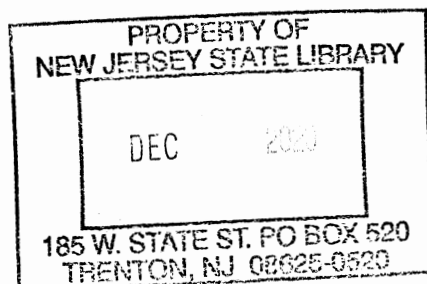


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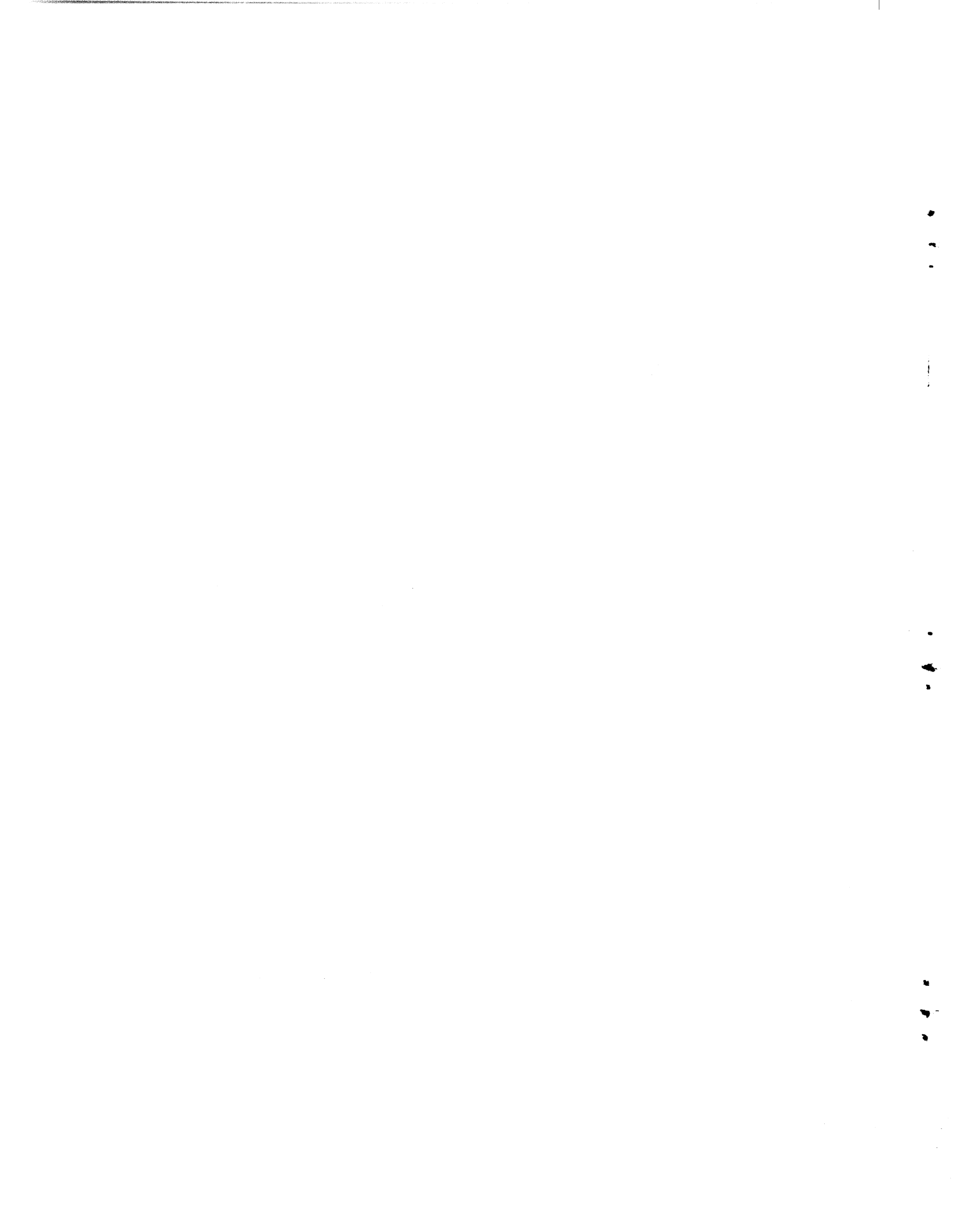
REPORT: USRA PROJECTION OF SUBSIDY PAYMENTS TO CONRAIL FOR PASSENGER OPERATIONS



NEW JERSEY DEPARTMENT
OF TRANSPORTATION

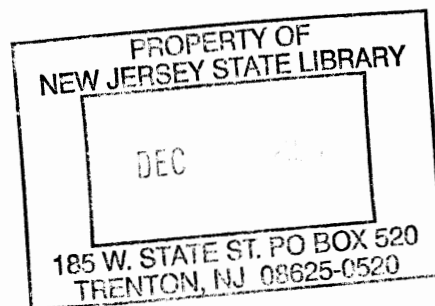
ALAN SAGNER
Commissioner

PETER E. STANGL
Assistant Commissioner
Public Transportation



FOREWORD

This report was prepared for the New Jersey Department of Transportation by L. E. Peabody & Associates, Inc., Lanham, Maryland, under the supervision of Martin E. Robins, Executive Assistant to the Assistant Commissioner for Public Transportation.





USRA PROJECTION OF SUBSIDY PAYMENTS
TO CONRAIL FOR PASSENGER OPERATIONS

This report discusses the various cost components considered by the USRA financial staff in developing passenger subsidy estimates and then identifies the total subsidy payment which would be required by ConRail from commuter authorities and AMTRAK. These topics and the methodology used by USRA's financial staff to develop financial projections for passenger operations are described in the body of this report under the following titles:

- ¶ Summary of Findings
- ¶ Context for Evaluation
- ¶ USRA Estimate of Passenger Service Costs by Individual Railroads
- ¶ USRA Adjustments to Reflect Ongoing Maintenance of Way Costs
- ¶ Capital Cost Considerations
- ¶ Analysis of USRA Estimated Operating Revenues and Government Payments

As will be seen from the text which follows, the USRA approach results in a significant increase in costs charged to passenger service.

SUMMARY OF CONCLUSIONS AND FINDINGS

The conclusions of this report can be succinctly stated. First, the methodology used by USRA to develop passenger costs and subsidies does not follow either the principles set out in the Final System Plan for passenger service cost sharing or any other set of consistent principles. Second, the costs, and therefore the subsidies estimated by USRA, substantially overstate the actual costs created by passenger service which ConRail would not incur if it did not operate the passenger service. Hence, the financial projections in the Final System Plan assume that the passenger authorities and AMTRAK will cross-subsidize freight operations to support the overall viability of ConRail.

This capsule conclusion above is supported by the following findings:

1. USRA projects \$465 million in subsidy payments from commuter authorities and AMTRAK for 1976. This would be two and one-half times larger than the \$185 million in subsidy payments made to the railroads in 1973 by the commuter authorities and AMTRAK.
2. The increase in subsidies from 1973 to 1976 projected by USRA amounts to \$280 million of which \$156 million constitutes increased charges for provision of passenger service and \$124 million reflects cost inflation. Therefore, even after eliminating the effects of inflation, USRA would require that 1973 level of subsidies be approximately doubled.

3. The projected \$156 million in increased charges for provision of passenger service includes an item of \$114 million in unreimbursed passenger service operating losses. The primary components of this figure are USRA's claimed unreimbursed deficit of \$78.6 million and USRA's estimated increase in ongoing maintenance of way charges to passenger service of \$33.5 million.

4. An analysis of USRA's unreimbursed deficit claim of \$78.6 million shows that data supplied to USRA by some of the railroads significantly overstated their actual passenger loss as measured by the net savings they could achieve in the absence of passenger service. USRA adjustments to data supplied by the railroads further overstated costs associated with passenger service and represent an amalgam of differing cost approaches with the uniform theme that the highest cost be assigned to passenger service out of the various alternatives available in each instance.

5. Passenger cost data developed by the commuter agencies on an avoidable basis were available for four of the five railroads operating passenger service in the northeast. They were EL, CNJ, PRSL, and Reading. In the case of the PC, comparative data were available only for New Jersey. For these operations alone, the USRA methodology resulted in a \$25 million overstatement of costs chargeable to passenger service at 1976 cost levels as compared to the avoidable costs of providing such service.

6. USRA's projection of ongoing maintenance requirements charges to passenger service ignores the present difference in maintenance levels in passenger territory versus freight territory. Consequently, a substantial portion of USRA's projected

\$33.5 million increase in maintenance of way costs chargeable to passenger service for 1976 is overstated and is in fact not likely to occur.

CONTEXT FOR EVALUATION

Chapter Three of the USRA Final System Plan (FSP) presents financial projections for ConRail. Note 4 and Note 5 to the pro forma statements in Chapter Three (at pages 59 and 60) discuss passenger operations and passenger corridor expenditures. A copy of the text and tables of Notes 4 and 5 is reproduced as Appendix A to this report. The financial figures in the table at page 60* are hereinafter sometimes referred to as the "USRA Passenger Pro Forma".

The USRA financial staff's analysis was based on information for calendar year 1973. Costs and revenues were analyzed at the 1973 level and then indexed up to future years in order to project each of the 10 calendar years from 1976 through 1985 inclusive. The method USRA used to index cost, revenue, and deficit figures is described in Appendix B to this report.

The discussion in this report deals with 1973 level costs and indexing to the 1976 level. Projection beyond 1976 to 1977, 1978, etc., is primarily a matter of further indexing and does not introduce any substantive new cost or revenue components.

COST SHARING PRINCIPLES
PROCLAIMED BY USRA
FOR PASSENGER SERVICE

In considering the methodology used by the USRA financial staff, it may be useful to keep in mind the cost sharing principles for treatment of passenger service as propounded in the Passenger

* The table at page 60 is entitled "ConRail passenger operations pro forma statements of results of operations and government payments," and shows revenues, expenses, and government payments for passenger operations.

Service chapter (Chapter Two) of the FSP. For purposes of reference, a synopsis of these principles is set out below:

1. ConRail should negotiate, where possible, with the various commuter authorities for new operating agreements with payments by each appropriate authority essentially on a "net avoidable cost" basis, with a provision penalizing the authorities for "freight train delay" and in accordance with the cost sharing "principles" set forth below.
2. ConRail has the responsibility to provide satisfactory passenger service on all lines in its system in accordance with the various principles for sharing ownership and operating costs recommended by USRA.
3. Passenger service should not be subsidized by freight service and ConRail should not be burdened with any passenger deficit.
4. Passenger operations should have priority over freight operations.
5. The exclusive user of a facility should be its owner and should bear the full ownership, maintenance, and operating costs of the facility.
6. Where freight and passenger operators both use a facility, the dominant user should own the facility and bear all the costs of that facility except those which could be avoided if the minority user were not present.
7. To determine the dominant user, all passenger services, both intercity and commuter, should be considered as one entity and all freight services, regardless of carrier, should be considered as one entity.
8. In instances where two or more passenger entities jointly use an exclusive passenger facility, the responsibility for allocating costs on an equitable basis should be with the users.
9. Where passenger and freight operators both use a facility on an equal basis, the costs of owning and using the facility should be shared equitably.
10. Passenger entities should make their own arrangements for financing.

As is shown in this report, there are significant contrasts between the methodology used by the USRA financial staff and that called for in the Passenger Service chapter of the FSP.

Furthermore, although the Passenger Service chapter of USRA's FSP proposes that costs be assigned on a dominant user basis, two important ingredients for applying this principle are missing. First, the FSP does not establish criteria for determining dominance. Some measure of usage (e.g., gross ton miles) or a combination of measures of usage must be established to determine dominance. Second, the FSP does not identify which specific line segments USRA considers to be freight dominant and which passenger dominant.

COSTS NOT INCLUDED IN
FINANCIAL PROJECTIONS

Another consideration one must keep in mind in interpreting the dollar impact of projections for passenger service is those components of costs which the USRA Passenger Pro Forma excludes. Note 4 to the Final System Plan specifically points out that the passenger forecasts reflected in the table on page 60 do not include provisions for major road improvements and equipment acquisition programs. Furthermore, the projections do not include provision for facility acquisition costs or return on investment on these facilities. There is also no provision in the USRA Passenger Pro Forma for charges for freight train delay attributable to passenger service. Such charges are, however, referred to in the Passenger Chapter of the FSP.

USRA ESTIMATE OF PASSENGER SERVICE
COSTS BY INDIVIDUAL RAILROADS

As a point of departure for its projection of passenger costs, USRA's financial staff obtained passenger operating revenues, passenger operating expenses, and passenger deficit figures from each of the individual railroads in reorganization. USRA made substantial adjustments to the cost data supplied by the railroads to reflect the USRA financial staff's interpretation of appropriate costs assignable to passenger service. The result of these adjustments was to significantly increase the costs charged to passenger service.

This section of our report discusses:

- . The "principles" used by the USRA financial staff to develop passenger costs
- . Comparison of USRA financial staff passenger costing "principles" with cost approaches used by other parties.
- . The bases on which the various railroads supplied passenger cost data to USRA
- . USRA adjustments to the passenger cost data they received
- . Impact of USRA adjustments on passenger costs of each individual railroad
- . Overstatement of charges to passenger service.

USRA FINANCIAL STAFF
PASSENGER SERVICE
COSTING PRINCIPLES

The FSP describes the general approach used by the USRA financial staff for determining passenger costs as follows:

"Costs were developed using 1973 data as reported by the railroads in reorganization in filings with the ICC and avoidable costs estimated by the railroads in reorganization. This costing approach is consistent with the ICC's Determination of Compensation ruling of September 19, 1973 covering AMTRAK operation over Penn Central Transportation Co. (PC) properties.¹ Using this approach, each regional commuter and AMTRAK passenger contract was analyzed separately and the results were aggregated to ascertain the total amount of operating deficit recovery ConRail should receive for passenger service at 1973 operating levels. The deficit recovery was then inflated by the composite annual expense inflation index to determine the annual deficit recoveries reflected in the forecasts."

¹"This arbitration ruling arose from a dispute between AMTRAK and PC concerning the appropriate cost reimbursement method used in the contract."
(FSP pg. 59)

The Interstate Commerce Commission (ICC) ruling referred to was issued in Finance Docket (FD) No. 27353. It concluded that AMTRAK should reimburse PC for AMTRAK passenger operations at the full cost level in the Boston-Washington corridor and at the long-run avoidable cost level for AMTRAK passenger operations over the remainder of the PC system.*

* Subsequently the AMTRAK Improvement Act of 1973 reversed this ruling in part. In that Act, Congress established incremental (i.e., avoidable) costs as the basis of AMTRAK reimbursement to the railroads for provision of services. The Act also states that any compensation in excess of incremental costs shall be based primarily on quality of service.

**USRA FINANCIAL STAFF
COSTING PRINCIPLES VS
OTHER COST APPROACHES**

The costing "principles" enunciated by the USRA at page 59 of the FSP do not match the methodology the USRA financial staff actually used to develop passenger costs. Nor does this methodology match any one specific costing approach or philosophy. Hence it is important at this point to identify the various cost concepts employed, both within USRA and by the railroads. It is also important to distinguish between form and substance - between what the words say and what was actually done with the numbers. The array of positions taken is listed below.

1. The USRA FSP Financial Analysis Chapter (Chapter 3, page 59) claims that the costing approach used to develop the USRA Passenger Pro Forma is consistent with the ICC's guidelines as set out in Finance Docket No. 27353.
2. The United States Congress, in the AMTRAK Improvement Act of 1973, established avoidable costs as the basis of reimbursement to the railroads for intercity passenger operations. This Act reverses the ICC ruling that AMTRAK passenger service in the corridor should be based on full costs and instead mandates avoidable costs.
3. In the Regional Rail Reorganization Act of 1973, the United States Congress established "the avoidable costs of providing service" as the basis for subsidy payments to continue rail service not designated for inclusion in the Final System Plan. (Sec. 304(c)(1)(A))

4. The USRA FSP Passenger Service Chapter (Chapter 2, pages 40-41) sets out "cost sharing principles" for assignment of costs between passenger service and freight service. Under these principles, the dominant user of any facility would bear all the costs of that facility except those which could be avoided if the minority user were not present. No guidelines are provided in the text for determination of "dominant user".
5. The USRA FSP Passenger Service Chapter (Chapter 2, pg. 45, footnote 3) provides a "model agreement" for use by ConRail and the suburban authorities. This agreement provides that "The suburban authorities pay the "net avoidable cost" of providing service . . ." USRA does not clarify the relationship of this costing basis to the "dominant user" theory.
6. Passenger cost data supplied to USRA by the individual railroads reflected a variety of approaches to passenger costing. Among the approaches included were: (a) avoidable costs of passenger service; (b) fully allocated passenger costs (solely related plus allocation of common) as shown in the ICC Annual Report Form R-1; (c) "fully shared" costs of passenger service; and (d) costs of passenger service with passenger considered as the base and "freight rides free".

On the surface, there appears to be some commonality between the costing "principles" espoused by the USRA financial staff in Chapter 3 of the FSP, the ICC guidelines set out in FD 27353, and the dominant user principles stated in Chapter 2 of the FSP. Based on detailed examination of underlying USRA financial staff workpapers, however, it is clear that the actual methodology utilized to develop the USRA Passenger Pro Forma is an amalgamation of differing approaches to cost analysis. The results do not conform to avoidable costs of passenger service as mandated by the United States Congress in two separate Acts. Neither do the results conform to any one of the various versions of passenger costing principles set out in the FSP. In fact, the methodology used by the USRA financial staff assigns the highest cost to passenger service out of the various alternatives available in each instance.

DATA SUPPLIED
BY RAILROADS

USRA requested passenger revenues and expenses for 1973 from the following carriers:

- Erie Lackawanna Railway Company (EL)
- Central Railroad Company of New Jersey (CNJ)
- Pennsylvania-Reading Seashore Lines (PRSL)
- Reading Company (Reading)
- Penn Central Transportation Company (PC)

From the text accompanying the USRA Passenger Pro Forma (FSP page 59 quoted hereinabove), it should follow that USRA developed passenger cost estimates based on: (a) each individual railroad's Annual Report to the Interstate Commerce Commission (ICC), Form R-1, for calendar year 1973, and (b) avoidable costs of passenger service as estimated by each of the individual railroads. Presumably then, each railroad was asked to furnish passenger service expenses on an avoidable cost basis. In fact however, review of the cost figures provided to USRA by the individual carriers indicates that the USRA financial staff accepted whatever cost figures the railroads provided on whatever basis they were provided. The actual basis of cost data provided by each of the individual railroads was:

- EL - Avoidable costs of passenger service, with freight considered as the dominant, or base service
- CNJ - Passenger service treated as the base service, freight rides free
- PRSL - ICC Annual Report Form R-1 total passenger expenses (solely related plus allocation of common)
- Reading - Avoidable costs of passenger service, with freight considered as the dominant or base service.
- PC - "fully shared" costs

The adjustments USRA made to each of these sets of figures are described next in this report.

USRA COST
ADJUSTMENTS

The USRA financial staff used each railroad's Annual Report to the ICC, Form R-1, as a benchmark for evaluating data submitted by the railroad.*

ICC Form R-1
Passenger and Freight Costs

Schedule 320 of the ICC Annual Report Form R-1 is entitled "Railway Operating Expenses". It shows total expenses by ICC account with a further identification of the amount assigned to passenger service and to freight service. Expenses in each ICC account are allocated between passenger and freight using the ICC's "Rules for Separation of Operating Expenses Between Freight and Passenger Services" (ICC separation rules). Under the ICC separation rules, carriers are instructed to first assign to freight service or passenger service the expenses, taxes, equipment rents, and joint facility rents incurred solely for the benefit of freight or passenger service respectively. Expenses, taxes, equipment rents, and joint facility rents common to passenger and freight are then apportioned between passenger and freight service using various measures of utilization specified by the ICC. (For example, expenses for maintenance of common running tracks are apportioned on the basis of gross ton miles.)

* For PC, the R-1 data were not used by USRA as they included costs for mail operations.

Limitations of
ICC Form R-1 Data
For Cost Determination

If solely related passenger costs and solely related freight costs are properly identified, these costs would be treated in essentially the same manner in the ICC Annual Report Form R-1 as they are treated in an avoidable cost analysis. However, an avoidable cost analysis differs from the ICC separation rules with regard to assignment of common expenses.

In its order setting forth the ICC separation rules, the Commission states:

"The total distribution to freight service or passenger service derived under the foregoing rules for separation consists of the solely related or directly assignable amounts plus an apportionment of the common on a service or use basis. Inasmuch as the amounts assigned and/or apportioned to the freight and passenger services, respectively, are based on the performance of both services, the operating expenses, taxes, equipment, and joint facility rents assigned and/or apportioned to either service may not represent the amounts that could be eliminated if either service were discontinued."

Moreover, the fully allocated costs of passenger service as shown in the ICC Annual Report Form R-1 substantially overstate the avoidable expenses of passenger service. This fact has been recognized by the ICC in its report entitled Investigation of Costs of Inter-City Rail Passenger Service. That investigation analyzed

eight inter-city rail passenger systems to determine how much these eight systems would have eventually saved if they had not operated passenger service in 1968. Comparing avoidable expenses to the ICC full deficit (as would be shown in ICC Form R-1), the Commission stated:

"Many of the common expenses which are incurred for both freight and passenger services and then allocated in part to passenger service cannot be saved." *

Further:

"Use of the ICC full expense procedures to calculate potential savings or the burden of passenger service is inappropriate."*

As a consequence:

"The total net avoidable expenses, for all the study carriers, of \$118.1 million is only 55.1 percent of their total ICC full deficit. For these inter-city carriers, the use of the full deficit results in a major overstatement of the savings which the carriers could have made by the complete cessation of their inter-city service as operated in 1968." * (emphasis added)

* Source: Investigation of Costs of Inter-City Rail Passenger Service, Report of the Interstate Commerce Commission July 16, 1969, pages 47 and 48.

In other words, the ICC has determined that its Annual Report Form R-1 separation rules make an artificial allocation of costs between passenger and freight and are not intended to provide an adequate tool for measuring costs which would not be incurred if a particular service were not operated. Use of the Annual Report Form R-1 charges to passenger service results in a passenger deficit figure which is nearly twice the loss which the railroads could eliminate if they did not operate passenger service.

USRA Cost
Analysis

To develop its estimate of passenger operating expenses, the USRA financial staff compared data provided by each of the individual railroads with expenses as shown in Schedule 320 of the ICC Annual Report Form R-1. Data were compared for each functional area (maintenance of way, maintenance of equipment, traffic, transportation, miscellaneous, general, taxes, and rents). The USRA financial staff then selected the larger number in each case. Thus, operating expenses in each functional area as constructed by the USRA financial staff reflect the greater of: (1) costs as provided by the railroad; or (2) costs as provided in the railroad's ICC Annual Report Form R-1. Consequently, for any carrier where costs were not uniformly higher in one showing than in another, the method used by USRA developed higher operating expenses than those shown in either set of source data referred to.

Shortcomings of USRA
Cost Methodology

The USRA methodology has several obvious shortcomings. First, the ICC Annual Report Form R-1 was used as a basis for comparison, or cost measuring stick, without consideration of the costing principles the results were intended to reflect. Second, no evaluation was made of data supplied by the railroads to determine whether they conformed to the costing principles the results were intended to reflect. Third, no analysis of the cost components of

the data supplied by the railroads was made to determine congruence with components in the ICC major functional categories.

In actuality then, construction of operating expenses using the USRA financial staff methodology produces cost estimates that are an amalgamation of differing approaches to cost analysis and do not conform to either the costing principles at pages 40-41 of the FSP or to the provisions of USRA's proposed Model Agreement at page 45 of the FSP.

IMPACT OF USRA ADJUSTMENTS
ON DATA SUPPLIED BY THE RAILROADS

The impact of the methodology USRA actually used on the passenger expenses reported by each of the individual railroads is discussed below.

Erie Lackawanna
Railway Company (EL)

Essentially all of the EL's passenger operations are in the State of New Jersey and the vast majority of all passenger operating expenses are assigned to New Jersey*.

EL furnished passenger operating expense data to USRA in accordance with its existing contract with the New Jersey Department of Transportation (NJDOT) on an avoidable cost basis with passenger service treated as the avoidable service and freight service treated as the dominant or base service. The avoidable costs for 1973 as furnished by EL total \$26,204,000 excluding return on investment.

* In addition to its New Jersey operations, EL operates 3 passenger trains daily in each direction on weekdays in New York State beyond Suffern to Port Jervis. The deficit incrementally attributable to this operation in 1973 was on the order of \$50,000. EL also operates one train per day in each direction between Cleveland and Youngstown, Ohio.

Total passenger expenses (solely related plus common) shown in the EL's Annual Report Form R-1 amount to \$24,575,000.

By comparing individual functional areas and choosing the larger expense figure in each area, the USRA constructed passenger operating expenses of \$29,640,000. This amount exceeds the EL's passenger avoidable costs by approximately \$3.4 million and exceeds passenger costs as shown in EL's Annual Report Form R-1 by approximately \$5.1 million.

The method used by USRA's financial staff assumes (among other things) that costs are recorded by EL in the same categories in its avoidable computation as they are in its Annual Report Form R-1. This is not correct. For example, the costs of servicing passenger rolling stock are included in the ICC Annual Report as transportation costs while the avoidable costs include this activity as part of maintenance of equipment. As a consequence, this element would serve to reduce avoidable costs as compared with ICC Annual Report costs in the transportation area and increase avoidable costs as compared with ICC Annual Report costs in the maintenance of equipment area.

We should mention that the adjustments to EL cost data made by the USRA financial staff ignore the fact that the USRA FSP Passenger Chapter identifies the EL commuter passenger service as being covered by a pre-act contract and therefore legally binding (FSP, pg. 45). The FSP text states that, pursuant to the Regional Rail Reorganization Act of 1973, ConRail will assume the EL-NJDOT

contract and operate the service upon the present contractual basis of payment. Hence ConRail cannot legally charge more than the passenger cost figures which EL reported to USRA.

Central Railroad Company
of New Jersey (CNJ)

All passenger service provided by the CNJ operates within the State of New Jersey. Passenger cost data provided by the CNJ appear to reflect the CNJ trustee's passenger service costing philosophy. This philosophy treats passenger service as the base service and freight service as the avoidable service. Freight service is considered to "ride free" throughout the territory where passenger service operates. All common costs are assigned entirely to passenger.

Depending on the measure of volume used, passenger service accounted for approximately one-fourth to one-third of total CNJ operations in 1973, with freight accounting for the other two-thirds to three-fourths. Hence, freight service rather than passenger service should be treated as the dominant service on the CNJ.

To resolve long standing differences as to the appropriate basis for determining costs assignable to passenger service, the CNJ and NJDOT submitted their existing passenger subsidy contract to binding arbitration by the Federal Railroad Administration of the United States Department of Transportation (FRA). After conducting an independent review, FRA concluded that CNJ passenger service costs should be developed on an avoidable basis with

passenger service treated as the avoidable service and freight service treated as the dominant or base service*. The FRA also determined that subsidy payments being made to CNJ by NJDOT exceeded the net loss CNJ was actually incurring in operating passenger service.

Passenger costs as furnished to USRA by the CNJ trustee total \$17,476,000 excluding return on investment (ROI). This amount substantially overstates the passenger costs as determined by FRA. Total passenger expenses (solely related plus common) shown in CNJ's Annual Report Form R-1 amount to \$13,008,000. The total differential of CNJ passenger costs as provided to USRA by the CNJ trustee over CNJ passenger costs as shown in the Annual Report Form R-1 is approximately \$4.5 million. Furthermore, neither the CNJ trustee's figures nor the Annual Report Form R-1 figures reflect avoidable costs of passenger service as determined by FRA.

The FRA determination showed CNJ passenger costs of \$7,996,000 for the last six months of 1974. Converting this 1974 amount to 1973 cost levels** and annualizing yields \$14,057,000. Hence, data submitted by CNJ and used by USRA overstates CNJ passenger costs as determined by FRA by \$3.4 million.

*FRA made two specific exceptions to this general approach. These were the Newark Bay Bridge and the New York and Long Branch Railroad Company south of Red Bank. For these two specific geographic segments of the CNJ, freight service was considered by FRA to be the avoidable service.

**Using Association of American Railroads (AAR) Indexes of Railroad Material Prices and Wage Rates for the Eastern District of the United States.

Pennsylvania-Reading
Seashore Lines (PRSL)

All passenger service provided by the PRSL operates within the State of New Jersey. Passenger cost data provided by the PRSL apparently consisted strictly of their ICC Annual Report Form R-1. Hence, the passenger service costs of \$1,339,000 for PRSL reflect ICC allocated costs. A passenger avoidable cost study of PRSL for the calendar year 1973 showed costs (before ROI) of \$833,000. Hence, allocated costs in the Annual Report Form R-1 exceed costs which would be avoidable with PRSL passenger service by some \$500,000.

Because freight service accounted for 90 percent or more of total PRSL 1973 operations, freight service should be treated as the dominant service on PRSL. Passenger costs on the PRSL should be developed on an avoidable basis.

Reading
Company (RDG)

Essentially all of Reading's passenger operations are in the State of Pennsylvania and the vast majority of all passenger operating expenditures are in the State of Pennsylvania.*

Reading furnished passenger operating expense data to USRA on an avoidable cost basis with passenger service treated as the avoidable service and freight service treated as the dominant or base service. The avoidable costs as furnished by Reading totalled \$18,976,000 before consideration of return on investment.

* In addition to its Pennsylvania operations, Reading operates two passenger trains daily in each direction on weekdays between Philadelphia, Pa., and Newark, N. J. The avoidable loss incrementally attributable to this operation in 1973 was on the order of \$100,000.

Total passenger expenses (solely related plus common) shown in the Reading Annual Report Form R-1 amount to \$20,857,000.

USRA compared individual functional areas and chose the larger expense figure in each area, thereby constructing passenger operating expenses of \$22,216,000. This amount exceeds the Reading passenger avoidable costs by approximately \$3.2 million and exceeds the passenger costs shown in the Reading's Annual Report Form R-1 by approximately \$1.4 million.

As with the EL, application of the USRA methodology to data submitted by Reading distorts and overstates the costs assignable to passenger service.

Penn Central
Company (PC)

Penn Central Company operates commuter service as well as inter-city passenger service for AMTRAK. The PC commuter operations are conducted in the following areas:

Boston
New York
New Jersey
Philadelphia
Baltimore - Washington
Chicago - Valpariso
Detroit - Ann Arbor
Buffalo - Wellington.

The passenger operating expense data provided by PC show costs on a "fully shared" basis. USRA used the PC figures without adjustment. The methodology used by Penn Central discriminates against passenger service in favor of freight service in some areas.

Additionally, the Penn Central methodology allocates substantial general system overhead costs to passenger service without consideration of how these costs would change if passenger service were not operated.

The overstatement of passenger costs inherent in the PC "fully shared" methodology is well illustrated by reference to passenger costs in the State of New Jersey. For calendar year 1974 Penn Central submitted data to the State of New Jersey which claimed costs of New Jersey commuter passenger operations amounting to some \$31.3 million. In contrast, an analysis of this data on behalf of the State of New Jersey indicated that avoidable costs of PC New Jersey passenger service are \$22.5 million or \$8.8 million less than the PC claim. Both sets of figures are before consideration of return on investment. Adjusting these results from 1974 cost levels to 1973 cost levels* shows that Penn Central's "fully shared" costs for this operation in 1973 dollars would overstate the actual avoidable costs of the service by \$7.7 million.

*Using Association of American Railroads (AAR) Indexes of Railroad Material Prices and Wage Rates for the Eastern District of the United States.

OVERSTATEMENT OF CHARGES
TO PASSENGER SERVICE

As described above, some of the railroads reported passenger expense data to the USRA on a basis which reflected costs they would expect to save if their passenger service were not operated. USRA made substantial adjustments to this data. Other railroads reported passenger expenses on various bases, all of which overstated their expected reduction in costs in the absence of passenger service. The overstatement of costs by individual railroad, after taking into account both the data supplied by the railroads and the adjustments made by the USRA financial staff, is shown below:

<u>Railroad</u>	<u>Overstatement of Passenger Costs in 1973 Dollars After USRA Adjustments</u>
EL	\$3.4 million
CNJ	3.4 million
PRSL	0.5 million
Reading Company	3.2 million
Penn Central	
New Jersey operations	7.7 million
All other PC commuter operations	Not Available
AMTRAK operations	Not Available

In the case of the Penn Central, analytical data to determine the overstatement were available only for New Jersey commuter operations. PC's New Jersey operations represent approximately 7 percent of the total costs of Penn Central's combined commuter and AMTRAK operations as reported by the Penn Central. Hence, using New

Jersey data as a base for projection, one might expect that the overstatement for other commuter services and for AMTRAK would be quite substantial.

For the EL, CNJ, PRSL, and Reading, where an estimate of overstatement could be developed, and for the New Jersey operations of Penn Central, the combined overstatement of passenger costs in 1973 dollars is \$18.2 million. Indexing this to 1976 cost levels yields an overstatement in excess of \$25 million. As pointed out immediately above, this figure includes only a small portion of the Penn Central's passenger services. Were the overstatement for all Penn Central passenger services available, the total would be expected to be substantially greater.

MAINTENANCE OF WAY COSTS

After constructing passenger operating expenses for each of the railroads as described in the previous sections of this report, the USRA financial staff next made further adjustments to those figures to reflect anticipated ongoing maintenance of way (M of W) requirements and costs.

Estimated ongoing maintenance of way costs for ConRail were developed separately by the USRA maintenance of way staff. The analysis did not maintain a separation of maintenance requirements by individual railroad, but rather considered costs for ConRail as an overall entity. However, the USRA did recognize three different ConRail ownership and usage situations. These are:

1. ConRail will own the property and perform all freight service. This situation applies to all of the PC (except the MTA/CTA territory) and all of the CNJ and PRSL.
2. ConRail will not own the property and will operate freight service via trackage rights. This situation applies to the MTA/CTA territory over which ConRail will utilize existing PC trackage rights.
3. ConRail will own the property and Chessie will operate freight service on a trackage rights basis. This situation applies to the EL and Reading passenger service areas.

The USRA financial staff adjusted passenger costs by deleting maintenance of way expenses as derived from the railroads' information and substituting maintenance of way expenses as computed by the USRA maintenance of way staff. Methodology in each of the three situations is described below.

M OF W COSTING METHODOLOGY
WHERE CONRAIL OWNS THE PROPERTY
AND OPERATES THE FREIGHT SERVICE

For all of the PC (except the MTA/CTA territory) and all of the CNJ and PRSL, passenger service ongoing maintenance of way costs were developed based on historical relationships of passenger costs to total costs. The historical relationship of passenger to total was defined as the ratio of: (a) passenger maintenance of way costs submitted to USRA by the individual carriers to: (b) the total maintenance of way costs for passenger and freight service as shown in the railroads' Annual Report Form R-1*. This ratio was then applied to total ongoing maintenance of way costs as projected by the USRA M of W staff to derive ongoing maintenance of way charges for passenger service. In building the ratio of passenger costs to total costs, maintenance of way costs for the MTA/CTA area were deducted from both the numerator and the denominator of the ratio to remove this territory for separate treatment.

The USRA computational process for projecting the portion of total maintenance of way costs assignable to passenger service implicitly assumes that the actual level of current undermaintenance is uniform throughout the ConRail system.

* The total costs include the Ann Arbor RR, the Lehigh Valley RR, and the Lehigh & Hudson River RR as well as the PC, CNJ, and PRSL.

M OF W COSTING METHODOLOGY
WHERE CONRAIL OPERATES FREIGHT
SERVICE VIA TRACKAGE RIGHTS

MTA/CTA territory is not included in ConRail. ConRail will acquire only the PC's trackage rights to operate freight service over this territory. Apparently because of this, the USRA M of W staff made no estimate of ongoing maintenance costs for the MTA/CTA area. Therefore, the USRA financial staff assumed that MTA/CTA would pay for whatever actual maintenance of way costs were incurred. To adjust for non-available data, 1973 MTA/CTA area maintenance of way costs were deleted from both costs and MTA/CTA subsidy payments.

M OF W COSTING METHODOLOGY
WHERE CHESSIE OPERATES OVER
CONRAIL VIA TRACKAGE RIGHTS

The USRA M of W staff developed total ongoing maintenance of way requirements for the EL and Reading passenger service areas. The USRA financial staff assumed that the M of W expenses reported by EL and Reading in their passenger cost estimates reflected appropriate charges to passenger service. Hence the USRA financial staff made no net change in M of W passenger charges for EL and Reading.

To adjust for the difference between the cost figures developed by the USRA M of W staff and the passenger costs supplied by EL and Reading, the USRA financial staff included a credit to passenger operations for freight usage of facilities. This credit reflects anticipated payments by Chessie for trackage rights to operate freight service in the EL and Reading passenger territories.

**COMPOSITE IMPACT OF M OF W
COSTING METHODOLOGY
ON PASSENGER COSTS**

The USRA financial staff estimate of maintenance of way expenses for passenger service, excluding depreciation, is \$58,553,000. This compares to maintenance of way expenses for passenger service of \$42,157,000 as reported by the railroads. However, the \$16,396,000 difference between these two figures does not represent the actual anticipated increase in maintenance of way charges to passenger service as the USRA financial staff's \$58 million figure does not reflect either: (a) maintenance in the MTA/CTA area; or (b) credits to passenger service maintenance costs for freight operations in the EL and Reading passenger areas. The actual increase in ongoing maintenance charges to passenger service is over \$24 million, as shown in the table below.

<u>Line No.</u>	<u>Item</u>	<u>1973 Amount (000)</u>
	USRA projected passenger ongoing maintenance of way costs:	
1.	Excluding MTA/CTA	\$58,553
2.	MTA/CTA as reported by PC	14,310
3.	Total (L.1 + L.2)	\$72,863
4.	Less: Estimated freight trackage rights payments for operations in EL and Reading passenger service areas	<u>(6,600)</u>
5.	Net USRA passenger costs (L.3 - L.4)	\$66,263
6.	Passenger maintenance of way expenses as claimed by the railroads (including MTA/CTA)	<u>42,157</u>
7.	Increase in ongoing maintenance of way costs to be paid by passenger service (L.5 - L.6)	\$24,106

In addition, there is a commensurate percentage increase in payroll taxes reflecting the labor component of the maintenance of way increase.

The \$24,106,000 increase in M of W cost payments relates entirely to PC, CNJ, and PRSL as net ongoing maintenance of way charges to passenger service for EL and Reading were unchanged by the USRA adjustments. Hence the net impact of the computations outlined above relative to property owned and operated by ConRail is a significant increase in maintenance of way costs for passenger service.

SHORTCOMINGS OF USRA
MAINTENANCE OF WAY
COST METHODOLOGY

The USRA methodology for projecting the portion of total maintenance of way costs assignable to passenger service assumes that the actual level of undermaintenance is uniform throughout the ConRail system. More particularly, it assumes that the shortfall of present maintenance levels versus ongoing maintenance requirements is proportionately the same in passenger territory as in freight territory. This assumption is incorrect. As a consequence, the increase in ongoing maintenance of way costs to be paid by passenger service must necessarily be overstated.

The reasoning to support this assertion is as follows. In order to operate regular passenger service (especially in the corridor and in the commuter regions) track must be maintained at a level to permit reasonable passenger speeds and safety levels.

This requires maintenance in accordance with higher FRA track safety standard levels. Such standards must be maintained on an ongoing basis. The current timetables and service maintained in the commuter regions and in the corridor indicate that this in fact is the case.

In contrast, operations in freight only territory tend to operate at decreased speeds, reflecting significantly greater under-maintenance and a failure of the railroads to meet FRA track safety standards for any but the lowest classes of track. Restoration of freight train speeds in freight only territory to levels previously existing will require not only significant rehabilitation efforts but also ongoing maintenance at a level substantially higher than that in effect today.

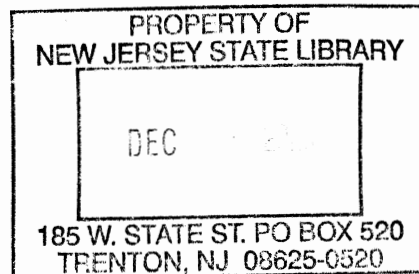
As the PC, CNJ, and PRSL have been practicing a higher level of ongoing maintenance in passenger territory than throughout the balance of their systems, the USRA computation overstates the difference between present maintenance of way costs for passenger service as reported by the carriers and projected ongoing maintenance of way costs assignable to passenger service.*

As a further consideration, the Penn Central's "fully shared" costing methodology overstates the portion of total maintenance of way costs which should be assigned to passenger service.**

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- * As discussed above, the USRA methodology did not result in any change in the net figures applicable to EL and Reading. Hence, this overstatement does not apply to EL and Reading.
 - ** The PC "fully shared" methodology allocates all track and road-bed maintenance costs between passenger and freight service based on speed factored gross tons. This unit of measure ignores important characteristics of various categories of traffic which must be considered in evaluating variability of costs with passenger or freight service. Furthermore, the computational process used by PC in applying this unit of measure has the effect of charging some of the wear caused by freight trains to passenger service.

The Penn Central's maintenance of way costs for passenger service (excluding the MTA/CTA region), as reported to USRA, comprise over 90 percent of the total maintenance of way expenses for passenger service for the PC, CNJ, and PRSL combined. Therefore, the effect of the PC's overstatement of passenger maintenance of way costs is to substantially increase the total.

In summary, there are at least two major errors in the USRA M of W costing methodology. First, the USRA assumption of uniform undermaintenance ignores the fact that passenger service trackage must necessarily have been maintained at a higher level than freight only trackage for passenger service to have been allowed to operate in 1973. Second, by using PC "fully shared" charges to passenger service in their allocation of M of W costs, USRA picked up the overcharges to passenger service built into these PC numbers. The effect of both factors is an inevitable overstatement of charges to passenger service.



CAPITAL COST CONSIDERATIONS

The USRA Passenger Pro Forma deals with operations and does not include various costs of a capital nature which might have to be borne by the commuter authorities and/or AMTRAK.

The text of Note 4 to the ConRail pro forma statements points out that the passenger forecasts do not include provisions for major road improvements and equipment acquisition programs. If a portion of the rehabilitation costs of trackage is assigned to AMTRAK and the commuter authorities, this will represent additional financing demands over those reflected in ongoing maintenance of way requirements.

Acquisition costs for rolling stock also are not shown in the operating results.

A third category of expenses which the Final System Plan refers to but does not assign is passenger corridor expenditures. As stated in Note 5 to the ConRail pro formas,

"To improve passenger service on the Northeast Corridor, ConRail freight operations (except local service) should be transferred to other rail trackage such as the Baltimore & Ohio Railroad's (B&O) tracks between Washington, D.C. and Philadelphia. Because the transfer from the corridor is for the convenience of the passenger operations, the Association has decided that the freight operations should not be expected to bear the costs of the purchase of the B&O tracks and other direct capital costs associated with eliminating freight interference with the passenger operation."

These costs include:

1. Purchase price for B&O tracks
2. Other related capital items
 - a. Purchase of diesel locomotives to replace electric locomotives which cannot be used on the B&O tracks
 - b. Double tracking the B&O line
 - c. Providing interconnections between the present northeast corridor line and other lines
 - d. Installing centralized traffic control
 - e. Other improvements.

A final category of capital costs which is not reflected in the USRA table at page 60 is acquisition costs or return on investment (ROI) costs for facilities. For facilities which will not be owned by the commuter authorities, some ROI payment will need to be made on avoidable facilities if the costing methodology is to follow that indicated in the Passenger Service chapter of the FSP (foot-note 3 at page 45). For facilities designated to a commuter authority, the commuter authority will have to pay acquisition costs or a lease payment to the estate of the railroad which presently owns the facilities.

ANALYSIS OF USRA ESTIMATED
OPERATING REVENUES AND GOVERNMENT PAYMENTS

The USRA Passenger Pro Forma (Table at page 60 of the FSP, as shown in Appendix A) shows \$434 million in ConRail "Operating revenues" from passenger service for calendar year 1976. The Passenger Pro Forma also indicates "Total government payments to passenger operations" of \$156 million for calendar year 1976. Hence, the total income to be received by ConRail for operating passenger service is projected as \$590 million for 1976.

This section of our report discusses:

- . The components of passenger "Operating revenues"
- . The components of "Total government payments to passenger operations"
- . Total subsidy payments expected by USRA from commuter authorities and AMTRAK

"OPERATING REVENUE"
COMPONENTS

The 1976 pro forma passenger "Operating revenues" for ConRail are made up of four components. These are: (a) passenger fares (as well as other passenger-related revenues); (b) subsidy payments from commuter authorities; (c) subsidy payments from AMTRAK; and (d) increase in revenues to cover cost level inflation from 1973 to 1976.

"Operating revenues" (passenger fares and subsidy payments) for 1973 were \$310.3 million, as shown in underlying USRA work-papers. Components of this amount are as follows.

Item (1)	1973 Amount (000)		
	Total (2)	Less MTA/CTA M/W Cost Reimbursement ^{a/} (3)	Net (4)
Direct receipts (passenger fares, etc.)	\$125,069	\$ -	\$125,069
Commuter subsidies	71,021	17,274	53,747
AMTRAK payments	<u>131,510</u>	<u>-</u>	<u>131,510</u>
Total	<u>\$327,600</u>	<u>\$17,274</u>	<u>\$310,326</u>

a/ The USRA projection of ongoing maintenance of way costs did not include maintenance of way for the MTA/CTA territory. To adjust for the absence of this figure in the ongoing maintenance of way projection, USRA deleted present level MTA/CTA maintenance of way costs from both operating expenses and operating revenues. The stated USRA intent was to keep revenues and expenses comparable and to reflect the assumption that subsidy payments by MTA/CTA would cover whatever level of maintenance of way costs was actually incurred.

The difference between 1976 level "Operating revenues" of \$434 million as shown in the USRA Passenger Pro Forma and 1973 level revenues of \$310 million reflects coverage of cost inflation. If it is assumed that there will be no fare or ridership increases, then the total \$124 million inflation impact must be covered by increased subsidies. Hence, \$309 million* of the total \$434 million in "Operating revenues" would come from the commuter authorities and AMTRAK.

* \$434 million less \$125 million in direct receipts

"TOTAL GOVERNMENT PAYMENTS
TO PASSENGER OPERATIONS"

The USRA Passenger Pro Forma shows two components of "Total government payments to passenger operations". These components and the amounts applicable to 1976 are:

- a. Net operating loss under ICC betterment accounting - \$114 million
- b. Working capital deficit (excess) - \$42 million.

It is important to note that the title "Total government payments to passenger operations" is a misnomer. The amounts USRA shows under this caption are not the total payments expected from commuter authorities and AMTRAK. Present subsidy payments and inflation are included in what USRA chooses to call "Operating revenues", and not in "Total government payments to passenger operations". To derive the true total expected subsidy payments one must add together "Total government payments to passenger operations" and all but \$125 million of "Operating revenues".

Net Operating
Loss

The \$114 million claimed as a net operating loss results from USRA computations, adjustments, and projections described earlier in this report. By reference to underlying USRA workpapers, the principal components of the operating loss may be identified as shown below.

<u>Item</u>	<u>1973 Amount (000)</u>	<u>1973 Amount Indexed to 1976^{a/} (000)</u>
Unreimbursed passenger service loss - combined result of railroad data submissions and USRA adjustments	\$56,562	\$ 76,621
Increase in costs to reflect ongoing maintenance of way requirements	24,106	33,507
Net Impact of miscellaneous adjustments <u>b/</u>	<u>1,088</u>	<u>1,512</u>
Total	\$81,756	\$113,640

a/ Using composite passenger cost inflation index from 1973 to 1976 of 1.39.

b/ In addition to the costing adjustments described above, the USRA's financial staff also made several other minor adjustments. These included:

1. Elimination of depreciation to convert costs to a cash basis.
2. Addition of interest expense for prior pension liabilities.
3. Inclusion of a return on investment component for use of fixed facilities in the freight operations trackage rights payment for the EL and Reading passenger service areas.

Working Capital
Requirements

To other passenger service payment requirements, USRA's financial staff added a prorata share of ConRail's working capital deficit. Working capital requirements represent the net cash required to cover the difference between assets and liabilities. USRA developed working capital figures by constructing a balance sheet for the passenger operations. The amount computed by USRA for 1976 was \$42 million.

Overstatements in
USRA Projection

As has been demonstrated in this report, both the unreimbursed loss and the anticipated ongoing maintenance of way charges to passenger service are overstated.

Quantitative data to estimate the magnitude of overstatement in USRA unreimbursed loss figures were available for EL, CNJ, PRSL, and Reading, as well as for the PC's New Jersey commuter passenger operations. As stated at pages 25 and 26 of this report, charges to passenger service for commuter operations of the four carriers and the New Jersey operations of PC exceed costs which would not be incurred if the services did not operate by \$18.2 million at 1973 cost levels. Indexing this up to 1976 cost levels results in an overpayment of passenger losses on the order of \$25 million.

No quantitative data were available to estimate the degree of overstatement in USRA's projection of ongoing maintenance of way requirements. However, it appears likely that a substantial portion of the \$33.5 million increase in costs at 1976 levels for ongoing maintenance of way requirements reflects an overcharge to passenger service.

Depending on how losses which USRA claims are attributable to passenger service were treated in developing the passenger balance sheet, working capital requirements assigned to passenger service may also be overstated.

**TRUE TOTAL
SUBSIDY PAYMENTS**

The true total "government payments" for 1976, as computed by the USRA financial staff, including present subsidies, absorption of cost inflation, and increased subsidy requirements, are \$465 million as shown below.

<u>Item</u>	<u>1976 Amount</u>
Present subsidy payments	
Commuter	\$ 54 million*
AMTRAK remuneration	131 million
Inflation	124 million
Government payments to pass. operations	
Net operating loss under ICC betterment accounting (USRA method)	114 million**
Working capital deficit	<u>42 million</u>
Total subsidy requirements	\$465 million

* Net of MTA/CTA M of W costs

** Excludes depreciation and is essentially the same as loss on a cash basis.

Assignment of True Total Subsidy
Requirement By Service Area

From a review of the USRA financial staff's workpapers we have assigned the total subsidy payments to the various passenger service territories. Components of the projected subsidy requirements have been treated as follows:

1. Inflation in subsidy requirements was assigned in proportion to 1973 subsidy payments.
2. Projected ongoing maintenance of way costs were assigned based on 1973 maintenance of way expenses in each of the individual service territories.
3. Other unreimbursed deficit components were assigned based on the 1973 estimate of the unreimbursed deficit in each service territory.

4. Working capital requirements were assigned based on total operating expenses in each of the service territories.

Using this approach, the total subsidy payment required for each service territory is shown below.

<u>Service Territory</u>	<u>1976 Subsidy Requirements (millions)</u>
State of New Jersey	
PC	\$ 21.3
CNJ	24.0
PRSL	2.1
EL	28.1
Subtotal New Jersey	<u>75.5</u>
State of Pennsylvania	
PC	27.5
Reading	<u>20.7</u>
Subtotal Pennsylvania	48.2
MTA/CTA (excluding M of W cost reimbursement)	28.0
All Other Penn Central Commuter Territories	11.0
AMTRAK	<u>302.2</u>
Total	<u>\$464.9</u>

It should be emphasized that USRA itself made no distribution of the subsidy by service area. The figures shown above represent our assignment using the procedure for distribution of cost components described immediately above.

with the ICC and avoidable costs estimated by the railroads in reorganization. This costing approach is consistent with the ICC's Determination of Compensation ruling of September 19, 1973 covering Amtrak operations over Penn Central Transportation Co. (PC) properties.¹ Using this approach, each regional commuter and Amtrak passenger contract was analyzed separately and the results were aggregated to ascertain the total amount of operating deficit recovery ConRail should receive for passenger service at 1973 operating levels. The deficit recovery was then inflated by the composite annual expense inflation index to determine the annual deficit recoveries reflected in the forecasts.

To implement the assumption of appropriate cost remuneration, ConRail will have to negotiate revisions to most existing contracts with passenger authorities. Negotiations are presently under way with Amtrak and local commuter authorities which will affect passenger subsidies and are discussed in detail in Chapter 2. If none of the contracts are renegotiated, and if no additional subsidies are received over the level prevailing in 1973, the passenger operations will generate an estimated cash deficit of \$1.65 billion (inflated) over the forecast period. Since the precise terms and conditions under which passenger-deficit reimbursements will be paid are still to be negotiated, these forecasts, which assume that these cash deficits will be reimbursed, are subject to modification.

¹ This arbitration ruling arose from a dispute between Amtrak and PC concerning the appropriate cost reimbursement method used in the contract.

Note 4—Passenger Operations

A summary of the *pro forma* financial forecasts and expected government payments for the passenger operations during the forecast period appears below. As stated in Note 1, ConRail will manage passenger operations on a custodial basis whereby Amtrak or local commuter authorities will finance capital projects and working capital needs and will fully subsidize operating deficits. No provision has been made in the forecasts for major road improvements and equipment acquisition programs. For development of forecasted costs the Association has assumed that Amtrak would not purchase or lease the corridor.

Revenues were based on the amount of conductor and agent receipts and commuter authority subsidy payments actually received by the railroads in reorganization in 1973. Costs were developed using 1973 data as reported by the railroads in reorganization in filings

ConRail passenger operations pro forma balance sheets

[Millions of inflated dollars]

	Initial	December 31,									
		1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
ASSETS											
Current assets.....	\$7	\$183	\$198	\$215	\$231	\$248	\$265	\$281	\$298	\$316	\$338
Property and equipment.....	114	137	163	197	234	274	317	363	412	465	521
Less accumulated depreciation.....	—	2	6	10	16	23	32	42	54	69	85
Net property and equipment ¹	114	135	157	187	218	251	285	321	358	396	436
Other assets.....	—	13	14	15	16	17	18	19	20	22	23
Total assets.....	121	331	369	417	465	516	568	621	676	734	797
LIABILITIES AND EXCESS OF ASSETS OVER LIABILITIES AND FREIGHT EQUITY											
Current liabilities.....	—	127	136	148	160	171	183	194	206	218	233
Noncurrent liabilities.....	1	20	36	55	57	61	65	67	69	73	76
Pension liability (Note 10).....	12	11	10	9	8	7	5	4	3	1	—
Excess of assets over liabilities and freight equity.....	\$ 86	151	165	183	218	255	288	334	376	420	466
	99	309	347	395	443	494	546	599	654	712	775
Freight equity in passenger net assets (Notes 1, 2 and 3).....	\$ 22	22	22	22	22	22	22	22	22	22	22

¹ The increase in net property and equipment capitalized stems from the use of the depreciation accounting method. Under ICC betterment accounting, there would not be an increase in this account.

² Represents an amount equal to the net liquidation value of the Northeast Corridor.

³ Represents an amount equal to the net liquidation value of other assets used in passenger operations at the date of asset conveyance.

⁴ These amounts plus the assumed liabilities have been allocated to the assets on the basis of their estimated fair values.

ConRail passenger operations pro forma statements of results of operations and government payments

[Millions of inflated dollars]

	For the years ending December 31,										
	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1976-85 Total
Results of operations:											
Operating revenues.....	\$434	\$468	\$505	\$545	\$586	\$625	\$665	\$703	\$747	\$796	\$6,074
Operating expenses.....	525	567	611	658	707	756	801	851	904	964	7,344
Operating loss.....	91	99	106	113	121	131	136	148	157	168	1,270
Payments from government entities...	156	113	124	148	158	169	177	190	201	214	1,650
Excess of payments from government entities over operating loss...	\$65	\$14	\$18	\$35	\$37	\$38	\$41	\$42	\$44	\$46	\$380
Government payments to passenger operations:											
Net operating loss.....	91	99	106	113	121	131	136	148	157	168	1,270
Net track expenditures capitalized under depreciation accounting.....	23	24	29	32	34	34	38	37	40	41	332
Net operating loss under ICC betterment accounting.....	114	123	135	145	155	165	174	185	197	209	1,602
Working capital deficit (excess).....	42	(10)	(11)	3	3	4	3	5	4	5	48
Total government payments to passenger operations.....	\$156	\$113	\$124	\$148	\$158	\$169	\$177	\$190	\$201	\$214	\$1,650
Total outside funding:											
Government payments to passenger operations.....	156	113	124	148	158	169	177	190	201	214	1,650
Payments to Con Rail for certain costs of diverting freight traffic from the electrified Northeast Corridor (Note 5) ¹	9	53	52	38	59	—	—	—	—	—	211
Total funding.....	\$165	\$166	\$176	\$186	\$217	\$169	\$177	\$190	\$201	\$214	\$1,861

¹ A Government entity must provide funds for the purchase of the Baltimore & Ohio Railroad (B & O) tracks between Washington and Philadelphia for ConRail freight operations so that the electrified Northeast Corridor can be devoted to passenger service. Because a purchase price has not yet been determined, the purchase of the B & O tracks has not been reflected in the schedule of outside funding required.

Note 5—Passenger Corridor Expenditures

To improve passenger service on the Northeast Corridor, ConRail freight operations (except local service) should be transferred to other rail trackage such as the Baltimore & Ohio Railroad's (B&O) tracks between Washington, D.C. and Philadelphia. Because the transfer from the corridor is for the convenience of the passenger operations, the Association has decided that the freight operations should not be expected to bear the costs of the purchase of the B&O tracks and other direct capital costs associated with eliminating freight interference with the passenger operation.

Since a purchase price for the B&O tracks has not been determined, and since the precise terms and conditions under which reimbursement will be paid are still to be negotiated, the acquisition of these tracks and the subsequent reimbursement to ConRail have not been reflected in the forecasts. Consequently, the results of freight operations for the forecast period do not include depreciation charges for the Northeast Corridor or the B&O tracks. Upon determination of the purchase price, operating expenses will be increased and income before taxes and extraordinary item will be reduced to the extent of the depreciation charges.

The other direct capital costs consist principally of the purchase of 81 diesel locomotives to replace electric locomotives which cannot be used on the B&O tracks, "double tracking" the B&O line, providing interconnections, installing central traffic control (CTC) and making certain other improvements that are required to enable the B&O tracks to carry significantly greater traffic volume. A summary of these costs follows:

[Millions of inflated dollars]

Year:	Equipment additions	Road additions	Total
1976.....	—	\$9	\$9
1977.....	\$21	32	53
1978.....	23	29	52
1979.....	—	38	38
1980.....	—	59	59
	\$44	\$167	\$211

These costs and the related reimbursements are reflected in the freight balance sheets as property and equipment with offsetting amounts included in the equity section.

USRA INFLATION ADJUSTMENT

After developing adjusted operating expenses as described in the body of this report, the USRA financial staff then indexed these figures from 1973 to each of the years from 1976 to 1985 inclusive. The basis for inflation adjustments was projected changes in cost levels. USRA developed a separate index for passenger service as distinct from freight service.

To develop projected operating expenses, labor and material components of each major functional area were determined and separate indices were applied to the labor component and the material component. The operating expense figure for any particular year was the result of summing the individual components for that year.

USRA developed the projected passenger deficit figure ("government payments to passenger operations") for each year by inflating the 1973 deficit by the composite operating expense index. The overall passenger index is somewhat higher than the overall freight index, reflecting a more labor intensive situation in passenger service than in freight service.

The composite index USRA used is shown below:

<u>Year</u>	<u>Inflation Index</u> <u>(1973 = 1.00)</u>
1976	1.39
1977	1.50
1978	1.63
1979	1.76
1980	1.88
1981	2.01
1982	2.13
1983	2.26
1984	2.40
1985	2.56

Operating revenues for each of the years 1976 through 1985 were computed by increasing 1973 revenues by the amount necessary to cover the increase in operating expenses. Hence the increase in revenues was a residual number.

The definition of operating revenues used by USRA includes both direct receipts for passenger fares (and other passenger related revenues) and financial support for passenger service in the form of subsidy payments from commuter authorities and remuneration received from AMTRAK. In projecting growth of operating revenues at the same rate as operating expenses, USRA has implicitly assumed that:

- (a) Fares will be increased to match increases in expenses, or
- (b) Ridership will increase at a rate which matches increases in expenses, or
- (c) Subsidy payments will be increased to match increases in expenses, or
- (d) A combination of fare increases, ridership increases, and subsidy increases will take place which will defray the impact of inflation on operating expenses.

