issues included renegotiating a differential for the fare structure, certain cost allocators, the disposition of administrative assets following contract termination, Grand Central Terminal costs, and other cost allocation and accounting matters.

- Since amicable resolution could not be reached, another arbitration proceeding was begun. In 1998, DOT was awarded the fare differential it wanted, but was also forced to accept the panel's ruling that in the future it would be allocated and have to pay 65% of the net main line deficit and continue to pay 100% of branch line deficits. The percentages have remained in effect since the arbitration award.

SERVICE PROFILE – 2001

Ridership

- Ridership reached an all-time high of 32.5 million in 2000 (an increase of 4.7% over 1999, 41% since 1984, and almost 100% since 1970).
- Ticket sales data indicates a 47% increase in intrastate ridership (between Connecticut stations) since 1995.
- There is agreement between DOT and Metro-North that opportunity exists to capture an even greater share of intrastate travel.

Service

- As of October 2000, service consists of 250 weekday trains, 143 Saturday trains, and 132 Sunday trains.

Revenue and Expenses

- As of 1999, the service generates over $175 million in revenues and incurs operating expenses of $237 million, for a net operating deficit of $62 million.

Subsidy

- Approximately 70% of operating expenses are recovered from fare revenue, the subsidy per passenger is approximately $2.00, and on-time performance is consistently above 96%.
- DOT’s annual deficit subsidy share is approximately $40 million.

2005 UPDATES

Ridership

- Ridership reached 33.2 million in FY 2004 (an increase of 5% over 1999, 43% since 1984, and almost 100% since 1970).

Service

- Service in 2005 consists of 258 weekday trains, 165 Saturday trains, and 133 Sunday trains.

Revenue and Expenses

- As of FY 2004, the service generates over $208.8 million in revenues and incurs operating expenses of $283.8 million, for an unadjusted total operating deficit of $75 million.

Subsidy

- DOT's annual operating deficit subsidy is approximately $45 million.

2014 UPDATE

Ridership

- Ridership reached an all-time high of 39.16 million riders in SFY 2012, but decreased slightly in the most recent state fiscal year (SFY 2014) to 38.98 million riders.

Service

- Service consists of 305 weekday trains, 203 Saturday trains, and 189 Sunday trains, as of November 2014, (compared to 258, 165, and 133, respectively, in 2005).

Revenue and Expenses

- The service generated over $309 million in revenues and incurred $442 million in operating expenses, for a net operating deficit of $133 million for FY 2014.

Subsidy

- DOT's annual deficit subsidy share is approximately $94 million for SFY 2014.

2014 DOT ADDITIONS

General ARSA Provisions

- The ARSA took effect January 1, 1983 and provided for an initial seven-year term, which is extended automatically for additional consecutive five-year terms as each successive term expires. As of January 1, 2015, the ARSA will automatically extend for another five-year term.

- Both DOT and MTA have the right to terminate the ARSA by notifying the other party in writing at least 18 months prior to the desired termination date. In the event of a termination, the ARSA calls for a substantial process of negotiation and possibly arbitration to bring the agreement to a fair and equitable resolution.

- The ARSA provides for a procedure (Contract Administration Letters) by which the parties may mutually agree to clarify or change existing ARSA provisions.

- ARSA also provides for a substantial arbitration process. Settlement of disputes among the parties that have not been settled after making every reasonable effort to come to a resolution may be submitted to an arbitration process as set forth in Section 10.02 of the ARSA.

- The ARSA provides access to all of Metro North's records related to the service and allows for DOT to conduct audit reviews, which are completed by DOT via a consultant contract with a Connecticut- based CPA firm.

- ARSA provides for regularly scheduled service meetings and finance meetings attended by Metro North and DOT.

PART II

DOT did not provide 2014 updates for the following sections of the 2001 and 2005 reports, which appear here as they did in the 2005 report.

WHERE PROBLEMS HAVE BEEN IDENTIFIED UNDER THE ARSA

- In some respects, the ARSA lacks precision and can be subject to interpretation. While this is not a "fatal flaw", it also can be said that it lacks the flexibility to correct this imprecision simply. As one example, the study cites the requirement that DOT share in all of Metro-North's direct, indirect, and administrative costs. Metro-North uses a cost allocation model for all costing situations that presumes the service, and Connecticut's riders, benefit proportionally to the Harlem and Hudson lines for all of Metro-North's activities. DOT has taken exception to the presumption, particularly with respect to the activities of Metro-North's legal department, property management office, marketing, MTA police, and station administration and maintenance. DOT has also requested a more equitable allocation of DC power costs in common areas (those operated through by all three Metro-North lines).

- A formal position paper on these issues is currently being prepared by DOT and will represent a starting point for negotiation on these issues.

2005 Update —These outstanding issues have yet to be resolved.

- The ARSA relies on Generally Accepted Accounting Principles (GAAP). DOT has long maintained that ARSA should incorporate standards that provide a more detailed allocation of costs and revenues such as those used by the federal government. Implementing these standards, DOT believes, would eliminate many of the problems that have arisen from the current cost allocation procedures. Although it is not certain whether this would result in a greater or lesser allocated share of the operating deficit, DOT believes it would certainly enhance consistency and fairness.

- Although ARSA provides a process to arbitrate non-financial disputes and an expedited financial arbitration procedure, these are often time-consuming, costly, and have the potential to create animosity between the parties. Even the expedited procedure can take up to 150 days for resolution. Thus DOT has been reluctant to utilize the available arbitration procedures.

- DOT has been "frustrated" by its inability to exert control in the budget process in the face of escalating Metro-North annual operating budgets and relatively static annual revenue appropriations for funding its share of the net operating deficit.

2005 Update — DOT has been "challenged" by its inability to exert "influence" in the budget process in the face of escalating Metro-North operating budgets and relatively static annual revenue appropriations.

- In the past, two factors have undermined DOT's effectiveness in the budget process.

    - One factor is that Metro-North has not provided a proposed service budget for DOT review, but only a system budget that gave only summaries of components of the service budget. On occasion, it has been difficult to review the budget and identify a causal and beneficial relationship between activities and service delivery. The ARSA requires that a detailed annual budget be submitted to DOT and MTA on or before October 1 each year. A recent memorandum of understanding between the parties restates the intent of the parties to follow the budget provisions more closely.

    - A second factor is that MTA/Metro-North's annual calendar year budget process does not conform well to Connecticut's biennial budget process. Metro-North issues its draft calendar year budget on October 1 for the upcoming calendar year while DOT prepares a budget for a two fiscal year period that begins 12 months after the budget is prepared. This can create difficulties when Metro-North's projected revenues and costs vary from actual, or when administrative assets project schedules slide. The study states that they have mutually agreed to "clarify" the budget process set forth in the ARSA to ensure timely and coordinated budget development.

DOT'S ROLE IN ARSA ADMINISTRATION

- Many of the ups and downs in the DOT/MTA-Metro-North relationship can be directly attributable to the changing personalities and managerial philosophies guiding the respective agencies and their interpretation of the letter and intent of the ARSA. DOT's effectiveness in administering the ARSA has fluctuated over time, usually in "direct proportion to the availability of financial and human resources." DOT summarizes its role in administering the ARSA as follows:
    - Monitor Metro-North's operating and financial effectiveness;
    - Review and approve annual capital and operating budgets;
    - Review, process, and audit monthly deficit billings and payments;
    - Develop and maintain fare policy and structure for the Connecticut portion of the line and coordinate revisions with MTA/Metro-North;
    - 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 capital improvements;
    - Conduct and administer planning and engineering studies; and
    - Coordinate and/or administer capital improvement projects for Connecticut facilities and structures.

- DOT has exercised its oversight right with respect to the deficit model, particularly since 1992, with the result of more than $17 million in questioned costs and a subsequent reduction in Connecticut's deficit share of $15 million.

2005 Update — As a result of DOT's oversight right with respect to the deficit model, the amount of reduced Connecticut deficit share has gone from $15 million to $22 million.

TARGETING AND CAPTURING A NEW MARKET

- For the first 25 years of service operation, the focus of New Haven line service has clearly centered on trips destined for Manhattan. Today, 90% of New Haven line trips still begin or end at Grand Central Terminal. However, there is growing awareness of a fast emerging intrastate and reverse commute market.

- Over the last seven years, DOT and Metro-North have jointly implemented targeted fare initiatives to attract new ridership in the intermediate commutation market to the major employment centers of southwestern Fairfield County. These were specifically directed at both the intrastate Connecticut market and the reverse commutation market from the Bronx and lower Westchester County.

- While targeted fare reductions in 1993, 1994, and 1997 produced ridership gains of 10-30% in the targeted markets, the Bridgeport fare reduction in 1998 resulted in ridership increases to and from Bridgeport of up to 40% in the first two years. The increase translates to over 500 additional riders, most of whom were new as opposed to riders diverted from other stations. Commutation ridership between Bridgeport and Manhattan increased by over 130% and by almost 60% between intermediate stations.

- Sufficient rail parking continues to be a key element in attracting new ridership. A current study of existing station parking and governance aims at determining if these facilities are being managed and maintained in the most efficient and cost-effective way.

- DOT currently has an agreement with two regional planning entities to study rail station parking alternatives in Fairfield County and the feasibility of a major regional train station between New Haven and Milford. Suitable sites have been identified in Orange and Milford, but as yet no funding has been identified.

2005 Update — Suitable station construction sites have been identified in Orange and West Haven (instead of Milford) but no construction funding has yet been identified.

- Parking initiatives are underway in New Haven, Stamford, and Fairfield to add 1,000, 900, and 1,200 new spaces respectively.

2005 Update — Little progress has been made in New Haven to date, Stamford has been completed, and Fairfield is in design. In addition, parking expansion initiatives are underway for Wilton, Stratford, and Bridgeport and are expected to yield 120, 455, and 500 new spaces respectively.

- A public/private partnership has been formed between DOT, Fairfield, and a private developer to establish a new passenger station and commuter rail parking in Fairfield.

2005 Update — Design of the station is underway.

- DOT reviews the activities of Metro-North's marketing department to ensure that an acceptable level of marketing services is being provided to Connecticut in relation to the amount being billed. DOT created its own Transit Marketing Unit in 1997.

- DOT's marketing unit gives final approval for all Metro-North marketing activities using Connecticut media and tries to assure that DOT's role in the Connecticut portion of the service is well represented in all in-state communications.

2005 Update — DOT marketing unit activities are continuing.

- For calendar 2001, DOT reviewed Metro-North's draft marketing plan. DOT's comments on the plan were incorporated into the final plan.

2005 Update — DOT continues to review all Metro-North annual marketing plans.

- In October 2000, DOT initiated a contract with the advertising, marketing, and public relations agency, FJC & N of Salt Lake City, Utah, for assistance in marketing rail and other public transportation services in Connecticut. They will develop a brand for public transportation in Connecticut that will be included in all marketing materials for DOT, including Metro-North's New Haven line marketing.

2005 Update — For a number of reasons, the "branding" concept never took hold.

CHALLENGES FOR DOT

- The most significant challenge to implementing a transportation strategy that will divert a meaningful number of commuters to the rail service is appropriating sufficient funds to pay the deficit for additional trains, regardless of whether this represents 65% or 100% of the total cost.

- The second significant challenge is identifying the resources necessary to address a critical shortage of passenger equipment, the storage and maintenance facilities to support this equipment, and rail station parking. DOT considers this to be the far greater concern of the two with respect to threatening existing service levels.

- The system for funding Metro-North administrative assets projects (moveable capital assets used to perform administrative functions for the service such as highway vehicles, fare collection and ticket selling systems, computers, and train control and power control systems) creates certain administrative difficulties for DOT in managing its annual rail appropriation effectively. Taken together with the likelihood that DOT's deficit share will continue to rise, it has the potential of creating a severe rail appropriation shortfall. While managing administrative assets may be the greatest variable in the budget process, the problem does not stem directly from any specific provision of the ARSA and DOT feels it may be correctible through renegotiation of current practices by both parties.

- If DOT's current bond authorization for capital projects remains static or does not have the flexibility to meet requirements that vary from year to year, a point may soon be reached when it has insufficient funds to access all the federal funds available. By comparison, only 35% of MTA/Metro-North's capital funds are derived from federal sources, while DOT is close to 80% reliant on federal funds.

- The 121 M-2 type rail cars that form the core of the service are nearly 30 years old and experience an increasing rate of component failure. This exacerbates the seat shortage created by increasing passenger loads and has created an untenable maintenance cycle. The current 17% spare ratio is below the 20% average of most comparable commuter railroad operations. DOT and Metro-North estimate that $89 million (Connecticut share) is necessary for an immediate interim fleet expansion of 10 locomotives and 60 coaches to maintain existing service levels and reliability, and to implement additional intrastate strategies. If funding is made available, the necessary equipment could be delivered in 2003.

2005 Update —The immediate interim fleet expansion of 10 locomotives and 60 coaches was a temporary option since dismissed. The Governor's 2005 Transportation Initiative (SB 1057) calls for the procurement of 342 new electric multiple unit rail cars at a cost of approximately $1.026 billion (approximately $667 million in Connecticut funding and $359 million in New York funding). If implemented as proposed, initial receipt of new rail equipment could occur in late 2008 or 2009.

- DOT must provide expanded storage and maintenance facilities for rolling stock. Neither a suitable site nor sufficient funding (approximately $250 million) has yet been identified.

2005 Update — A conceptual design for a campus of maintenance facilities has been developed for the New Haven Yard. The Governor's 2005 Transportation Initiative includes $300 million for these facilities. Design will begin immediately after approval of the legislation.

- Finding suitable sites for expanded or new rail station parking facilities continues to be a problem as municipalities do not want to lose the tax value of the required land or view the planned facilities as inconsistent with aesthetic values they want to create or preserve. DOT feels there must be a greater understanding by all of the municipalities in the region of the need for and value of expanded parking for rail commuters.

RECOMMENDATIONS

- The commissioner and key DOT managers must work at maintaining an improved working relationship with their MTA/Metro-North counterparts with the goal of ensuring DOT's meaningful participation in development of annual operating budgets and establishment of future service policies and strategies.

- DOT and Metro-North must continue ongoing negotiations to modify the way in which specific costs are allocated to resolve current and future issues, to improve administrative practices, demonstrate value for subsidy, and eliminate wasteful practices and spending.

- DOT must exercise the provisions and protections of the ARSA more fully, including arbitration, financial arbitration, and renegotiation of specific articles of the agreement.

- The legislature needs to authorize funds outside of existing appropriation levels for DOT to expand intrastate rail passenger services and to acquire additional rail equipment and construct storage and maintenance facilities for this equipment.

- The Connecticut Congressional delegation must be made aware of the critical rail equipment and maintenance facility shortage so that substantial funding allocations can be sought for them.

- The commissioner should be granted explicit legislative authority to award contracts on the basis of future guaranteed federal funding levels and the reasonable expectation that bonds will be authorized to provide the required local share for federal grants.

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