THE JERSEY CENTRAL SITUATION

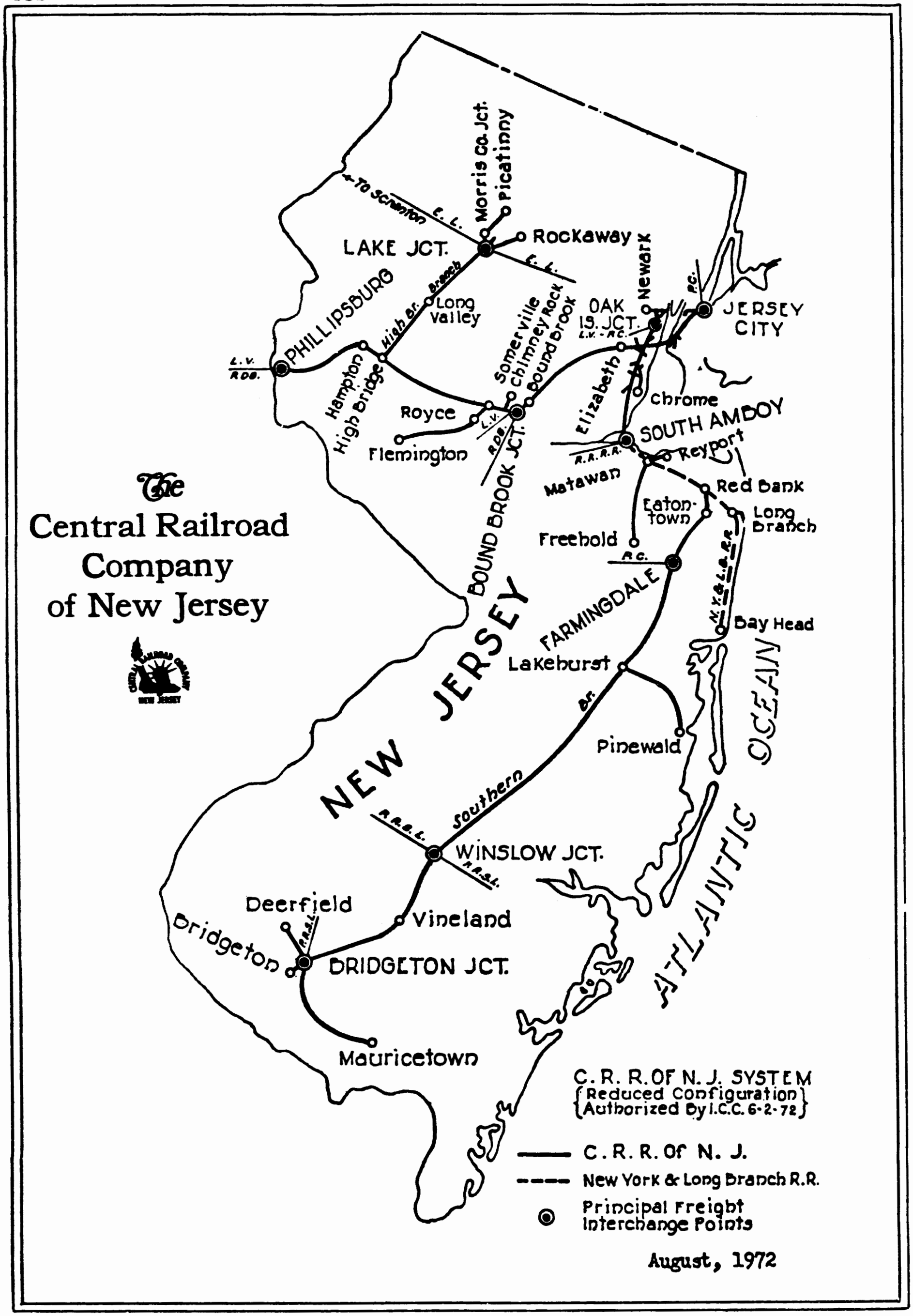
A REPORT BY

THE NEW JERSEY DEPARTMENT OF TRANSPORTATION

TO

GOVERNOR WILLIAM T. CAHILL

December 29, 1972


The Central Railroad Company of New Jersey
NEW JERSEY
ATLANTIC OCEAN
To Scranton
E. L.
Morris Co. Jct.
Picatinny
Rockaway
LAKE JCT.
PHILLIPSBURG
L.V.
RDG.
High Br. Branch
Long Valley
Hampton
High Bridge
Royce
Flemington
Somerville
Chimney Rock
Bound Brook
BOUND BROOK JCT.
Newark
OAK IS. JCT.
L.V. - P.C.
P.C.
JERSEY CITY
Elizabeth
Chrome
SOUTH AMBOY
R.A.R.R.
Keyport
Matawan
Red Bank
Eaton-town
Long Branch
Freehold
FARMINGDALE
N.Y. & L.B. R.R.
Bay Head
Lakehurst
Pinewald
Southern Br.
R.R.S.L.
WINSLOW JCT.
Deerfield
Vineland
Bridgeton
BRIDGETON JCT.
Mauricetown
C.R.R. OF N.J. SYSTEM
(Reduced Configuration Authorized By I.C.C. 6-2-72)
C.R.R. Of N.J.
New York & Long Branch R.R.
Principal Freight Interchange Points
August, 1972

THE JERSEY CENTRAL SITUATION

The recent developments leading to the anticipated discontinuance of passenger service on the Central Railroad of New Jersey warrant this detailed, factual report on the situation.

While the State has made every reasonable effort to preserve the rail service, it has been seriously handicapped because the Railroad has been in bankruptcy since 1967. All action must be understood in the context of that condition in which many normal business relationships do not apply.

Every aspect of the Railroad operation is under the jurisdiction of the Federal Court assigned to review and approve the reorganization. A Court-appointed Trustee oversees the continuing affairs of the bankrupt carrier.

The objective of the Trustee is basically the conservation of the Railroad estate in the interest of the creditors and with due regard for the public interest. Although the restoration of profitable operations is a desirable end, that consideration cannot be the sole criterion by which decisions are made. The Trustee, therefore, must perform a difficult dual role of skillful operator and conservator if he is to discharge his responsibilities properly.

There is always, in the bankrupt situation, the possibility that liquidation and distribution to its creditors of realized returns from the sale of the property, in whole or piecemeal, will take place. This, in effect, is an ever-present threat of loss of service.

Thus, the imposition of economic penalties upon a bankrupt rail carrier for failure to perform acceptably, an action typically effective in a normal business relationship, does not work in bankruptcy. A withholding of funds as a penalty for late-train performance, for instance, may aggravate the financial problem and actually increase the threat of liquidation, rather than gaining the desired end result of improved operation.

Accordingly, the following recital of facts must be viewed with the overriding circumstance of bankruptcy clearly in mind.

I. Summary of CNJ Operations

The Central Railroad of New Jersey, familiarly known as "The Jersey Central" or the "CNJ" operates both rail passenger and freight service on approximately 250 miles of line entirely within the State of New Jersey since the discontinuance of its lines in Pennsylvania. As shown on the map, its "main-line" tracks extend across the State from Phillipsburg to Jersey City. Other trackage extends from Newark through the Amboys to the New York and Long Branch Railroad, owned and operated jointly with the Penn Central along the North Jersey Coast to Bay Head. From Red Bank the Southern Division extends southward to the Vineland-Millville-Bridgeton triangle.

On the "main-line" passenger service is operated from Hampton to Newark via Somerville, Bound Brook, Plainfield, Westfield, Cranford, and Roselle. Most trains originate or terminate at Raritan, just west of Somerville. At Cranford, they are switched to Lehigh Valley tracks via the Aldene Connection for the run into Newark where connecting service into Manhattan is provided by Penn Central and PATH.

During a typical weekday, 26 eastbound trains are scheduled with the largest number operated during the morning rush hours. An average of 7300 revenue passengers and 350 "dead-heads" (in railroad parlance, those riding on passes -- principally rail employees) are carried on the main-line on weekdays.

On the North Jersey Coast, the Jersey Shore service is operated from Bay Head to Newark via Point Pleasant, Brielle, Spring Lake, Belmar, Asbury Park, Long Branch, Little Silver, Red Bank, Middletown, Matawan and the Amboys. From Bay Head to Perth Amboy the tracks are those of the New York and Long Branch. From Perth Amboy passenger trains operate over Penn Central tracks via Rahway to Newark, where connections are also made for New York.

In the "Shore Service," seven eastbound (or northbound) CNJ trains are operated on a typical weekday with three scheduled during the morning rush hours. (Penn Central operates 10 such trains, 7 during the morning rush hours). Approximately 3700 revenue passengers and 250 "dead-heads" are carried on these trains during an average weekday.

Between Cranford and Bayonne via Elizabeth, passenger service is operated over the former main-line. Primarily, this is a shuttle service providing connections with the regular "main-line" trains at Cranford. Twenty-one eastbound trains are operated on the typical week and handle an average of 600 revenue passengers and 250 railroad employees traveling free between home and work, principally located at Elizabethport Yard.

On all the above schedules a similar number of trains carrying like numbers of riders operates in the opposite direction with a concentration during the evening rush hours as might be expected. On weekends service is minimal with buses being substituted for trains on the Bayonne shuttle.

Since 1961, when State subsidies were instituted, the average daily number of riders has varied only slightly from a total of 15,000 including both revenue and dead-head passengers. In 1971, the average daily number of revenue passengers was reported as 12,400. There have been no indications of any significant increases in passengers as long as the present level and quality of service persists.

Freight service over all lines is provided by the CNJ to more than 600 industries, among them some of the largest in the State. Through freight operations are: from the midwest via the Erie Lackawanna via Dover and High Bridge; from the south and midwest via the Norfolk and Western and Baltimore & Ohio-Chesapeake & Ohio using the Reading Railroad as a "bridge" via Philadelphia or via Allentown; and from Pennsylvania and the midwest using the Lehigh Valley Railroad as a "bridge" via Allentown. Some 267,000 carloads of freight are reported to have been handled by CNJ in the past year.

The CNJ is the primary rail freight access to Port Elizabeth and Port Newark on Newark Bay. A new container-handling yard was installed at Port Elizabeth early in 1972 with financial assistance from the Port Authority. It is proving to be a very valuable asset for CNJ, and for the other railroads providing joint service with CNJ. The Erie Lackawanna is now operating through service via Lake Junction, New Jersey and the CNJ's main-line to handle its traffic to and from the Port area, and is vitally concerned with the preservation of that access.

The CNJ also provided freight service in direct competition with the Lehigh Valley and

Penn Central to Bayonne and Jersey City in Hudson County. This service in recent years has declined in importance to the CNJ while the Port area has come to recently dominate the CNJ freight picture. Also, CNJ serves exclusively much of the area between Elizabeth and Perth Amboy in Union and Middlesex Counties -- an area comprising many chemical, oil and heavy industrial complexes, for which rail freight transportation is essential. Such places are Carteret, Grasselli, Chrome, Trenley, Sewaren and Barber, as well as Elizabeth and Perth and South Amboy. There is also a piggyback (highway trailers on rail cars) terminal at the CNJ Elizabethport Yard.

Freight movements south of South Amboy are largely restricted to carloads of sand which are brought from South Jersey on the CNJ Southern Division extending from the Bridgeton - Millville - Vineland area north to Red Bank and thence to South Amboy. Other freight is miscellaneous and minimal, yet this link constitutes the only direct rail connection from the southern New Jersey industrial area to North Jersey and the New York area. This freight line is considered to have a promising passenger potential from Red Bank as far south to Lakewood, Lakehurst and perhaps to Toms River. On the New York and Long Branch proper there is very little freight -- occasional carloads of newsprint to Asbury Park, of beer to a wholesale distributor and building materials.

The physical facilities, except for those which have been rehabilitated with State funds supporting passenger service, have been allowed to deteriorate to an alarming degree. Heavy maintenance has long been deferred to conserve cash, and with the severe reductions in personnel that have occurred, even routine maintenance operations are not being regularly performed. While no catastrophic or tragic rail accidents have yet happened, derailments have become alarmingly frequent.

Repeatedly the Department has expressed its concern for safe and reliable operation, and has suggested to CNJ management that the neglect of maintenance has reached a critical point. The response has been, in effect, "Put up the money and we'll take care of it!" How much of this burden should be assumed by the State is still an open question.

Since 1970, when more than 2000 people were employed, the CNJ payroll has been reduced to 1420 employees as of December 1972. Of this 1420, approximately 600 are assigned to passenger services and the other 820 to freight and other duties. (It should be noted that the CNJ has indicated roughly 800 employees as required for passenger service in discussions of cost items under a fully-compensatory operating agreement with the State).

As in the area of maintenance, there is serious concern on the part of the Department as to the effect of these personnel reductions on the safety and reliability of the rail operations. Since November 1972, 440 employees have been laid off with the result that the car repair shops at Elizabethport, for example, are virtually unmanned despite the fact that some 25 passenger cars are usually "out-of-service awaiting repairs."

If, as the Trustee is reported to have announced in effecting the November 1972 cutback in the work force, these employees were "superfluous and not needed," the question may legitimately be raised, "Why has it taken so long to realize this and why were not the economies achieved long ago?"

If these employees were not really superfluous but were laid off for reasons of expediency, a much more serious question is, "How safe and competently run is the CNJ today?" The Department does not have any answer as yet, but is genuinely concerned.

II. Public Financial Support of the CNJ

Public funds, both directly and indirectly, have been contributed to the support of the Jersey Central, and particularly its commuter services, since 1961. As nearly as can be determined the total to date exceeds $75,000,000, of which nearly $50,000,000 represents operating subsidies. Because the magnitude and extent of this public financial support has not been generally recognized, the ensuing paragraphs are intended to delineate its nature.

In addition to the State's direct subsidy of passenger operations which have been highlighted, public support has taken a variety of forms: Cars and locomotives have been purchased and reconditioned by the State and then made available to the Railroad at nominal cost; numerous minor capital outlays for equipment and rehabilitation of facilities have been granted; Trustee Certificates, which might not otherwise have been marketable except on prohibitive terms, have been purchased by the State Treasurer; and both the State and local units of government have sacrificed much-needed income through the deferral of taxes.

Passenger Service Subsidies

Beginning with Fiscal 1961, the State of New Jersey has appropriated a total of $47,405,875 for subsidy of CNJ commuter operations and $45,320,875 will have been paid as of December 31, 1972.

For the current fiscal year, $5.1 million has been appropriated and this amount closely approximates the $5 million anticipated passenger revenues. In other words, the State is sharing the cost of commuter operations on a 50-50 basis with the passengers. On the basis of the average number of weekday riders, the current subsidy represents an average payment by the State of $0.82 per passenger trip.

Proposals by the Trustee for a new level of State subsidy could, if they were to be adopted at the maximum figure, result in more than a threefold increase, or an average subsidy of as much as $2.83 per passenger ride and more than $1,400 per year per passenger.

The Trustee's latest proposition as presented in the Federal Court hearings is calculated by DOT to amount to $2.00 per ride or $1,000 per year per passenger.

It has been claimed that this is far less than the subsidy already being paid for the riders on the Pennsylvania-Reading Seashore Lines where the average figures are roughly $2,000 per year per passenger. But the total amount of the P-RSL subsidy for the current year will not exceed $675,000 as compared to the $5.1 million for the Jersey Central (and which the Trustee alleges is less than one-half of the amount he should be receiving). And for the relatively small contribution, the entire P-RSL rail network in South Jersey has been preserved in support of the long-range well-being of that important, but less populous area of the State.

<u>Freight Service Subsidy</u>

In 1971, when the CNJ experienced a severe shortage of cash for operations and was threatened with a complete shutdown of all services, the Legislature provided a special appropriation of $2 million which was granted to the Railroad for the support of essential freight services. This amount was in addition to the passenger service contract for that year, and allowed the continuation of freight service to the several hundred New Jersey industries dependent upon CNJ for transportation.

Trustee Certificates

The State Treasurer purchased $2 million in Trustee Certificates issued in 1967 under the authority of the Federal Court to provide necessary operating cash. Repayment was due in September 1972, along with accrued interest of $20,000, but has not been paid because of the continuing critical financial condition of the Railroad.

Acting upon request of the Trustee, the State has agreed to an extension of the due date "up to one year." Ultimate repayment will, of course, be dependent upon the adopted reorganization plan or liquidation, and is at this point uncertain.

Equipment and Facilities

In sustained efforts to enhance safety and reliability of train operations, and to improve the convenience and comfort of the commuters, the State has paid for a number of improvements and has planned for the electrification of the commuter lines, both on the main-line and on the Shore.

Because of the legal technicalities of the bankruptcy, major outlays for fixed facilities, such as the plant required for electrification have been delayed. It has not yet been possible to work out a satisfactory agreement with the creditors of the CNJ whereby the State's investment in such improvements could be protected against loss through possible liquidation -- without such protection, public funds could well be channeled to private creditors. So, the State's capital support has been directed to cars and locomotives which could be moved to other uses in the event of a shutdown, and to minor fixed improvements.

Prior to the bankruptcy, in 1965, State and Federal funds in the amount of $7,225,000 were expended to accomplish the so-called "Aldene Plan" which has been in operation since 1967. Under this plan, the CNJ was enabled to abandon its Hudson River ferry service and its Jersey City terminal, and utilize PATH services at Newark. Resulting economies, it was hoped, would sufficiently improve the Railroad's financial picture to avert bankruptcy -- a forlorn hope, so events later proved.

To relieve the CNJ of the burden of modernizing its fleet of passenger cars, and to improve the ride of the commuter, the State has acquired 147 rehabilitated and reconditioned cars at a total cost of $5,417,000 utilizing 1968 Bond funds. These cars have been leased to the CNJ at the nominal $1 rental.

Also, to upgrade motive power, the State is underwriting the CNJ's lease of 13 diesel locomotives at a cost of $312,000 per year. A total of $1,256,000 has been paid out of public funds to date.

The most recent acquisition, 35 cars from the surplus fleet of the Burlington Northern Railroad, is scheduled for delivery during January 1973 and would replace the oldest Jersey Central cars which have become obsolete. In the event of a shutdown of CNJ services, these cars and the balance of the present State-owned fleet, and the 13 locomotives would become available for alternative services on other railroads.

For a number of capital improvements of fixed nature, such as a car washer and electrical standby facilities at Harrison Yard, a total of $396,600 has been invested for the benefit of the commuter operations and the Railroad. Also, of partial benefit to the CNJ which operates jointly with the Penn Central on the New York and Long Branch, improvements on the Shore have totaled over $700,000 of which some $308,000 may be regarded as of benefit to the CNJ.

More than $12 million has been indicated by the Trustee as urgently needed for track rehabilitation and other physical betterments. But the State has not yet committed such funds, which could legitimately be drawn from 1968 Bond monies, because of the legal technicalities previously described. For the same reason, the electrification program called for in the 1968 and 1972 Transportation Master Plans, and to be financed in part from 1968 Bond funds, has not moved forward.

Tax Deferrals

According to advice from the Office of the State Treasurer, taxes unpaid and due the State amounted to $9,272,837.97 on CNJ railroad property. There is no present prospect of their payment, either in part or in total, yet the State has had to make, from other funds, the regular State-aid payments to local units of government in accordance with the statute which relieved the railroads of local taxes upon their property utilized for rail operations. Thus, there is what amounts to a double burden upon the State which is in reality financing the railroad's obligation at a very high rate.

CNJ has also postponed payments of local taxes still imposed upon railroad-owned property not utilized in rail operations. In many instances such property has been leased by the CNJ and is earning income.

Most critically affected is the City of Elizabeth. Its City Assessor reported that no tax payments have been received since the date of bankruptcy in 1967, and that the present amount due in taxes, penalties and interest is $1,450,000. Lesser amounts are owed to other communities; Jersey City reports the CNJ tax arrears as some $32,700, for example.

In effect then, local communities, as well as the State, are underwriting the CNJ through deferral of taxes, and at the same time are paying a penalty by having to finance from other sources this lag in their revenues.

III. The Financial Picture

Complete collapse of the Central Railroad of New Jersey as an independent carrier with resultant disruption of its rail operations, both freight and passenger, appears to be inevitable without massively increasing public financial support.

Total liabilities of the CNJ increased by almost $6 million during the first six months of 1972 to reach a total of $143,260,000 as of June 30, 1972, according to the Railroad's latest available complete financial statement.

Further, it would appear that the financial condition has not improved in recent months and may in fact be worsening. The CNJ Comptroller's Monthly Statement of Income Account for September and October 1972 (Exhibits B and C appended to the Trustee's Petition to the U.S. District Court for New Jersey for Authority to Discontinue All Passenger Operations) show net railway operating losses of $563,216 and $557,547 respectively, and total losses (after fixed charges) of $705,177 and $631,184 respectively for the two months.

The Trustee claims that passenger operations account for the major portion of these losses -- $448,000 in September and $531,000 in October -- despite the State's subsidy of approximately $423,000 each month under the current Passenger Service Contract which the Railroad seeks to cancel.

Certainly, such figures would seem to provide no basis for any expectation of rapid and significant improvement which would stablize the CNJ finances.

Nevertheless, the Trustee claims that relieved of the burden of passenger operations, either by full compensation of all losses through subsidy or by discontinuance of all passenger service, the Railroad would operate at a profit. As part of the Trustee's testimony in the Federal Court hearings during the week of December 11, a 1973 Income Forecast (Exhibit T-6) was presented to show that, operating only freight services, the Railroad could anticipate a net income for the year of $828,000 as contrasted with a net loss of $1,944,000 if the present level of passenger service were to be continued. That loss assumed as income a $5,088,000 State subsidy.

It was further claimed that a fully compensatory passenger contract providing for a State subsidy of $10,464,000, as estimated in this 1973 Income Forecast, would permit a total "Ordinary Income" of $3,432,000. Additionally, but not apparent in the Forecast tabulation, there is an implied assumption that the State payments should be increased to provide a rental or return on investment, for facilities used in passenger service. In such case the net income would be further improved and the Trustee claimed that there would be a firm base for reorganization and survival as an independent carrier.

The Trustee's figures and estimates cannot be verified by the Department of Transportation and its financial consultant, L.E. Peabody and Associates, on the basis of information presently available. It must be noted that economy measures instituted by the Trustee have so depleted CNJ staff competent to compile data that the preparation and distribution of operating and financial reports have been seriously delayed and curtailed. Also, there seem to be grounds for reasonable doubt as to the accuracy of available data.

In the absence of objective and detailed analysis and review by competent authorities -- the PUC and the ICC -- the State has no reliable way of determining the validity of the Trustee's claims.

IV. The Passenger Subsidy Situation

The State's subsidies to all of New Jersey's railroads continuing to operate commuter services have been based upon the so-called "avoidable cost" concept. Briefly, under this concept, the subsidy represents the difference between the net cost of operations if the particular service were to be discontinued and the actual net cost of the Railroad's total operations including the subsidized service -- i.e. the costs which would be "avoided" by dropping that service.

As set forth in the New Jersey Transportation Act of 1966 (P.L. 1966, Chapter 301), the subsidy for a given fiscal year is based upon the determination of the avoidable cost for the calender year preceding. In other words, payments for Fiscal 1973 (July 1, 1972 - June 30, 1973) are based upon the Calendar 1971 figures. The Department's budget request is so established, and the Lesiglative appropriation becomes the basis for a contract with the Railroad.

In an inflationary period marked by sharply rising expenses, the prescribed "avoidable cost" basis for a subsidy obviously introduces a time lag which imposes a financial burden upon the railroad. Also, the aviodable cost approach does not necessarily reflect all of the expenses attributable to the operation of a particular service such as the commuter trains.

Because of chronic "cash-flow" problems on the Jersey Central, the CNJ Trustee has continually been requesting -- and lately demanding -- that the State of New Jersey shift its subsidy to a current schedule and establish the amount upon a "fully compensatory" instead of an "avoidable cost" basis.

The "fully compensatory" approach received official sanction early in 1972 when the Federal Court having jurisdiction in the Penn Central bankruptcy approved such a contract for the subsidy of certain New York State services by the Metropolitan Transportation Authority. That contract further recognized "return on investment" in the facilities employed in performing the subsidized service as a legitimate element of the subsidy determination. Following approval of that contract, the Penn Central Trustees notified the Department of Transportation that the Court mandated that all passenger service, on and after January 1, 1973, should be conducted by the Railroad on a "fully compensatory" basis. Otherwise, they would move to have the uncompensated service discontinued.

Recognizing the need for a more flexible approach to the negotiations for passenger service contracts, and with the precedent of the statutory provisions for bus service contracts, the Department recommended an amendment to the Transportation Act of 1966. This amendment, was approved by the Legislature and signed by the Governor as P.L. 1972, Chapter 101, on July 18, 1972. It broadened the authorization for rail subsidy contracts to encompass either "avoidable" or "compensatory" cost arrangements.

Almost immediately thereafter the CNJ Trustee proposed that the State sign a letter of intent to enter into such a fully-compensatory cost arrangement retroactive to July 1, 1972, and subject to later agreement on the details of a contract. The Penn Central Trustees also notified the Department of their intention to negotiate such a contract.

In contrast, the Erie Lackawanna indicated their intention to continue on an avoidable cost basis, but with provision for payments related to current expenses rather than to those of the prior year.

Rough estimates of the cost of these revised contracts were submitted by the railroads and formed the basis of the Department's budget request for a 1974 appropriation to cover these operations. Because of the prospect that contracts might become effective earlier than the 1974 Fiscal Year to comply with Federal Court mandates, estimates for the costs for the balance of the 1973 Fiscal Year were also sought. The only "firm" figures were received from the Erie Lackawanna Railroad which updated previous avoidable cost data.

The determination of "fully compensatory" costs involves many more complexities than are evident in the well-established "avoidable cost" procedures. Not only are the inclusions of specific costs and their amounts to be determined, but there must also be agreements on the allocations of cost between the subsidized passenger service, other passenger services (if any) and freight services which are jointly incurred.

Further there are basic and difficult questions as to any allowance for a return-on-investment, or rental charge, for the property utilized in the conduct of the subsidized service: "Should there by any such allowance?" "What property is properly assignable to the subsidized service and how shall its value be determined?" "What is an equitable rate of return, or rental?"

Obviously, answers require clear and accurate cost information, detailed and objective analysis, and a mutual understanding and agreement upon the principles and guidelines to be followed in reaching a determination of costs. The process is time-consuming and has not progressed to the point where any firm and supportable estimates of "fully compensatory" costs to the State can be cited for either the CNJ or Penn Central.

The situation has become badly confused by the disparate figures proposed by the Trustee and staff of the CNJ over the past several months. As shown in the following tabulation, proposed costs range from $7.1 million to approximately $23 million per year depending upon the assumptions made:

State Passenger Service Subsidy Proposed by CNJ

June 1972	Estimated total cost of fully-compensatory contract for Fiscal 1973 (present contract plus $3 million).	$8.1 million
July 1972	Proposed by Trustee as interim annual cost basis for letter-of-intent to modify present contract retroactive to July 1, 1972.	$7.1 million
Aug. 1972	Revised estimate of June 1972 from CNJ staff.	$12.1 million
Oct. 1972	Further revision from CNJ staff based upon $8.1 million "full cost" and	

	$7.1 million representing 6% return on investment.	$15.2 million
Nov. 1972	(1) Further revision from CNJ staff based upon $11.7 million operating deficit in passenger service and $7.1 million return on investment @ 6%.	$18.8 million
	(2) Same as (1) but 10% return proposed to yield $11.7 million.	$23.4 million
	(3) Trustee proposed State immediately agree to a letter-of-intent for "full cost of service contract" and pay $500,000 per month from July 1, 1972 to date of contract and thereafter pay monthly the full cost as determined by contract formula. In addition, State would make up difference between amount paid at $500,000 rate and full cost for period from July 1 to contract date, with credit for payments under present contract. Estimated annual cost.	$18.8 million
Dec. 1972	(1) CNJ staff indicated $10.5 million estimated operating cost plus $7.0 million return on investment.	$17.5 million

Dec. 1972	(2) CNJ staff informally advised DOT that "lease was negotiable" and suggested a $3.5 million compromise figure with new annual total. (Note - references to a figure of this magnitude were made in the Federal Court hearings during week of December 4.)	$14.0 million
	(3) Trustee proposed in Federal Court hearings during week of December 11 that State pay $500,000 per month, or $6 million per year, in addition to present $5.1 contract, and a rental for use of facilities (not specified but implied at $7.0 million).	$18.1 million
	(4) Trustee further proposed that such a contract be worked out with State to take effect July 1, 1973 and in meantime current contract be adjusted upward on $2.8 million annual basis ($1.4 million additional payments to July 1) to "make the Railroad whole" in the interim.	$7.9 million

Following the "full-cost" proposals from the CNJ staff, the Department's consultant, L. E. Peabody and Associates, was requested to review the Railroad's data and to make recommendations as a basis for negotiations. It was stressed to the Trustee that a condition underlying such negotiations was that he give evidence of meaningful efforts to advance plans for consolidation of the CNJ with the Reading and Lehigh Valley Railroads -- a plan which will be generally described in a separate report.

However, before Peabody could complete its review of the CNJ data, the Trustee, on November 22, 1972 submitted to the Department a proposed "letter-of-intent" incorporating the arrangement described as "(3)" under November in the tabulation above and demanded immediate acceptance. The Department, having no indication of a bona fide effort to progress consolidation plans and lacking any funds to commit to an increase in subsidy without a special appropriation, declined to accede to the Trustee's demand. The Trustee then proceeded to file a petition to the Federal Court for authority to cancel the present contract with the State and to abandon passenger service as of December 31, 1972.

The Court hearing was set for December 11. The decision, after a week of hearings, was to authorize cancellation of the contract and to discontinue passenger service as of January 21, 1973 -- the date to which advance subsidy payments had committed the Railroad. The Court urged, however, that the Trustee attempt to reach some agreement with the State by which passenger service could be continued, but emphasized that losses could not be permitted to continue and thus further erode the assets of the estate.

In the meantime, the Consultant has indicated to the Department his finding that the supportable increase in subsidy does not exceed $2.8 million and that a total of $7.9 million would represent a "fully compensatory" payment for the year 1973. If an "avoidable cost" contract were to be continued, but on a current basis, the Consultant estimated that the State's subsidy for 1973 would increase to an amount between $6.9 and $7.5 million.

Estimates are at best imprecise at this date because the effect of the recently negotiated changes in certain union work-rules has not yet been assessed. Nor, has the Railroad's response to the National Wage Agreement been clearly developed -- several million dollars in back wages have been due under increases previously mandated by that Agreement authorized by the Congress, and an additional increase totaling more than $2 million becomes effective on January 1. Because the Court had permitted the Trustee to delay payments of these increases, their impact upon costs has not been definitely established.

Further, the Consultant questioned the basis for the determination of the rental charge proposed by the railroad. It was his recommendation that the lease of such property -- if the principle of rental or return-on-investment were to be accepted -- should be based upon the "liquidation" or "salvage" value and not the "replacement" value proposed by the Trustee. On that basis, the Consultant estimated that no rental in excess of $1.3 million would be justified.

If the State were to lease facilities for passenger service which the CNJ would also use for freight service, the Consultant indicated that equity required the Railroad to credit the State with trackage payments for freight use. Otherwise, the State would be underwriting freight service on which the Railroad, if its claims to the Court were valid, would be operating at a profit at the expense of public funds; the freight would, in effect, be riding "free" and the CNJ would gain a competitive advantage over other railroads.

The wide gap between the figures proposed by the Trustee and those recommended by the Department's Consultant -- from $18.8 million down to $7.9 million, the numerous unresolved questions as to the accuracy and validity of the Trustee's proposals and the apparent disregard on the part of the Trustee of his commitment to work out a consolidation arrangement with the other bankrupt railroads -- all these considerations reinforced the conclusion that negotiation of a new passenger service contract would cost the State significantly more money but would not hasten any desirable and lasting solution to the CNJ's critical situation.