

Excerpts from Testimony of Michael Zarin

The Court: Yes. You have to have a projection.

The Witness: That is right.

The Court: And if you have such a projection what you are saying is that you can include in the revenue part up to 25 percent of the projected net revenues.

The Witness: That is right. So that when you do that, as I was tossing this around in my mind thinking about it, if you are using historical revenues to the maximum, it is close to but not quite a one-times coverage test.

If you are using only historical revenues it is a 1.3 times test, because if you [527] use all of the historical revenues plus the 25, you are saying you are at 125 percent as against the 1.3 situation.

The Court: Right.

The Witness: And there is a thin margin over what we would call a one-times coverage in that situation. However, if you do include estimates you may also have to include on the original side of the equation additional bonds which are necessary to be issued in order to achieve those revenues. T 522-17 to 527-11.

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[528] The Court: If you ever use the project to augment your income then you would have to use the debt service requirements of the bonds that you will have to issue to achieve those revenues for the next three years. Is that right?

The Witness: That in essence is it. How the technical method would go and precisely which bonds they are is something we would have to analyze very closely. We have not done this really to any great

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extent as far as that is concerned. Although we may have to.

The Court: Is there anything else about the 1.3 test we should know?

The Witness: Your Honor, if I may say so, that is the kind of question to which your [529] Honor subjected me when you asked me to appear to consider this matter independently with the respective counsel, almost word for word. I will answer your question.

The Court: No; in the context of this case, you know what the issues are.

The Witness: I understand.

The Court: Is there anything else that is important for us to know in the requirement of meeting the 1.3 test? Because up to this point I have a certain question which occurs to me, and maybe that will show you what I mean.

The Witness: Well, your Honor, we have addressed the technical provisions of the 1.3 test. The questions which I have addressed myself to have to do with what protection the 1.3 test affords.

The Court: Right.

The Witness: I will be glad to—how do I understand your question? How am I to understand your question?

The Court: Let me ask you a specific question and see if that sheds any light on what I really want to know.

Supposing the Authority wanted to issue [530] consolidated bonds in X amount to purchase a mass transit facility, and they projected a deficit for the foreseeable future with respect to that facility. How would you utilize that deficit in the 1.3 test?

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The Witness: Your Honor, in my judgment the 1.3 test would in most cases not take cognizance of the deficit, because the 1.3 test is a protection against, in the context in which we have discussed it, general reserve fund bond maximum future years debt service.

So that certainly the particular obligation which was issued in order to commence an additional rapid transit operation, let's say of the type we are now working on in both the states of New York and New Jersey, the bonds to be issued at that time for that particular facility would be included as far as the maximum future years debt service is concerned. But the operating deficits and future issuance of debt for future capital expenditures in connection with that facility would not then be there. So it would just furnish as far as I understand it the limited protection with regard to the capital expenditures for which the [531] bonds are then being issued.

The Court: That is precisely what I am trying to find out: whether the 1.3 test furnishes any protection against the assumption of a huge operating deficit situation. And suppose you only had to issue \$10 million in bonds, let's say, to acquire the Erie Railroad—I don't know whether the Erie is in bankruptcy or not, but let's make that assumption—or to acquire all of the commuter railroads that are operating in North Jersey; so your debt service requirements in this formula would not be particularly increased. But the operating deficit was \$100 million a year.

Are you saying that you could nevertheless apply the 1.3 test using your historical earnings? And you

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have no projected earnings to augment it; it is going to be a deficit. You apply the 1.3 test using your historical earnings to the bonded debt.

[532] The Witness: First of all, in answer to your question, I understand your question to be isolating it to the 1.3 test.

The Court: That is right.

The Witness: And recognizing that if 1962 will be applied to it, it would be one kind of thing, and all the other protections—

The Court: We are sticking in 1952.

The Witness: That's right.

The Court: Now we've got the consolidated bond resolution, and we don't have the covenant. All I want to know is whether the 1.3 test would preclude the Authority's assumption of a deficit operation.

The Witness: Your Honor, that would depend on the type of deficit operation concerned, how the Authority was going to assume the deficit operation, and the precise methods of doing it.

The Court: Well, take my hypothetical.

The Witness: Yes. If I were to answer your hypothetical question, it would be in answer—and I will answer it—to one method by which such a proposition might be presented. If I understand the particular **[533]** proposition which you were presenting, it is that you were undertaking the totality of a rapid transit system which has \$100 million of deficits in a prior year.

The Court: Forget about that. Let's assume that the Authority is going to build rapid transit facilities throughout the meadowlands, and let's say Newark, et cetera; they are not going to acquire it from somebody else.

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The Witness: What your Honor is describing now is akin to the connections of the Erie and Lackawanna and so on that are presently under contemplation and an extension of the PATH systems say down to Plainfield and that kind of thing which we are thinking about now.

The Court: Let's take it in two different phases. One is that they build a totally new facility.

The Witness: Right. Okay.

The Court: So it has no historical operating deficit as such.

The Witness: All right.

The Court: So you are going to build [534] that facility, and let's say it would cost you \$10 million to build it, whatever it may be.

The Witness: Yes.

The Court: It may be a very small facility, but nevertheless it is a commuter transit facility, and you build it; you need to issue \$10 million in bonds; and you can project—let's say you have \$50 million in operating deficit each year.

The Witness: The 1.3 test, as I understand it, furnishes no protection in that situation.

The Court: That is what I want to know. You do not have to throw the \$50 million operating loss into the equation when you are computing 1.3.

The Witness: That is my understanding.

The Court: Now let's assume that instead of building it they acquired the trackage for \$10 million and that those railroads which were operating the trackage had a \$50 million loss each year.

The Witness: Your Honor, if you were acquiring just the trackage—

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The Court: —and the passenger cars, [535] similar to what was done with H & M.

The Witness: In the case of H & M, then we were acquiring an entire system.

The Court: Right.

The Witness: And in that situation, your Honor is saying that we would be operating the entire system as well, I take it.

The Court: Yes.

The Witness: Well, in that situation, which I am not sure that we have ever addressed before, that is an area—I am trying to define these areas where I have actual experience from those in which you are discussing in the situation.

The Court: Yes.

The Witness: And I am not sure that that situation even existed with respect to the H & M, namely, that it was operating at a deficit prior to the takeover.

The Court: Sure it was, wasn't it?

The Witness: No, I am not sure about that.

The Court: It was in bankruptcy.

The Witness: It was in bankruptcy, not able to meet its obligations. It was an [536] operation that consisted not only of the railroad operation but a number of other operations, also. And what was happening there—

The Court: Let's not go into detail with respect to it. Let's just stick with the hypothetical.

The Witness: In the hypothetical situation we would have to address the Condition 3, small Roman i, that in the case of facilities which have been in operation during the entire period of thirty-six months next preceding such time of issuance, we

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would have to look at the combined net revenues derived from all such facilities.

There is an initial question which I would have to address if I were to examine this in an actual situation, whether the words "derived from" in that situation included a deficit or not.

If I did determine that it did include a deficit, which it may very well—as I say, that is something I really would have to consider, if it included a deficit in that particular small Roman i section, then obviously [537] we would be including those in that projection, if I came to that conclusion and so recommended and counsel for the Authority and others coincided with that judgment.

We are talking now in the case of the takeover of a complete facility operating at a deficit in the preceding thirty-six months.

The Court: Now you are not prepared or could not at this time express an opinion on that?

The Witness: Well, I think that, as I say, these are things I have been thinking about over the past few days and so on.

The Court: Yes.

The Witness: I think that if you are going to take over a whole operation, which is one of the possibilities, with that kind of a deficit you might very well have to include the deficits in that particular situation.

[538] The Court: Okay. Suppose you took over less than the whole operation?

The Witness: Your Honor, that goes to another type of question, which I am not addressing myself to, but which I have considered. T 528-10 to 538-6.

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[540] The Court: All I want to know is, in your opinion, is the Authority required to include the deficit in its calculation to determine whether the 1.3 test has been satisfied?

The Witness: If we're talking about the deficits on an existing operation, which has existed in the past 36 months that's really the same question which we addressed ourselves to before.

The Court: You said if they took over the whole operation, in your opinion, they would have to include it. Now, we are **[541]** taking less than the whole operation.

The Witness: If they took over parts of the operation, which were deficit producing at that moment in time then—and having passed under the assumptions, the hurdle that we would include it in the deficits in the subdivision 1 the answer to that question would be yes. T 540-13 to 541-8.

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[543] [By Mr. Landis] Q. Mr. Zarin, does the 1.3 test really protect against deficit railroad financing by the Port Authority?

The Witness: Your Honor, the 1.3 test may be protective in certain very limited cases, but as I have examined it, I do not believe that it is protective against operating deficits. It is not protective in the situation in which your Honor outlined initially, namely the assumption of operation of a new facility and if I take protection to mean what I have listened to in the courtroom, what has been addressed to, namely protection of the security of bondholders, therefore it would not be protective in that situation and it would not be protective in my judgment in the event of the takeover an existing facility, if one

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were to approach that facility with the objective of bringing that facility within what we would call the general reserve fund family.

If you were to take it in particular ways, once you had taken it in even a limited [544] manner, there are some very real additional problems because the method of building a facility is not only a method through the use of the issuance of consolidated bonds. I really have—I think I have a few specific things in mind.

One would be the method of bringing in such a facility. I think, your Honor is correct in both assumptions which you addressed before the recess, namely if you were to assume an entire deficit operation at one time—as I say, I have never addressed this practically. If I had to address it, I think that fairly read you would probably have to include the prior deficits.

I could conceive a situation in which I would be pushed fairly hard on that question of if the Port Authority were directed to take something over because I would then be asked whether those were derived from, really mean only pluses, because in other cases, they do mean only pluses in this and other documents, but I think I would probably take the position in that situation that you would have to include [545] the prior deficits, and likewise in the situation which would be undertaking part of a facility which is operating at a deficit, but in thinking about the situation, I can see a possibility of taking on parts of an operation which were not deficit-producing as part of the Port Authority's obligations, and then taking on additional portions which

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were deficit operations. If you did that, even if those deficits were to in a subsequent year prevent you from issuing any consolidated bonds, there are still sources of funds available to the Port Authority which could and probably would be used for the development of that facility and the payment of its deficits, funds which now stand as security for the bondholders.

Q. You are getting into then the flow of funds under the consolidated bond resolution, aren't you?

The Witness: When we —once we have issued an obligation for a facility, then all of the covenants and the flows of funds apply to that facility.

The Court: I realize that, yes.

【546】 The Witness: Now, so that part of it does have to do with the flow of funds.

That part that I am talking about has to do with, for example, and it is a dramatic example, is the one that occurs to me, is that if you wanted to assume —you being the Commissioners of the Port Authority—wanted to assume the development and operation of, say, the Second Avenue subway which is not yet in operation, there being no deficits, operating deficits on that facility, and say the prior bonds being the obligation of the Transit Authority or the City of New York, you could, absent all other protections which exist, which we are not talking about, probably undertake that portion of that kind of deficit operation.

Having undertaken that portion of the deficit operation of the subway system, we are bypassing right now, whether other covenants, which we will get into,

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Section 7 and Section 6 of the statute, might protect against that, but having taken that as part of the general reserve fund family under the 1.3 test which we are addressing now, the [547] hypothetical situation in which—which you have addressed in the past days and which we have addressed from time to time at the Port Authority in thinking about what are the perimeters of this thing, the rest of the system, there being now a facility on the Port Authority's books dealing with the rail situation, there is nothing under the 1.3 test which would prevent the balance of that system from being given to the Authority without the issuance of any obligations, thus incurring even a more—well, and obviously a type of deficit that would be more substantial.

In my judgment, for that reason and for a number of other reasons, if we are talking in terms of what the protective perimeters are of the statute so far as someone working with it, with an objective to bring into it, and let's even put the New York City subway to the side for a moment, if you have an objection to bring into the family substantial deficit operations, it is not the 1.3 test which furnishes the protection, whether with respect to railroads or with [548] respect to facilities of any other type.

The 1.3 test, if I were to ask a lawyer in my division to bring—to somehow bring within the family such a facility without looking at anything but the 1.3 test, I would feel that he was not being appropriately creative if he could not figure out some way to do so. T 543-2 to 548-9.

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The Court: Well, now, in that connection, the legality of the issue of the bonds under the consolidated bond resolution, which is the only time the 1.3 test comes into play when you go to issue a bond—

The Witness: The 1.3 test comes into play at the time of issuance.

The Court: The legality then of the issuance of the bonds is passed upon not only by Mr. Falvey, the general counsel of the Authority, but also by bond counsel.

The Witness: Yes, sir.

The Court: So that you not only have to think of some ingenious way of circumventing the intent and purpose of 1.3 that satisfies Mr. Falvey, but you have to satisfy somebody [549] else.

The Witness: That's correct, your Honor, and as far as the 1.3 test is concerned, I would not deem that to be a difficult job. T 548-11 to 549-5.

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[551] [By Mr. Sovern] Q. Let's take the hypothetical you gave of the Second Avenue Subway in which first the Port Authority, through the issuance of consolidated bonds acquires some non-deficit producing—well, it would [552] have no deficit because it has no operations, and then becomes the proprietor of the entire subway system. You said 1.3 test provides no protection against that. I understood that very literally, that is to say it provides no protection against that in the sense that by itself at that moment it provides no protection. But if that event were to occur and at any time thereafter the Port Authority sought to sell consolidated bonds to finish the World Trade Center or improve LaGuardia Airport or put new toll booths on the Washington Bridge would the 1.3 test apply

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to that issue of bonds? A. Somehow, Mr. Sovern, we would find a way to build those toll booths, but apart from that I think your statement is quite correct. When you—

The Witness: And that's one of the reasons, your Honor, that the 1.3 test has a little bit of unreality to us, because the—if we can't meet 1.3 with respect to the issuance of consolidated bonds our operations, as far as their financing to consolidated bonds are at a standstill.

So really just to meet the 1.3 is not, is not—is skating very close to the point of stagnation for the organization, * * *. T 551-22 to 552-24.

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[556] Q. All right. Let me ask just a couple of other questions. I take it that the point at which Mr. Falvey came to you and said, "Tell me, Mike, whether we can do the Second Avenue Subway and the New York City Transit System this way", you would say, "We can do it, but that's the end", is that correct? A. Oh, absolutely not. I would certainly not say that at all.

Q. You would not say that? A. I would not say that in that manner at all, nor would he address it in that way. T 556-1 to 556-12.

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[557] Q. (Continuing) If we bring into the general reserve family a facility with a 300 million operating deficit, that deficit will have to be calculated in the next time we come to issue bonds and apply the 1.3 test. Is that correct? You would so advise him. A. Mr. Sovern, that's not the way I give advice. And if you want to address the question with respect to the various hypotheticals we're giving here, that's one thing, but I—to answer that question, I would have to go into areas which are—the first thing I

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would talk about would be, [558] for example, basic covenants and Section 7 and whether it's a good idea and lots of other kinds of things, but that's not what you are addressing.

The Court: All we want though, Mr. Zarin, is your opinion, not how you would advise a client who is pushing you, but your opinion as to the interpretation and effect of the consolidated bond resolution on these various hypotheticals. T 557-14 to 558-9.

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[559] [By Mr. Sovern] Q. When you said that the 1.3 test provides no protection in this situation, there they are referring to the building of a new facility or a sort of acquisition of their Second Avenue subway which you hypothesized, when you said the 1.3 protection—I'm sorry, the 1.3 test provides no protection in this situation you are looking at that very limited moment in time without reference to future actions of the Authority in answering the—you were being very literal. Is that correct? A. I was answering in two respects. One in point—in that point of time; secondly, with regard to the limited period of, call it the next three years, which we could analyze out.

And now your question takes me to the point beyond that and saying, "What protection would the 1.3 test then provide?"

And what would happen in that situation is that if there were another occasion to issue consolidated bonds and the maximum future years debt service was exceeded—I beg your pardon—and the maximum future years debt service was—

Q. Off the record, you have to turn [560] that sentence around. A. All right. If the net revenues of the Authority as we have discussed them including such estimates as we might bring into that situation did not equal or exceed 1.3

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times the maximum future year's debt service, at that point the Authority could not issue a consolidated bond.

Now, that does not mean, however—your Honor, this does get slightly out of 1.3, but I think you are talking about whether 1.3 is protective of the securities. That does not mean, however, that the security of the bondholders is protected because you have brought this deficit operation into the family of facilities.

Being a member of the family it must be nourished. And the general reserve fund and the consolidated bond reserve fund would then nourish that new member of the family, because they are required to.

If the deficit was as large as you postulated it to be the general reserve fund and the consolidated bond reserve fund would be—

Q. Last about six months? A. It would last a very short time.

Now, that's not only to speak of the deficits [561] because if we did undertake that kind of operation we have an obligation under the miscellaneous covenants in Section 12 to complete that facility.

The Court: Mr. Goldberg, I think, said that perhaps, if you get the disease in your system you may die.

The Witness: Judge Gelman, I'm really sorry in a way that that remark is on the record, because I've devoted considerable part of my professional career to trying to help in bringing into the Port Authority, in a method which would be satisfying to both the bondholders and to the public need for transportation, mass transportation. And I certainly do not consider it to be a disease at all. T 559-2 to 561-16

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[562] By Mr. Sovern:

Q. To come back to your sequence of events then, this massive deficit is in the general reserve fund family of facilities. It prevents the Port Authority from issuing any further consolidated bonds, because the 1.3 test cannot be met. The consolidated bond reserve, the general reserve fund are then totally absorbed by the deficits. Then what happens? A. Well, then we can't pay the bondholders. And the first bondholders whom we cannot pay—in that situation which is again, we are addressing only the 1.3 test protection, we are not addressing the protections of the 1962 covenant, and so on. And I make that statement very clearly, your Honor, because of the next statement that I am going to say, which is that I am not saying this protection does not—is not currently protected in other ways.

The protection may very well exist in other ways, but under this hypothesis which is presently theoretical, sixteen major banks in the New York Metropolitan area would have no source of payment for over 200 million in bank loans. T 562-2 to 562-25

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[563] Q. All right. I don't want to get us into that by-way, but what I do want to conclude on this line of inquiry is I take it that if there were propositions put before the Commissioners by anyone, and anybody who was disposed to take it seriously, you would, and I don't now propose to stipulate the form in which you would give it or **[564]** what else you would say, you would advise your superiors that they might have before them this probable series of events, as a consequence of the proposed action. Is that correct? A. If we were going to take the actions precisely along the lines that we have hypothesized, and with the

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particular deficits that we have hypothesized, and so forth, I would so advise. T 563-20 to 564-8

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[567] Q. May I ask, you described the 1.3 test as mathematical and precise when dealing with both the calculation of the maximum debt service and the historical revenues. Then you went into a discussion of the possible inclusion of estimates of up to 25 percent more of additional revenues from the facilities that were not operational at the time of the issue. How were those estimates made? Are they made with great care? A. Mr. Sovern, I do not make those estimates. I believe them to be made with care.

The Court: It is the professional staff of the Authority which makes the estimates.

The Witness: Yes, that is right, your Honor.

Q. And outside consultants are consulted as well? A. To make those estimates?

Q. Yes. A. I would say that would not usually be the case.

Q. But it is the professional staff of the **[568]** Authority that does that estimating? A. That is correct. T 567-4 to 568-2.

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[By Mr. Landis] Q. In response to Mr. Sovern's question about the 1.3 test you indicated the need to nourish a facility in the consolidated bond family. Would you be specific about the source of that requirement and describe it in more detail?

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[569] The Witness: We are not talking about flow from the general reserve fund or anything of that sort, but just on Page 67 of the official state-

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ment that we are talking about, there is a Section 12 called "Miscellaneous Covenants." I was referring to Paragraphs [c], [d] and [e] which reads as follows. The introduction I should say to all of these is:

"The Authority covenants and agrees with the holders of Consolidated Bonds, and with each such holder, as follows." And then skipping [a], talking about performing all duties required by the Constitutions and so forth and others, to [c]. [c] reads:

"To proceed promptly and in an economical [570] and efficient manner with the effectuation, establishment, acquisition, construction, rehabilitation or improvement of all facilities, the effectuation, establishment, acquisition, construction, rehabilitation or improvement whereof is financed with Consolidated Bonds."

Mr. Landis: Or if you could not finance it with Consolidated Bonds.

The Witness: That is what I was addressing, if you could not do that you would have to look—it is a covenant, to proceed. So you would look to see whether you had any other source of funds.

Once having financed a portion of the facility with Consolidated Bonds, and covenanting to proceed promptly with the effectuation of the facility which is financed with Consolidated Bonds, we would look to another source, or could continue.

But I am also referring to Subsection [d] which says:

"To maintain in good condition all facilities the surplus revenues of which are payable into the General Reserve Fund, and to operate them in an

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efficient and economical [571] manner, making all such renewals and replacements and acquiring and using all such equipment as the Authority shall determine to be necessary or desirable for the proper and economical maintenance and operation thereof.”

And [e]:

“To make such improvements as part of or in connection with facilities the surplus revenues of which are payable into the General Reserve Fund as the Authority shall determine to be necessary or desirable as incidental to or in connection with the operation of said facilities.”

I perhaps should not have used so imprecise a word as nourish, but I think that perhaps is descriptive when considered along with another term which I used, namely, bring the facility into the family. T 569-11 to 571-18.

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[573] The Court: I would like you to describe the flow of funds under the consolidated bond resolution prior to the enactment of the covenant.

The Witness: When your Honor speaks of covenant—

The Court: Or as it would occur without the covenant—as it would occur today without the covenant.

The Witness: When your Honor speaks of covenant, I take it you are speaking of section 6 of the 1962 legislation.

The Court: That is right, exactly. And let's take it as of today, assuming that there is no covenant that is in effect.

The Witness: The flow of funds with respect to the consolidated bond resolution is the same as the

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flow of funds which I have described with respect to the general and refunding, Air Terminal and Marine Terminal Bonds, with the—

The Court: Let's see if I understand it. You collect all of the revenues from all of the facilities of the Authority. Is that right?

The Witness: Yes.

[574] Mr. Sovern: If I may, your Honor, for which consolidated bonds have been issued. Is that not correct?

The Witness: The flow is the same. Mr. Sovern is correct with respect to the facilities, and as your Honor well knows, the Air Terminal Bonds, or the Revenues were flowing from the particular facilities and the others from those facilities, and so on.

The Court: But not any more.

The Witness: Now, when I said the same, I meant all of those facilities and any facilities constructed since then, because having placed to one side the prior lien bonds then all the facilities are within the consolidated bonds family.

The Court: I am looking at the Pledge of Revenues under section 4.

The Witness: Right.

The Court: You have pledged the revenues from each of the following, and you list all the facilities. Are there any facilities owned and operated by the Port Authority other than those described in subparagraph i?

Mr. Laulicht: Either under i or under ii?

[575] The Court: I understand.

Mr. Laulicht: Because PATH and World Trade Center would come under ii.

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The Witness: It isn't only PATH and World Trade Center, it is also the new passenger ship terminal.

The Court: So it is all facilities presently owned and operated by the Authority.

The Witness: It is all facilities, your Honor.

The Court: You take the net revenues from those facilities.

The Witness: That is correct.

The Court: Now, PATH is presently operating at a deficit, is that right?

The Witness: Yes.

The Court: And I assume that the World Trade Center is operating at a deficit, is that right?

The Witness: I am not sure that that is the case, your Honor. I don't believe that the World Trade Center is operating at a deficit.

Mr. Landis: Your Honor, I believe that is in the stipulation, and I believe for the year 1973 as stipulated, the stipulation is [576] that there were net operating revenues from the World Trade Center.

The Court: That there were, okay. Then forget about the World Trade Center.

Now, when you start moving the funds around, do you shift funds over to PATH first before you calculate your net revenues?

The Witness: Your Honor, we are at another one of those questions to which I have not been asked—

The Court: Just express an opinion as to how it is supposed to be done.

The Witness: These net revenues as far as these particular facilities are concerned, whether you treat them as being satisfied before net revenues or after net revenues, the year end results for the Port

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Authority, that is to say, what its results from operations are, what the status of its reserve funds are, and so forth, are exactly the same whether you have in fact satisfied the deficit, say, move the money before or whether you move the money afterwards, the result is precisely the same result.

The Court: All right. Then the net revenues are applied to debt service on the [577] consolidated bonds.

The Witness: Yes. Your Honor is putting it in the framework of what it is we do today, is that right?

The Court: What do you do today?

The Witness: We do that, and let's say that today just for the sake of setting the framework is December 31 of any given year, because that is a day on which we can best describe this, within that time.

The Court: All right. You pay the debt service on the consolidated bonds.

The Witness: The debt service on the consolidated bonds would be paid.

The Court: Now, what do you do with what is left over? T 573-1 to 577-16.

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[578] The Witness: It goes to the general reserve fund within that context.

The Court: Up to the 10 percent figure, is that right?

The Witness: That is correct. Actually, if in a particular year the reserve fund were full then nothing goes to it.

The Court: Sure. Then it goes into the consolidated bond special reserve fund or—

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The Witness: Called the consolidated bond reserve fund.

The Court: Now, as I understand it, there is no limit on the consolidated bond reserve fund. In other words, it does not have to be maintained at any specified level. It is whatever is left. Is that right?

The Witness: That is correct, your Honor.

The Court: Now what are the charges on the consolidated bond reserve fund? That is, what is it pledged to?

The Witness: Your Honor, the consolidated bond reserve fund is treated at Section 7 of the consolidated bond resolution appearing on Page 64 of the official statement with respect to the [579] 41st series of consolidated bonds. I think your Honor referred to that as Exhibit II.

The Court: That is Exhibit II annexed to the the stipulation.

The Witness: Yes.

The Court: Now, would you explain that and particularly what may be paid out of the consolidated bonds reserve fund?

The Witness: Yes, your Honor. The section begins by describing the funds and the payments into the fund; that is what we have already discussed.

The Court: That is right.

The Witness: And then the purposes to which the fund may be applied are listed. The first is the payment of consolidated bonds at maturity under certain conditions. So I take it that your Honor wants a brief description, and that has to do with the payment of bonds.

The Court: That is right.

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The Witness: (b) has to do with the payment of debt service on consolidated bonds.

(c) has to do with the purchase for retirement of consolidated bonds.

(d) has to do with the redemption of [580] consolidated bonds. I will read (e) if you would like.

The Court: No, it is not necessary. Here is where you can pay expenses.

The Witness: I just meant that this was more than those rather than formal and obvious ones.

The Court: That is right. Here you can pay expenses for the operation of any facility where the net revenues of the facility so long as they were pledged as security for consolidated bonds, to the extent that the gross operating revenues of that facility are insufficient.

The Witness: Yes, your Honor.

The Court: Here is where deficit operation would be subsidized by consolidated bonds.

The Witness: Consolidated bond reserve funds.

The Court: By consolidated bond reserve funds.

The Witness: That is right.

The Court: So accountingwise when we are talking about whether you go up and then come [581] back down to the deficit operation; actually, the way it is literally applied, even though the result may be the same, you are supposed to take the net revenue from each facility and flow it through into the reserve fund and then pass it back to the deficit facility. Is that correct?

The Witness: Your Honor, I am not sure that that is correct.

The Court: All right. Now, [f] is what, the payment of debt service on bonds other than consoli-

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dated bonds? We are on [f] now on Page 65.

The Witness: Yes. [f] says: For the payment of debt service on bonds other than consolidated bonds which are described in the last paragraph of this Section 7. And that one states that the pledge made is subject to the rights of the Authority to issue bonds other than consolidated bonds secured by a pledge of or lien or charge upon the consolidated bond reserve fund prior to equal to the pledge, lien and charge in favor of consolidated bonds, only if those bonds are issued to fulfill obligations undertaken for the benefit of the holders of consolidated bonds and if they are also secured by a pledge of the general reserve fund.

[582] The Court: All right. Now, supposing the Authority issues a different class of bonds other than consolidated bonds, you say mass transit bonds, and you incurred this deficit, could the Authority use monies in the consolidated bond reserve fund to pay that deficit?

The Witness: Your Honor, without the protection of any other covenant, statutory or under the bond indenture, but just looking at this section, we are not even going to other parts of this resolution, but just under this particular section and not going to any other statutory material at all, this particular section might permit that kind of a bond, that is again an issue that I would want to sit down and consider carefully which we have not had, but I think that we have not had such a bond, but I think that under this particular section, you could so construct such a bond.

The Court: Which paragraph, F or G?

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The Witness: Well, more certainly under—more certainly under G than F, but under F probably with respect to, say, you were talking—you were talking about a railroad, [583] if I understand you correctly.

Under F, probably with respect to PATH, which is a general reserve fund facility.

The Court: Well, PATH bonds are consolidated bonds, aren't they?

The Witness: Your Honor, I believe asked me whether we could issue an additional type of bond.

The Court: I see what you mean, it would be for the benefit of the holders of consolidated bonds?

The Witness: Yes, sir.

The Court: Now, going back to section four, maybe this obviates the question, but the question I was going to ask was assuming that the Authority never issued a bond for the purpose of engaging in a mass transit operation, but acquired the facilities by way of gift or otherwise, would the Authority be able to use the net revenues annually or funds in the consolidated bond reserve fund to pay deficits in that facility.

The Witness: That is a question which we have addressed, thought about some, and if I understand that correctly, I have to know whether [584] you want me to answer only within the perimeters of section 7 of the consolidated—if I may, your Honor, we are about to embark on some wholesale confusion with section numbers—I am speaking now—

The Court: Let's take section 4, first.

Mr. Sovern: I wonder if the witness could first state his conclusions and then give us the answer.

The Court: Why don't you give us an answer to the question.

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The Witness: I will, your Honor.

The Court: Yes, no or maybe.

The Witness: If we were talking about the section 7 of the consolidated bond resolution adopted in 1952, subparagraph G provides that.

The Court: Can you answer the question yes or no, first, and then explain why.

The Witness: In my opinion, deficits could, if confined just to the section, be satisfied out of the consolidated bond reserve fund. T 578-1 to 584-22.

* * *

[593] The Court: All right.

Now, if you look at page 22 of Mr. Goldberg's remarks.

The Witness: Yes, sir.

The Court: Beginning with the first full paragraph on that page, the second sentence of that paragraph, he says, "All the revenues were pledged to particular families of bonds; all of them had to be used either to pay —", and so forth.

And the next paragraph he says, "You could not make the claim that reserve fund expenditures would maintain or enhance the security of our bonds if the money was to go outside of the P.A. families, as was proposed in one suggestion that we simply subsidize the private railroads to the extent of their commuter operating deficits."

[594] Now, is his position as it is stated here inconsistent with what you have—with the opinion you have just expressed?

The Witness: No, your Honor.

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The Court: Well, could you explain how you reconcile what you said or what you have just testified to and what he says here?

First of all, do I understand you are still talking only about the consolidated bond resolution of 1952?

【595】 The Witness: Your Honor, Mr. Sovern stated before you commenced this line of questioning that the next step that we would undoubtedly be considering is Section 7 of what it is that we call the series resolution.

By that I have reference to the resolution contained in the official statement which we have been considering at Page 72, entitled "Resolution Establishing 41st Series of Consolidated Bond Resolution, Due 2008, Section 7."

The Court: Section 7 certification?

The Witness: That is correct, Section 7 appears on Page 76 of that statement.

The Court: But if you follow Mr. Goldberg's remarks on Page 22, he is talking about the situation as it was prior to the adoption of the Section 7 certification in which he says commenced with the 12th series of consolidated bonds.

The Witness: Mr. Goldberg goes on, your Honor, immediately thereafter to speak of a fear in the financial community and I think that Mr. Goldberg is speaking, as well, with the benefit of Section 7 of the consolidated 【596】 bond series resolution in mind.

The Court: Well, that is not the way I read his report.

Mr. Sovern: I think I can clarify it. Mr. Goldberg is referring to the decision, 1958, of the Sec-

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tion 7 certification. That is to be found in Paragraph 2 of Page 76.

I assume that I would ask the witness to correct me if I am wrong, that the first paragraph of Section 7 has been there for some time. Am I correct?

The Witness: Mr. Sovern, I had been sitting here thinking about how I was going to ask you if you had a copy of the consolidated bond official statement with regard to the 11th series of bonds. May I see that, if you have it?

Mr. Sovern: I am afraid I do not, that is why I was stating an assumption rather than a fact.

The key point, your Honor, is that there are two protections in Section 7 that we are talking about, in the series resolution.

The Court: All right.

So, now, let's move from the '52 [597] resolution to the series resolutions.

The Witness: The ones which I previously identified, and also this resolution, Section 7, that I have spoken about in the series resolutions, is, as I understand it, consistent in issues of Port Authority obligations, consolidated bonds and notes, from the 12th series on so that that is what we are talking about.

The Court: What about the first paragraph of Section 7?

The Witness: I had wanted to take a look at it. I am not certain whether it is or is not in that as well, but it certainly is consistent, the 12th series, and if we take this in terms of your Honor's statement this morning with reference to where we are today, it certainly is here today and has been through the period which you are addressing yourselves, namely, 1960, '62 and on.

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The Court: Section 7 has not changed, then, from the 12th series on?

The Witness: That is my understanding.

The Court: Now, does this provide for any limitation the use of consolidated bond reserve funds to pay the operating deficits [598] of a facility acquired without the issuance of consolidated bonds?

The Witness: This does not permit such application.

The Court: What language specifically contains the prohibition?

The Witness: Section 7 states the Authority shall not apply any moneys in the consolidated bond reserve fund or in any special reserve fund established for the benefit of bonds of any prior issue except for the payment of bonds secured by a pledge of the general reserve fund in whole or in part.

The payment of debt service upon bonds so secured, then without reading the whole of it, your Honor, it goes on to speak only of undertakings with respect to bonds secured by a pledge of the general reserve fund, in whole or in part.

If I may, your Honor, could I heard your question, because I assume that you are going to ask a series of questions based upon it. May I hear your question that you raised?

The Court: Yes.

[The reporter read back as requested.]

[599] The Witness: Your Honor, there is here with regard to Subdivision [g] an area which we have not specifically addressed at the Port Authority which would raise a question in this regard, namely, could you apply moneys under Subdivision [g] from the consolidated bond reserve fund for bonds which

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are general reserve fund bonds, but not consolidated bonds, and that would not appear to be proscribed.

If I take your Honor's question to include when you say without the issuance of consolidated bonds to mean without the issuance of bonds backed by the general reserve fund, the answer would, I think, be completely accurate in regard to my understanding, but it is perhaps in the present context, a distinction without a difference.

By Mr. Sovern:

Q. I take it the key point in Section 7 of the [Series] Resolution, plunges the gap you identified in Section 7 [g] of the consolidated bond resolution? A. Well, Section 7 in its totality—

The Court: Not just the first paragraph? I thought you derived that from the [600] first paragraph, that is why I said—

The Witness: If the gap be defined as whether you could issue bonds extraneously or just—

Q. As I understand the gap, what we have been talking about is the white elephant hypothesis—that is to say, a gift of a facility, deficit-generating mass rail transit is made to the Port Authority and the question is may the consolidated bond reserve fund be used to pay the operating deficits of that enterprise and the question I need to put is to the extent that 7[g] permits that, does not Section 7 of the series resolution preclude it? A. In order to bring a facility, without characterizing it, into the family of facilities, one would have to issue an obligation secured by the general reserve fund.

Mr. Sovern: Thank you.

[601] The Court: Now that much is contained in the first paragraph of Section 7.

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The Witness: I believe that is so, your Honor.

The Court: Now we will get to the second paragraph of Section 7 which we have been referring to here as the Section 7 certification.

The Witness: Would you like me to describe that at this time?

The Court: Yes. What is the certification which the Authority must issue before it can authorize the issuance of further consolidated bonds?

The Witness: Your Honor, Section 7 certification contained in Paragraph 2 is a certification which must be made by the Authority prior to the issuance of Consolidated Bonds or at the time of the issuance of Consolidated Bonds for the application of the funds.

That certification consists of the opinion of the Authority that the issuance of the bonds or the pledge of the General Reserve Fund as security for bonds other than [602] consolidated bonds will not, during the ensuing ten years or during the longest term of any of such bonds proposed to be issued [whether or not consolidated bonds], whichever shall be longer, in the light of its estimated expenditures in connection with such additional facility or such group of additional facilities, materially impair the sound credit standing of the Authority or the investment status of consolidated bonds or the ability of the Authority to fulfill its commitments, whether statutory or contractual or reasonably incidental thereto, including its undertakings to the holders of consolidated bonds.

Those are substantially the words behind it. But the meaning behind it, and what happens with respect to an additional facility is that that facility

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coming into the group of facilities with the first issuance of bonds, for example, a new passenger ship terminal or whatever you might consider, is analyzed and judgment made, assuming we are to go ahead with it, that issuing bonds for that facility and bringing them within the family will not impair the credit of the entire enterprise.

【603】 That I think is the most important concept of this judgment which is made as to whether or not the facility should be taken into this group.

The Court: Well, that is not the only certification that is required.

The Witness: Your Honor has reference to—

The Court: Impairing the sound credit standing of the Authority or the investment status of the Consolidated Bonds—is that right?

The Witness: That is right.

The Court: —or the ability of the Authority to fulfill its commitments. Now I can appreciate—

The Witness: When I said impair the standing, perhaps I abbreviated too much. I meant to read the word hereafter to refer to them.

The Court: But do I understand correctly that before the bonds can be issued under such a resolution the certification must be made that all three conditions that are set forth in this sentence must be met?

The Witness: Oh, yes. There would, if 【604】 the commissioners decided to go ahead with a new facility in this way, be a resolution adopted which would so provide.

The Court: Now forgetting for the moment what the words impair the sound credit standing of the

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Authority may mean; what do the words investment status of consolidated bonds have reference to?

Is that to the Moody's or Standard and Poor's rating? Is it to the question as to whether they are legal for investment purposes for trusts and so forth?

The Witness: Your Honor, I have given some considerable thought to the meaning of this over the years, and also since Monday afternoon when I was asked to come down here.

What your Honor has asked is a very difficult question, because this particular section is quite different from some of the other sections which we have discussed, say the 1.3 test and so forth, where there are mathematical computations to be made.

In my opinion this section permits of a range of possible answers to your question. And the range of possible answers to the question [605] of what the investment status means, and many of those other phrases in the section would range from the commissioners' or a commissioner's judgment—because I assume that each one would think about this thing individually and get the benefit of the group's understanding as well—would range from a commissioner's judgment that he thinks that there will be over the years sufficient amount available from all of the sources that we have discussed to pay principal and interest when due on the bonds, all the way through the other protections which we have. For example—

The Court: Are you going behind the words investment status?

The Witness: No, your Honor.

The Court: You are just confining it to investment status?

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The Witness: Yes.

The Court: Does investment status have reference in your opinion to a Moody's rating or a Standard and Poor's rating?

The Witness: Your Honor, I did not draft this resolution. Investment status means what it is which affects the bonds as far as our [606] ability to issue the bonds is concerned and its market relationships to the bonds and so forth.

It takes in the whole area of an investor's willingness to buy our bonds. It takes in the whole area of what happens to those bonds in the hands of the investors.

And that is why I say that judging from all of the things that I have read and listened to, different individuals have different ideas about that which are not encompassed solely within Moody's rating.

Some people indicate—when I look at this I have to look at it from the standpoint of an analyst looking at what other components are making up the investment status of Port Authority bonds. What is it that makes them what they are?

The Court: I take it what you are saying is that there are no objective criteria or no single criterion.

The Witness: No single criterion. If you would like the benefit of my thinking on it, what the criteria are, not generally, but just Port Authority bonds, they would range from, as I say, just the payment of principal and [607] interest through the kinds of things that we were discussing this morning, namely, would the issuance of such a bond impair the ability of the Authority—

The Court: To fulfill its commitments?

The Witness: Right.

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The Court: All right. Now, as to that phrase—

Mr. Sovern: Which phrase, your Honor?

The Court: The ability of the Authority to fulfill its commitments. If the Authority were contemplating the issuance of consolidated bonds for the acquisition of or the construction of a mass transit facility, and the projections made by the Authority showed let's say an operating deficit of \$100 million a year for the next ten years; in your opinion could a commissioner or could the commissioners issue a certification satisfying the requirements of Section 7? And here we are today, and assuming the Authority's financial statement as it presently exists.

The Witness: Your Honor, that would require an answer which I would need and would ask in that situation if that was presented to [608] me, that here we want to take on this particular deficit; I think the commissioners would also be interested in projections of revenues from other facilities.

The Court: Of course.

The Witness: And so we would be speaking not only of today's statement but rather our analysis of where we would be over the next ten-year period.

The Court: Right.

The Witness: So, for example, if a commissioner were to state or in thinking it through himself, or whoever was judging this thing also to feel that revenues were to be substantially increased over the next ten years; the answer to that question might be under Section 7 that it would be suitable.

For example, and again we are talking about—

[609] The Court: He couldn't just sit there and turn his head upwardly and say, "Yes, I think we're

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going to have enough money.” He’d have to base it on some objective projections that were made by somebody.

The Witness: Your Honor, that’s exactly what happens.

The Court: What?

The Witness: There are projections made.

The Court: Right.

The Witness: For example—

The Court: Hasn’t it been the practice heretofore in connection with the issuance of consolidated bonds since this Section 7 certification requirement has existed that the Commissioners have presented to them by the staff of the Authority who are responsible for making those projections a set of projections which shows what the anticipated revenues will be over a ten-year period, at least ten-year period, and what the debt service requirements will be, etcetera, so that they can make this certification?

【610】 The Witness: Your Honor, just such a certification was made in connection, for example, with the undertaking of the Hudson Tubes, and in that situation the Commissioners anticipated that there would be a deficit of between 5 and 6 million dollars, which they could accommodate within the family.

They also anticipated that there would be, in their judgment, not looking up to the sky, but looking at analysis, that all of the future deficits of the 5 to 6 million dollar amount would be accommodated through fare increases and made their certification on that basis.

The Court: Well, you see now that sounds slightly partisan, if you don’t mind my saying so, because that’s not the question which I asked. All I

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asked was that heretofore with respect to any issue, whether it was PATH, whether it was World Trade Center or any particular issue, the Commissioners sit with projections in front of them before they made such a certification.

The Witness: Your Honor, if that was [611] a partisan statement I beg your pardon. It was intended as an example, and I had another example in mind.

The Court: No, I don't want examples. All I want is to know what the practice has been? Has that been the practice or hasn't it been?

The Witness: The practice has been as I described it.

The Court: They do have the projections?

The Witness: The Director of Finance will make certain projections and assumptions which he will present to the Commission.

The Court: So the accuracy of those projections, and here the certification, will depend, presumably, upon how good the people are who made the projections and the assumptions which they used. Right?

The Witness: I don't think it depends entirely on the people who have made the projections, your Honor.

The Court: Well, I only meant that in the sense that—

The Witness: It has to do with what [612] then happens over things which such people may or may not have control over. For example—well, I'm sorry.

The Court: But presumably there is as objective a set of facts, projections in front of the Commissioners as you can get. Is that a fair statement?

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The Witness: Your Honor, it's going to be difficult for me to discuss this without any examples whatsoever.

Let me take bridges and tunnels as an example, if I may.

The Court: All right. Why don't you take the second deck of the George Washington Bridge.

The Witness: All right. Well, with respect to the second deck of the George Washington Bridge or with respect, say, to a resurfacing of the bridge, which we now are thinking about, we may have a need. This is also hypothetical. Okay? We may also have a need to have additional revenues in order to support that resurfacing of the bridge.

In that situation you might project that an increase in bridge and toll revenues, [613] bridge tolls would be adopted by the Commissioners and approved by the Governors and accepted without challenge by the Department of Transportation, which has the ability to determine the just and reasonable tolls over the bridge, or you might have something more definite involved.

In such a situation as this, a Governor may have given an assurance that he would not veto such an action, or the Department of Transportation may have analyzed it.

The Court: Let's not get involved with those matters, please. And I would prefer staying with something which actually happened. They did put a second deck on the George Washington Bridge.

The Witness: Right.

The Court: That was done. That was financed through the issuance of consolidated bonds, wasn't it?

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The Witness: Right.

The Court: Now, before the Authority issued the certification required for the bonds, I assume that the staff prepared [614] projections showing what the additional income would be as the result of the installation of the second deck on the bridge?

The Witness: Well, your Honor, I'm sure there were projections, but there were not projections under this section.

The Court: Well, don't they have to have them, that's all?

The Witness: No, your Honor.

The Court: Well, what was the past practice of the Authority?

The Witness: The only past practice to which I may refer, your Honor, are things to which I have alluded such as the PATH certification and passenger ship terminal because the second deck of the George Washington Bridge is a matter with respect to an existing facility. And this certification need be made only the first time bonds are issued for a facility, not each time bonds are issued. This is as distinguished from the 1.3 test which must be satisfied each time consolidated bonds must be issued.

[615] The Court: All right. I've got it. I've got your point. But with new facilities, then, that were issued and which were constructed and financed through consolidated bonds, wasn't it the practice of the Authority to waive the objections made to determine whether or not the issuance of the bonds would impair the ability of the Authority to fulfill its commitment to the holders of consolidated bonds?

The Witness: Your Honor, those projections were made. However, in the— and I don't mean that they

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were not made carefully. I assume they were made carefully. But in the actual practice of making such certifications under Section 7 there was at the time those certifications were made, not describing it, your Honor, but with respect to PATH or other of the facilities which were certified, some heliports and other kinds of things, and there have not been a great number of these because you will recognize that many of the facilities were in place before that. There was reasonably wide latitude when considered as part of the [616] revenue flow of the entire Port Authority. So that a Commissioner focusing on this might be wrong within a very wide latitude of millions of dollars as far as an exact projection is concerned and still be perfectly right with regard to this provision because the provision might not cut in at all points along the way.

If you say that as part of the investment status of Port Authority, you will consider something that we have not yet talked about, for example, the policy of the Port—

[617] The Court: I just want to dwell on this one phrase for the time being and see if I can understand what is required of the Commissioners in order to make the certification, and as I understand it, and maybe I don't understand it, they do have projections, don't you agree?

The Witness: Yes, your Honor.

The Court: And do those projections show that within the ten-year period by reason of the operating deficits that would be incurred by this new facility, the Port Authority would have depleted its consolidated bond reserve, it would have depleted the general reserve fund, it would no longer be able to

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meet the debt service requirements on the consolidated bonds.

You mean to tell me that the Commissioners could then affix their signatures to a certification saying that the Authority's ability to meet its commitments is not impaired?

The Witness: Your Honor, under those conditions, if my advice were asked, I would say they should not so certify.

The Court: They could not, could they? [618] If they had a set of figures in front of them, showing all of those circumstances, what happens?

The Witness: Your Honor, I would not think that they would so certify. I can't speak for what they would or would not do.

The Court: I am only asking for your opinion.

The Witness: In my opinion, they should not so certify under that hypothesis. T 593-8 to 618-11.

* * *

[621] By Mr. Landis:

Q. One question, your Honor, does the Section 7 certification have to be made in connection with improvements and additions to a consolidated bond facility?

The Court: You mean existing facility?

Mr. Landis: Right.

A. Well, the answer to that is no. At Newark Airport, the redevelopment program, for example, your Honor, as you will recall, that there was at one time the possibility of building an additional airport in New Jersey which was not constructed and yet the additional capacity was needed. The State had made a determination it did not want that

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capacity in that particular location and the airport at Newark was rather modest in size, as major airports go. Today, it is one of the most modern and efficient airports in the nation.

I believe that the expenditure of 400 million dollars with more to come has been made at Newark Airport since the time—that the redevelopment was initiated and that was made without certification under Section 7. T 620-3 to 620-25.

* * *

[622] Q. If a subway rail system were constructed within the geographic boundaries of Newark Airport or if it suits, perhaps, if the same answer would be the same, the geographic boundaries of Newark Airport and the adjacent Port Elizabeth, Port Newark facilities, all of which are owned by the Port Authority or leased by the Port Authority under their control, and that railroad would cost 50 million dollars to construct and would lose 50 million dollars a year in net operating loss above revenues, would a Section 7 certification be necessary for the Port Authority to embark on a sale of bonds to pay for the 50 million dollar cost?

The Court: Are you saying would that constitute an addition to an existing facility or would that be an additional facility?

Mr. Landis: That's right.

The Court: Do you have an opinion as to that?

Mr. Sovern: It might be helpful to give the witness a copy of bond counsel's opinion, that a statute could not define a railroad to be an airport.

[623] Mr. Landis: I believe that it was a different set of facts.

Mr. Sovern: All right.

Excerpts from Testimony of Michael Zarin

Mr. Landis: I have no objection to getting into that, but I would prefer Mr. Sovern do it.

The Court: If you can answer that question, do you have an opinion?

The Witness: That is a difficult question because it is a question which has not only to do with the Commissioner or the Port Authority's judgment, there has been a legislative judgment that certain railroad facilities are in fact part of an airport, so that I am not so sure that counsel's opinion, Mr. Sovern, goes so much to the issue of Section 7, it goes to the issue of the 1962 covenant.

The Legislatures have, in effect, made the determination that at least certain railroad facilities by redefining the term airports, have made certain railroad facilities part of Newark Airport or part of Kennedy Airport, as I understand it.

That poses for the Commissioners and the [624] Authority a very difficult problem, mainly is this airport part of the facility or isn't it? The easy answer to the question is, it is part of the airport because the Legislatures have so determined it to be part of that airport.

As a matter of fact, when we were trying to build these airports, railroads and so forth within the covenant which we still are—I am sorry, I should not say that—at any rate, there was a theory that was propounded called the “adjunct” theory, which said that if the railroad was part of the airport, why could we not construct that facility and the Commissioner's easy answer, as I say, the definition of the airport now includes a railroad.

Therefore, the airport being an existing facility would not need to be certified in answer to your question.

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I think, myself, the question has a little bit more difficulty than that attached to it because in that event, what else could you add to the airport, but it is a question which we have not faced. In other words, [625] your Honor, if the World Trade Center had been defined to be part of the airport, could we then not have to certify the World Trade Center? I don't know, and that is why the theory is propounded as an adjunct theory, because at least this railroad would be going to and from the airport and some questions involved in that discussion ranged along the lines of if it was a railroad, just to the airport, would that be part of the airport or if you had commuter stops on it, would it not be, and so forth, even before the Legislature made that determination, but once they made the determination, I think your Honor will appreciate the difficulty of counsel advising that it is not part of the airport when the definition says it is, and what that advice would be, I don't know, because actually that problem was resolved in a different context which you will probably get into, namely whether it is part of an airport or an, it is still a railroad, and that I think is the opinion which Mr. Sovern was alluding to, namely that if it is a railroad, whether or not it [626] is part of the facility, there was a covenant protection for it. That is the way the analysis went. T 622-2 to 626-3.

* * *

[630] The Court: If no one has thought of any more questions we will get to the covenant.

In what way does the covenant grant to the consolidated bondholders any greater protection than

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they already had under the terms of the consolidated bond resolution and the Series Resolutions against the assumption by the Authority of a substantial deficit operation in the mass transit field? T 630-1 to 630-9.

* * *

[631] The Witness: I believe that this morning, your Honor, we had commenced some discussion of this subject, and that we had been discussing the permitted purposes set forth in the covenant protection; the covenant providing that the resources, the revenues and so forth **[632]** of the Authority would not be pledged for any other purposes whatsoever other than permitted purposes, and we were discussing the permitted purposes under the mathematical deficit test. Your question—

The Court: As I understand Subsection 6—let's take the two aspects of the Subsection 6[b], the permitted purposes which are involved here. They could acquire, construct, operate a rail mass transit facility, if the Authority first certifies that the facility is self-supporting. Is that right?

The Witness: It could be approached from any particular way, and that is certainly a good way to approach it, the first or second—certainly if it is self-supporting.

The Court: That is right, if it is self-supporting. They include here a definition of what self-supporting means, that at the time of the certification the amount estimated for the ensuing ten years to be the average annual net income—which I guess is synonymous with the net revenues as that term is used in the consolidated bond resolution—derived from or incidental to such facility, equals or exceeds **[633]**

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the amount estimated for such ten years to be the average annual debt service upon the bonds, presumably issued for purposes in connection with the facility. Is that right?

The Witness: That is correct. Essentially that is what we would call a one-times coverage.

The Court: One-times coverage.

The Witness: Right.

The Court: Now in order for the commissioners—I take it the commissioners must make the certification.

The Witness: Your Honor, in this case as distinguished from the previous case, the commissioners must make the certification. But I believe that the certification must also be signed by the governors. In the last sentence at the conclusion of Section 6 it says: Anything herein to the contrary notwithstanding any such certification by the Port Authority hereunder shall not be effective unless and until affirmatively concurred in in writing by the governors of the said two states.

The Court: Right. Now in order for the commissioners to make the certification I [634] assume that they would have to make projections.

The Witness: Subject to—I won't say the same thing to you I said to Mr. Landis. But subject to what I said to Mr. Landis the commissioners must certify it.

The Court: And they would have to have projections available to them of what the average net income would be and what the debt service requirements would be.

The Witness: Yes, your Honor, they would.

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The Court: Isn't that the same thing they would have to have in front of them to make a Section 7 certification that we were talking about before?

The Witness: I think in regard to this section they would have to have something more than under Section 7's certifications for a couple of reasons: one reason being that this certification as distinguished from the Section 7 certification is not certification as to whether the Port Authority may meet that facility within the whole family of facilities.

In other words, there is a great deal more room for a range in that projection under [635] Section 7 than there is under this Section 6. As a commissioner you would need more precision to be able to get the answer to this subject. There are some other differences as well on that point.

The Court: I think I understand what you are saying. But in essence there must be projections made, so that the commissioners can make a determination whether they can certify.

The Witness: Your Honor, there must be projections; the bases of those projections are quite different one from the other.

The Court: I understand that. Now it was suggested I thought in some of the questions which were asked of you in connection with the Section 7 certification that it would be possible under Section 7 for the commissioners to indulge in a lot of latitude, but they were subject to pressures; and I think you were indicating that that would be a factor et cetera in making the certification.

The Witness: Your Honor, I made the statement that I was not able to judge what the commissioners

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would take into consideration. And I am certainly not here to characterize the [636] actions of the commissioners of the Port Authority.

The Court: But presumably I can, if we assume that they are acting in good faith in both instances in making their certification. Is that right?

The Witness: Of course.

The Court: Then one would be really the equivalent of the others.

Let me go about it the other way.

If you want to attribute bad faith to the commissioners they could just as easily make a certification that a facility is self-supporting as they could that the Authority would be able to meet its financial commitments under Section 7.

The Witness: Your Honor, I am prepared to discuss the requirements of Section 6 and the requirements of Section 7. I am not prepared to discuss or characterize the commissioners of the Port Authority.

The Court: No.

The Witness: I could compare those sections and tell you I find certain differences and certain similarities. But as to the [637] commission's motivations I can't—

The Court: I grant you, we are not trying to go into—

The Witness: Furthermore I have some board meetings to attend after I leave this courtroom.

[638] The Court: No, all I am suggesting to you is this: that if one wants to assume that the commissioners would act in bad faith, which is an assumption that I would not make, moreover I'm not asking

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you to make an assumption, other than for the purpose of this question, so if one wants to assume that they would act in bad faith they could make a certification as to whether a facility is self-supporting under this section just as easily as they could under Section 7.

The Witness: Your Honor, I respectfully differ with that statement. I'll be glad to explain why.

The Court: Please explain why.

The Witness: Your Honor, in order to explain this it would be helpful to utilize precise examples, and I don't know whether your Honor wishes to—

The Court: I don't want to get involved really in examples.

The Witness: All right. Then let me just read from the—let me just point out the portions of the statutes involved.

In a situation in which you are dealing with Section 7 under the consolidated bond resolution a commissioner would be permitted, [639] I would think, to rely upon understandings and projections with respect to his judgmental estimates of the future revenues of the Authority and that which he could reasonably assume would take place with regard to that facility and the entire family of Port Authority facilities.

On the other hand, when it comes to making up deficits with respect to the permitted deficits on Page 60 of my book, but I guess it's Section 6 under the definition of permitted deficits, you would not have to consider the amount of deficits as of the time of any certification hereunder for the payment of which one or both of the two states in connection with the proposed other railroad facility as to which the cer-

Excerpts from Testimony of Michael Zarin

tification is made and in connection with the prior other railroad facilities has made adequate, secure and effective provision for the duration of the period for which the Port Authority is liable for such deficits.

Now, that means to me—

The Court: Doesn't that refer to the second half of it? That doesn't relate to a [640] self-supporting facility. That refers to a permitted deficit rail operation coming in under the second half of the permitted purposes.

We are still talking about a certification as to a facility being self-supporting. And they have a very exact definition of what self-supporting means, which you said was a one-to-one test. And on the assumption that this would be, let's say, a new facility, the commission will have to have the projections made.

And, granted, that they would not have the latitude that would be available to them in a Section 7 certification, because now you would only be focusing upon the operations of one specific facility. Nevertheless if you want to attribute bad faith to them they could either enlarge the projections or, let's say, be very liberal in their projections of the income and very restrictive in their projections of the expenses to show that it is self-supporting, couldn't they?

The Witness: Your Honor, I'm not assuming, of course, that anybody would be more than looking at the particular certification. [641] I don't know whether I read the statute precisely in that manner. I see in the statute taking them in progressive steps that your Honor is pointing to this one paragraph with respect to self-supporting as a certification. I would point out, as I have in that regard, that if you

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wanted to make those projections you would in this particular statute have to make them with a much greater degree of care, first, because of the gubernatorial signature, which means that, I take it, that when a governor makes a certification he does not just sign his name also, but that it is there for the purpose that those certifications be subjected to a retest.

I would say to you as a person who has worked in government for a long time that when something is going to a governor it is treated with certain degree of great respect. So you would certainly not want anyone in the Governor's office, let alone the Governor, to be able to come back and say to you one thing or another about the certification.

That is not to say that the certifications under Section 7 would not be conducted with care, also. But if you want to talk about latitude [642] there is not that much latitude in this which there might be under that other one with relation to the assumptions which you make.

[643] The Court: All right.

The Witness: The second thing I would say, and, of course, we are looking at some things through different eyes than we have to look our own in analyzing some of these things, but I would read this statute in a way under which a portion of these two tests, one self-supporting, and one deficits, are really two sides of the coin, namely if you found that there was a deficit, you could take care of that deficit in a particular manner under this statute either as I think we went into this this morning, a little bit out of the estimate of the general reserve fund or if there was an actual deficit.

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The Court: I don't see how you can—maybe you can explain it further to me or maybe I am missing something, but as I read the statute, there are two types of permitted purposes with respect to the passenger rail transit. One is if the Authority certifies that the facility of that is self-supporting as hereinafter defined and the very next paragraph contains a definition [644] of self-supporting.

They were not involved with any question of deficits in that certification because by definition it has to be self-supporting.

Now, the other class of permitted purposes where you do have a deficit operation and just want to try to get over the first half, the first hurdle, and to contrast the kind of certification that you get there with the Section 7 certification.

The Witness: Your Honor, let us take an expenditure, a projected expenditure for operations on this railroad which is, let's say, the wages of the employees on this railroad and let us say that we estimate that the revenues under certain assumptions will be adequate to meet those projected wages and if in fact there is an increase in the fare over a certain period of time.

Now, as I understand what your Honor is asking me to opine, if in fact there was an inadequacy or a shortfall in that so that there were certain deficits, it was not self-supporting, that I might—and yet I am going to make that up in my judgment [645] with a—with a certain adequate, secure and effective provisions from the State, if there were a deficit and I could make it up with adequate safeguards—

The Court: We are not talking about deficits.

Excerpts from Testimony of Michael Zarin

The Witness: Your Honor, I am construing the same Section, we are dealing with the same Section and we are dealing with a statute which is providing for particular protections and I am just trying to understand how it is that a piece of an estimate which is not yet in hand in one part of this Section, namely the self-supporting section, should be treated differently from the protection which you would have to have if you had a dollar's worth of deficit.

In other words, this statute has within it the requirement, if there were a dollar of deficit and we were able to do this, that there be adequate, secure and effective protection or it be within the area of support and I cannot see why, at this moment, why in the self-support section, if we would just consider this generally, why that element of [646] revenues does not also need to be that sure.

The Court: All I am saying to you is that the Legislature that the Authority must certify that the facility is self-supporting. They have furnished us with a definition of self-supporting and in order to make that definition, one has to project the revenues.

The Witness: That's correct.

The Court: And the expenses, the debt service requirement, you fairly well know that that is not a problem.

Now, that is a projection of income and expense and all I am saying is that it is the same kind of projection of income and expense, I grant you, that there may be—you might have to be more exacting in making your projections, if you are acting in good faith.

The Witness: Because it is one facility.

Excerpts from Testimony of Michael Zarin

The Court: Because you are dealing with one facility rather than the whole panoply of facilities that the Port Authority has, still the certification is **【647】** based upon the projections.

The Witness: Without any doubts, it is based upon projections.

The Court: Now, you get to the second kind of permitted use and that is where you do have a deficit operation and perhaps you could explain to me how that operates in terms of how much of a deficit operation is permitted.

The Witness: A deficit operation is permitted under the permitted deficit definition and there it is stated, as I have indicated previously, that that deficit may be made up with adequate, secure and effective provision for the duration of the period for which the Port Authority is liable for such deficits is one way in which the deficits may be made up.

The Court: Now, let us go back to the beginning. At the very outset before you can go into a deficit operation, the general reserve fund must be full. Right?

The Witness: That is correct.

The Court: Okay.

The Witness: Well, I went directly to the permitted deficit definition, and **【648】** in going to the permitted purpose section.

The Court: You have to have your full reserve fund intact.

The Witness: That's right.

The Court: When the deficit of the new operation is combined, plus the PATH that was organized under Section C?

The Witness: That is correct.

Excerpts from Testimony of Michael Zarin

The Court: Cannot exceed the permitted deficits.

The Witness: That is correct.

The Court: Now, to get the permitted deficit, then we drop down to, first of all, the definition of a deficit. Right?

The Witness: That is right.

The Court: Now, what is your definition of a deficit, if you can give it to me without reading the paragraph?

The Witness: Well, the definition of the deficit is essentially the same definition as deficits. It is a definition which runs along the same lines as the definition of self-support which we discussed before.

It is a measure of income and outgo [649] and if the outgo over a ten-year period exceeds the income, you've got a deficit.

The Court: So again that is based on a projection?

The Witness: Again, it is based on an estimate by the Port Authority.

The Court: Now, the permitted deficit, supposing we went after that?

The Witness: That estimate, of course, also is—has a gubernatorial concurrence.

The Court: Yes.

The Witness: Well, now, there are essentially two methods of meeting that deficit.

The Court: A part is if you get the states—some kind of commitment that satisfies you?

The Witness: If there is adequate, secure and effective provisions.

The Court: That they are going to make up the deficit.

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The Witness: Right.

The Court: Now, we come to B.

The Witness: The B portion is essentially where we were this morning, namely [650] a measure of ten percent of the general reserve fund or an equity measure which essentially is measuring the same thing except that it is a testing situation in which the Port Authority has paid off a considerable amount of its obligations so the equity measure plus the ten percent of the general reserve fund would be a great amount of permitted deficits. We can go into that in some detail.

The Court: I do not think it is necessary. T 631-20 to 650-13. * * * So as I understand, if we go back to 1973 and take the Authority's financial statement or annual report for the year ending December 31, 1973, exhibit [III to the Stipulation], applying the B formula, the permitted deficit that would be authorized under B, could you show me how you calculate that?

I see it is ten percent of the general reserve.

The Witness: That's right, your Honor, [651] it is a moving decimal point calculation.

The Court: It does not include the consolidated reserve?

The Witness: That is correct.

The Court: Just the general?

The Witness: Just the general.

The Court: So you had 156 million dollars, approximately in the general reserve fund, right?

The Witness: If that is the amount, I am sure it is. This is the January 1 balance, your Honor. The balance of December 31, is 173 million.

Excerpts from Testimony of Michael Zarin

The Court: Okay. So you have 173 million so you could have a permitted deficit of 17 million under that test.

The Witness: Approximately so, yes.

The Court: Applying the second part of the test, would you have a greater amount?

The Witness: No, your Honor, my understanding, and I am not testifying as an expert as far as the accounting is concerned, but my understanding is that the general reserve fund amounts to ten percent would give you the higher of the two.

[652] The Court: From what I understand, I think somewhere in the stipulation, the [loss] or the deficit from the PATH operation which must be included in the permitted deficit, right, exceeds the 17 million.

The Witness: Both statements are correct.

The Court: So therefore under the application of this formula, the Authority would be absolutely prevented in engaging in any rail transit operation.

The Witness: No, your Honor.

Mr. Sovern: Which is not—

The Witness: Which was not self-supporting.

The Court: Which is not self-supporting. T 650-16 to 652-17.

* * *

The Witness: Your Honor, under the definitions, there are many railroad operations which could be self-supporting.

The Court: I realize.

[653] The Witness: Because we talked about adequate, safe, secure—

The Court: Are you suggesting that in the definition of self-supporting in the statute, the Authority

Excerpts from Testimony of Michael Zarin

could take into account the state commitment?

The Witness: Yes, your Honor.

The Court: That would render them self-supporting?

The Witness: Yes, your Honor. T 652-23 to 653-11.

* * *

【655】 The Witness: Well, we have talked—that was the question, your Honor, that I understood you to be interested in, and the question, as I understood you to have addressed to me in which I considered since Monday night and we discussed most of the aspects of it, we discussed the exactness of this, of some of the mathematical computations of this distinction to Section 7 and we discussed the limit on 7, but we have not discussed at least from the standpoint of drawing the distinction, I think, your Honor probably has this in mind, is that in bringing an additional facility on line in the railroad area, we have under Section 7, the PATH railroad certified under Section 7 of the series resolution.

If we had done that and there had been no covenant protection under the statute, then we'd be in a position today of being able to add to the PATH railroad and take it to Plainfield, say, as we are trying to do on a self-supporting basis 【656】 on the basis of an additional certification.

What this does in Section 6 is to say in paragraph “i” under purposes, that the permitted purposes include the Hudson Tubes as authorized and limited on the effective day of this covenant and the agreement. Then anything additional must be certified, as your Honor has very carefully pointed out when I went originally to the permitted deficit section

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rather than staying with the permitted purposes section for a longer period.

When you look at it that way, you see in some respects that it is really the heart of what it is that we are talking about.

We were able to undertake the PATH system, extend it 200 million or whatever it is on PATH, but we were not permitted to undertake additional operations, and your Honor knows that the deficits under the statute, as far as the Hudson Tubes are what we now call the PATH system is concerned, are not limited by the covenant. We may develop the PATH system and have [657] beyond, for example, the estimates which may have been before the Commissioners at the time of the PATH certification in the case of an additional railroad facility.

However, we might not go immediately on as, for example, we were able to do in the Newark Airport situation and that, in essence, is the covenant protection that we are talking about and I felt that without saying that to you, I would not have answered your question.

[658] The Court: All right. Well, couldn't the Authority then provide or, let's say, button up that loophole simply by amending the consolidated bond resolution or by changing the form of the series resolution?

The Witness: To do what?

The Court: So that a certification under Section 7 would be required whenever you are going to add to an existing facility.

The Witness: Could we increase the protections under Section 7?

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The Court: Right. As I understand you, and unless I just didn't comprehend what you just said, you said that the covenant gives greater protection than existed under the series resolution Section 7 certification because once having acquired PATH without the covenant you would then not have to issue any Section 7 certification to extend the PATH operation. But with the covenant now you must make certification. T 655-2 to 658-22.

* * *

[661] All right, do you have any other reasons for your statement that the covenant [grants] greater protection than what the bondholders had before?

Now, for example, I assume that the covenant does not give the bondholders any protection at all against the Port Authority's assuming other massive deficit facilities **[662]** other [than] rail transit.

The Witness: As far as that's concerned, your Honor, the covenant only applies to railroads. And that really is an example of response, as I've looked at it, that was made to the problem that was presented at that time. We, for example, as we just discussed in connection with the ability to free the consolidated bond reserve fund a little more, we were able to do that. In essence, these covenants, and I've negotiated some of them, are exactly that, a process of negotiation, and even within the covenant itself if it was opened up actually—actually today I don't think it's significantly greater. It would be if—if the original projections were true for example. I don't mean that they weren't, held true. If the original protections had held true with respect to PATH, that is to say that the fares had been increased as we went

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along and we were still at the 5 million or 6 million dollar figure we would now have an ability to put \$12 million per year into those deficits, but I think **[663]** your Honor is quite right that just addresses this particular problem and it doesn't address the problem, for example, that that Goldberg speech did of taking the school system into the Port Authority.

[664] The Court: Or a second World Trade Center, or let's say the hospitals of the City of New York. These are all deficit operations which somebody would like to pass off on to you.

The Witness: That is true, your Honor. This responded only to the one that was in the public eye at the time and not to others. . . . T 661-19 to 664-8.

* * *

[674] [By Mr. Landis] Q. Would it be fair to state that the certification required under the 1962 covenant is a certification of an amount?

The Court: Certification?

Mr. Landis: Of an amount.

The Court: Which one?

Mr. Landis: The certification under the 1962 covenant.

The Court: But there are different kinds, self-supporting—

Mr. Landis: Whether it is self-supporting or deficit, I don't think in the context of the question it matters.

The Court: You say certification of an amount.

Mr. Landis: Yes, I am asking if that is a correct characterization of the certification.

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A. I don't know, Mr. Landis, whether it is the certification of an amount in the sense that the amount itself would have to be spread on the certification. In order to make the certification you would have to [675] have materials, and certainly which would reveal that amount. I have not myself gone through the process of preparing—as Mr. Sovern indicated, I have not prepared such a certification for a facility. So I am certain it hasn't been done as yet under this particular statute.

In order to make the certification, if you were making it or if you were concurring in it, you would of course have to have documents which would show amounts. But whether the certification itself would say that you want to certify that this complies with Section so-and-so, and so forth, and that would be signed, or whether it would spread forth the entire economic analysis, I don't know at this point.

Q. It would be necessary to come to certain conclusions as to amounts, would it not? A. Yes, sir.

Q. Would it be fair to state that the certification required under section 7 would be the certification of an opinion?

Mr. Sovern: I think I will object, your Honor, the covenant is explicit and you examined at considerable length on this subject.

The Court: Yes. He apparently has never had to cross that bridge yet. That is what he is telling you.

[676] Mr. Landis: I am not sure what the answer is, but I am simply trying to get a characterization of what may appear on the record as a rather confusing discussion.

Mr. Sovern: I will withdraw my objection. The text of the resolution says it shall certify its opinion.

The Court: The text of—

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Mr. Sovern: —of the resolution about which Mr. Landis inquired. Section 7. He asked whether the consolidated bond resolution the series resolution, Section 7, called for a certification of an opinion. I objected. I looked at it. I saw it does. I withdrew the objection.

The Witness: You are speaking now of the series resolution itself?

Mr. Landis: Yes, the Section 7 of the series.

The Witness: Mr. Sovern has read it.

Q. Do you subscribe to his answer? A. It says: If the Authority shall certify at the time of issuance its opinion. T 674-5 to 676-23.

* * *

【684】 [By Mr. Sovern] Q. * * * Mr. Zarin, tell me again why you regarded little “i” of permitted purposes as an important limitation? The Port Authority has in fact improved the facilities on the line and I thought you testified that had it been but for little “i”, the PATH could have grown like Newark Airport, you would have added more. A. If I gave you that assumption, I’m just saying to you that little “i” delimited a particular system and took the PATH system as one—for example, let’s assume that we started with your railroad, that you are talking 【685】 about B and that was little “i”. We could have improved that railroad as much as we wanted to.

Q. Stay with PATH, if you would, please. You said little i was very important. Those weren’t your exact words, but that was your message.

Now, what is its importance? A. The importance is under little i, you can improve PATH as a system as far as PATH is concerned.

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In contradistinction—and then taking the covenant protection, let's assume, if I may, and stop me if I am going out of your hypothetical, staying with PATH, you asked me to assume the covenant protections. Let's for a moment assume only section 7 with respect to little i.

Q. I'd really rather not.

The Court: Just stick with PATH, and the question, is really, what does little i mean?

A. Little i means that just as you can build a railroad across the George Washington Bridge without reference to the covenant, you may acquire and improve the PATH system without reference to the covenant.

The Court: But you could not add trackage to PATH, extended to—

The Witness: Your Honor, that is [686] precisely so, that is the nub of the—

Q. When you said little i was the nub of the covenant, what did you mean? A. I really am trying to explain that, and what I meant was the question to which I was really responding was really all through this thing, is what is the difference, what is the added protection of the covenant and little i illustrates the difference between PATH and say, Newark Airport in the examples I have given today.

In the case of Newark Airport, we were able to extend the Airport by agreements and it is in different locations and so on and so forth.

Q. If it were not for little i, you could have done that with PATH? A. If it were not for little i we could have done with PATH, right.

Q. That is what I thought you said, if you could have done that for PATH. A. Not if it were not for little i, I

Excerpts from Testimony of Michael Zarin

beg your pardon. With little i we could do it for PATH. If it were not for the covenant, we could extend PATH as far as—let us put it this way, section 7 would not have to be put into play again with respect to little i as a facility, a railroad facility.

Q. If you want to tell me section i is [687] unimportant, I would take that, but I do not think you could have meant to say that it is the heart of the covenant in that it authorized the greater expenditures on the H&M because if you recall the Judge had just asked you an open-ended question, what else did the covenant do to protect bondholders that the other things didn't and as you did with me and I assume Mr. Landis, pointed out that little i limits the extent to which the H&M can grow. A. Mr. Sovern, I don't believe that I specifically referred in our conversation to little i. I believe that my first reference to that was here on the stand.

Q. You are quite right. A. Thank you.

Q. I withdraw that reference. I was just collapsing a lot of stuff together. A. What I was intending to say, and I have been very careful today, it is starting to get late, and when I said the heart of the matter, there are so many things that I could have characterized that way, and I am sorry I said the heart of the matter. It demonstrates to me the difference of PATH and the Hudson Tubes by putting it into the exceptions and saying it is not subject to the covenant, makes PATH the same kind of thing as other facilities except for one fact, and that is in order to [688] prevent it from being considered the same as those facilities, it says not PATH but—or Hudson Tubes, which is virtually synonymous. It says as authorized and limited on the effective date of this covenant and agreement.

Newark Airport on the other hand, does not say Newark Airport as authorized and limited on the effective date of

Excerpts from Testimony of Michael Zarin

this covenant and agreement, so that settled PATH in one section and then if you wanted to do anything additional, you have to name it and certify it. Once you named it and certified it, if it meets all of those tests, then it too becomes part of the family but if you want to add to it you have to certify more to that.

Now, if that is not the heart of the matter, it has—maybe it is not and it has some importance.

Q. The paragraph at the end of the covenant says in the third sentence, “Each certification by the Port Authority hereunder shall be made at the time of the issuance of its first bonds,” et cetera.

Now, I would suppose that that applies to PATH.

A. No, sir, it says, “In connection with a proposed other railroad facility,” is what I have been trying to point to permitted purposes for.

Any other railroad facility. I assume this has nothing to do with PATH.

【689】 Q. I wasn’t fully—precise. I would assume it would apply to an effort to extend PATH beyond its present boundaries? A. Yes.

【690】 Q. All right. So that paragraph, if you read it that way, would require a fresh certification if PATH was sought to be extended beyond its present boundaries. A. Precisely so.

Q. What does a little “i” do for the bondholders? A. Oh, little “i” doesn’t help the bondholders. Little “i” is what we got.

Q. Okay, fine. I think I— A. We got— we got that. We got that. We got the ability to put all that money into this system. That’s what this whole statute was about. T 684-16 to 690-13.

* * *

Excerpts from Testimony of Michael Zarin

[711] Q. I take it there is no question, is there, Mr. Zarin, the bonds in the 40 and 41st series do not have the covenant in their contract? A. They do not have the covenant in their contract with respect to those obligations, right. I think the official statement—

The Court: That is your answer, that is sufficient.

Q. Now, second, I don't want to go into a long list, but you had not finished your answer— A. Well, your Honor, the official statement is put together in very careful terms with respect to the 40th and 41st series of bonds and states on page 17 in the statutory covenant against dilution of pledged revenues and reserves by additional passenger railroad facilities, remains in effect with respect to affected bonds and remains binding on the Authority, although it does not apply to the bonds of the present offering. T 711-2 to 711-19.

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Excerpts from Testimony of Austin F. Fitzgerald

* * *

【721】 AUSTIN F. FITZGERALD, 53 Central Avenue, Glen Rock, New Jersey, sworn.

Direct Examination By Mr. Landis:

Q. By whom are you employed and in what capacity, Mr. Fitzgerald? A. I'm employed by Weeden & Company, and at the present time I'm vice-president in charge of dollar bond deposits and I am also in charge of the corporate bond trading department, and have the responsibility for our activities in the long government bond area.

Q. What is your educational background? A. I'm a graduate of Saint Peter's College in Jersey City where I received a Bachelor of Arts degree with a pre-med major. I have also taken courses in NYU Graduate School of Business Administration.

Q. How long have you worked in the area of municipal bonds? A. For approximately 20 years.

I came out of service in 1954, joined James H. Olyphant & Company, became a registered representative.

I think I then switched to the firm of **【722】** Meaney and joined Weeden & Company in 1957.

Q. What did you do when you first joined Weeden? A. At that time, I was in the stock area of the firm.

I then moved into the municipal dollar bond trading area. From 1958 to 1962 I worked with another fellow in the department.

At that time I became responsible for running the department, and by 1970 I was responsible to, allowed by the firm to commit up to 30 million during any one trading day.

In August of 1973 I also assumed my additional responsibilities in the corporate and government area.

Excerpts from Testimony of Austin F. Fitzgerald

Q. Were you what is commonly known as a trader during that period of time? A. Yes. At this time I was a trader, which meant I would purchase and sell bonds for the benefit of the firm's account.

Q. At the present time what are your responsibilities? A. All right. At the present time I actively supervise the trading of bonds. Previously I was actively engaged each day in terms of the trading [723] responsibilities. At this time I now have the overall supervision of the dollar bond trading department as well as the corporate trading and our government activities.

In this I will confer with Allen Weeden, to whom I am directly responsible, as the president of the company.

Q. And what is the involvement of Weeden and the scope of that involvement in the municipal bond area? A. In terms of this Weeden is a major dealer, in terms of underwriting of securities, we also are participants in the secondary market and are major market makers in terms of this. Weeden itself has approximately 500 employees.

We have eight offices, which are located in San Francisco, Los Angeles, Chicago, Philadelphia, Boston, New York and London.

Of our business, it's broken approximately into the bond business is approximately 60 percent in the municipal bond area, 40 percent in the corporate and government area. Of our business in the municipal area two-thirds of this is done in the secondary market. We will take a position in a dollar bond area of, as I had said earlier, [724] of approximately as high as 30 million.

We would have transactions in Port of New York Authority bonds one given day, probably in the area of four to six hundred thousand.

Excerpts from Testimony of Austin F. Fitzgerald

We also would do business in the dollar bond area of between approximately two to three million in purchases and sales. Our total business in the firm for the year would come to approximately 25 billion.

【725】 Q. Has Weeden been involved in underwriting Port Bonds? A. Yes, we have. We have been a major in the underwritings of most of the Port issues.

We also have been managers of several of the competitive bidding deals and the ones that we have not been involved in, those where we were lost out in the competitive.

Q. How many different issuers of bonds are you familiar with? A. Approximately one hundred.

Q. That is on a personal basis? A. Yes.

Q. And what kind of clients does your firm deal with? A. We deal primarily with institutions and dealers. Institutions would be composed of such as banks, insurance companies, public and private pension plans, municipalities, trusts, etc.

Q. And are the dealings of Weeden in the Revenue Bonds on a national basis? A. Yes, [they are].

Q. Is that true also of deals specifically with Port of New York Bonds? A. Yes, it would be.

【726】 Q. Who are the major dollar bond dealers in the business today? A. The major ones would be Salomon Brothers, Barr Brothers, Merrill Lynch, Park Ryan, and ourselves.

Q. Specifically with reference to the dollar bonds that we are involved with here in this litigation, the Port Authority Bonds, who are the major dealers in those bonds? A. It would be Barr Brothers and ourselves.

Q. How long has your firm been making a market in dealing in Port Bonds? A. I guess about 25 years.

Excerpts from Testimony of Austin F. Fitzgerald

Q. Do you consider yourself to be familiar with the secondary market of Consolidated Bonds of the Port Authority? A. Yes, I would.

Q. How do you base that judgment, what do you base that judgment on?

The Court: On everything he has just told me.

Mr. Landis: Fine. I would then offer him as an expert dealer.

The Court: Any questions with respect to his qualifications as an expert?

Mr. Sovern: No questions. We accept [727] him as a expert.

Q. You are aware, are you not, Mr. Fitzgerald, of the subject matter of this litigation? A. Yes.

Q. And you have heard of the 1962 covenant? A. Yes, I have.

Q. What is your general understanding of what that means? A. Generally, it was considered as a security for the bondholders and it protected the diversion of the earnings of the Port Authority into deficit mass rail transit.

Q. What effect did the legislation repealing the covenant have on your attitude and your firm's attitude towards Port bonds? A. A very negative effect in terms of that. It greatly restricted the amount of money we were willing to commit to the secondary and primary market. As soon as we became aware of the possibility of the repeal.

I might add, that we were undoubtedly not alone in terms of this feeling. In other words, the feeling of the community was—we could determine that they were less willing to make commitments in terms of this and this had a great effect in the market in terms of the fact that the market was no longer as viable a market [728] as it had been prior to the repeal of the covenant.

Excerpts from Testimony of Austin F. Fitzgerald

Q. Since the repeal, has Weeden continued to make a market in Ports? A. Yes, we have continued to make a market and we will continue to make a market. However, we no longer do it to the degree, nor commit the capital that we would have prior to this, and in addition as to not being willing to commit the same amount of money, we also wish to receive a greater margin of profit in terms of the amount that we commit. In other words, the risk has increased, so therefore the profitability should.

Q. In general, how would you describe the market for the Port bonds since the repeal of the covenant? A. Very thin and very sensitive. T 721-2 to 728-15.

* * *

Q. Do you still deal with any investors? A. Yes.

[729] Q. Would you explain that? A. Yes. While I no longer have the day-to-day responsibility, or while I have the responsibility I no longer conduct the activities myself. There are still people with whom I will talk and discuss things in this manner.

Q. What effect did the repeal have on the attitude of those people? A. They no longer will either buy the bonds outright, nor will they buy them on swaps. This is true of customers such as Banker's Trust, United States Trust, Connecticut General, Fireman's Fund, First National Bank of Chicago, First National Bank of Louisville, and St. Louis Union.

Q. What effect, then, do you see that the repeal has had on the market for Port bonds? A. Basically it has had a very negative effect, and the repeal of the covenant has caused the bonds to decline to a much greater degree than other comparable bonds during this period of time. It also has—

Excerpts from Testimony of Austin F. Fitzgerald

Mr. Sovern: Excuse me. Would you say what period of time, please?

The Witness: The period of time of the repeal.

Mr. Sovern: Down to today?

【730】 The Witness: Excuse me?

Mr. Sovern: Down to today's date? Yesterday's? What is the cutoff period that you are referring to when you say during this period of time?

Mr. Landis: May I object to cross-examination during the midst of his answer.

Mr. Sovern: It is not cross-examination. I was objecting to the question as insufficiently clear, if you would prefer that I do it that way.

Mr. Landis: I think you should object before he starts to answer the question rather than after he starts to answer the question.

The Court: I think Mr. Sovern was asking the witness that just for purposes of continuity. I think it would be proper to specify what period of time you are talking about. You say since the repeal to date?

The Witness: Yes.

The Court: The decline has proven greater in comparable bonds?

The Witness: That is true. Although when you say today, there has been an improvement in the market in the bonds.

The Court: In Port Authority's 【731】 particularly or in all bonds?

The Witness: In all bonds. However, the improvement in the Port Authority bonds has been greater recently than the improvement in some of the other bonds.

Excerpts from Testimony of Austin F. Fitzgerald

The Court: When you say recently, could you indicate approximately when, for Mr. Sovern's purposes, that improvement began? You do not have to give an exact date, but just generally a period of time.

The Witness: I would say approximately in the middle of January, the first week in January.

By Mr. Landis:

Q. Do you have an opinion as to the result— A. Yes, in terms of this: that this has caused this negative effect, and if the repeal in our opinion, if the repeal does not take place, the covenant is still allowed to stand that this will then continue into the future. In other words, if the covenant is not repealed we will see a further decline in terms of the price of the Port of New York Authority bonds. T 728-22 to 731-22.

* * *

【732】 Q. Would you explain what your opinion actually is? A. Basically it is that obviously the covenant was repealed. So unless the covenant is reinstated, we will continue to see the same type of thing that takes place in terms of the price of the bonds.

Q. You mean—A. A decline in relationship comparable to the bonds. T 732-9 to 732-16.

* * *

【734】 *Cross-Examination By Mr. Sovern:*

Q. Mr. Fitzgerald, you testified that there were certain movements in the price of Port Authority bonds from sometime around repeal down to date. Is that correct? A. That is correct.

Excerpts from Testimony of Austin F. Fitzgerald

Q. Relative to other bonds and the Port's themselves.

Would it be accurate to say that some portion of the change in the prices of Port Authority bonds during this period was attributable to a technical situation? A. From the repeal to the present time?

Q. That is right. A. In my opinion that would probably be true.

【735】 Q. A short-term technical situation? A. To answer in terms of short-term is a—

The Court: You want to know what he means by short-term?

The Witness: That would be helpful.

The Court: Is that a term used in the security industry and municipal bond industry, a short-term technical situation?

The Witness: Yes.

Q. Okay. What does it mean? A. Okay. Basically when people refer to short-term, they mean over a period of time which they will anticipate will be two, three days, a week, two weeks, three weeks.

Q. Three weeks? A. But it could—this is what I was going to say in terms of this: When you get into the idea of short-term technical there are times when short-term technical situations can last for a longer period of time, and you could have—short-term, there is no definite period of time when people will pick to say, that's short-term when they do things such as this, you know.

Q. But normally it would be from anywhere from two to three days to three weeks? 【736】 A. Well, it could last for two months.

Q. Could it last for nine months? A. No.

Excerpts from Testimony of Austin F. Fitzgerald

The Court: In the bond market that would be a long-term phenomenon, nine months, if something happened it would be considered long-term?

The Witness: In the trading aspect of it, your Honor. It obviously wouldn't be in terms of an investment approach. T 734-3 to 736-11.

* * *

[737] Q. So the price decline about which you **[738]** were speaking is roughly from May, early May, mid May, late May [1974]? Can you be more precise? A. It's pretty hard to be.

Q. All right. Sometime in May until the first week of February [1975].

Now, during that period, put it this way, did anything occur during that period other than repeal of the covenant that might, in your opinion, have affected the price of Port Authority bonds? A. Nothing as it would be say opposed to you know, the general market area, in other words, the general level of interest rates.

Q. Because a general decline would have affected the prices, repeal would have affected the prices, what else, if anything, can you think of that would have affected the prices? A. Offhand, I—you know, in terms of specifics, I can't really think of anything.

Q. Are you familiar with the basic financial condition of the Port Authority insofar as publicly reported? A. Yes, although I couldn't claim to be an analyst, or anything in that respect.

Q. Are you aware of anything that has **[739]** happened, any reports of its financial condition that came out during the period between May and the present that might have affected the price of Ports? A. In what sense?

Excerpts from Testimony of Austin F. Fitzgerald

Q. Well, do you recall seeing the [reports] of the World Trade Center being in difficulty? A. I may have in terms of that, but in terms of that, people have been aware for some time.

Q. That the World Trade Center is in difficulty? A. No, I wouldn't use the word "difficulty," but in terms of the fact that they are attempting to rent their space. Office building rental space in New York isn't what it used to be.

【740】 Q. Has that market gotten better or worse in the last seven or eight months? A. Gee, there, again, frankly, I couldn't tell you the answer to that. I don't know. T 737-25 to 740-5.

* * *

Q. That [S-1] is a *Wall Street Journal* story, you see that came out during the month of August. Could that have an effect on bondholder enthusiasm in Ports? A. Do you mind if I finish reading it?

Q. No, not at all.

Do you think, Mr. Fitzgerald, that that might have had an effect on bondholder acceptance of Ports? A. I don't believe that it would have in terms of this article.

Q. And that is because you think—well, why do you think that? A. All right. I believe that it was known by 【741】 people at that time that this was approximately the level of the rental of space in the World Trade Center.

Q. Have you seen this story before? A. I don't believe that I have seen this specific one.

Q. Counsel provided us with some documents.

Were they your personal documents or the firm's documents? A. They were the firm's documents, yes.

Q. There may be material in that file that you have not seen? A. That's quite possible.

Excerpts from Testimony of Austin F. Fitzgerald

Q. I want you to show you now an Exhibit marked as S-2 from the *New York Times*—I am sorry, November 10, 1974, and I can now tell your Honor that it was on the front page of that [edition] of the TIMES headed, “Port Authority has fallen on hard times” T 740-13 to 741-21.

* * *

【742】 Q. I would ask the witness to examine, as well, P-89, and the question—and please feel free to take as much time as you need, Mr. Fitzgerald, do you think the *New York Times* story, S-2, in evidence, had an effect on the price of Port Authority bonds? A. May I finish reading it before I answer the question?

Q. Yes.

Now, you have read S-2. Have you had a chance to look at P-89? A. Yes.

Q. The question is do you think the Sunday 【743】 *Times* story of November 10, 1974, may have had an impact on the price of Port Authority bonds? A. In my opinion, it would not have had an impact to that great a degree, this story.

The Court: Keep your voice up.

The Witness: No, I don't believe it would have had an impact to that great a degree. I believe that most people who were owners of bonds would have probably have known in terms of the facts that are contained in this story. * * *

[By Mr. Sovern]: . . . Some Bondholders would not, though. Is that correct?

The Witness: It's possible. T 742-13 to 743-24.

* * *

【744】 Q. As you look at P-89 and you see a price of Port bonds dropping like a shot right after this story appeared in the *Sunday Times*, can you explain that drop by any other event? A. I would, to my mind, the way I would characterize it in terms of this, is that it is a continuation

Excerpts from Testimony of Austin F. Fitzgerald

of what had been going on before. In other words, I could not say that it would be due to the story in the *Times*, as well as it would be due to the earlier decline that took place prior to this story.

Q. So you think that the drop in the chart reflected immediately after November 10 is just a delayed reaction to the repeal? A. I wouldn't—I don't believe that the true answer can come out in that manner in the sense that if you have a negative reaction to news, this will take place, but the length of time that it will take it to take place, no one can really tell that, it will be an ongoing thing.

Q. Did you notice any pattern on selling immediately after the repeal? Was there heavy selling? [745] A. There was a reasonable amount of selling, but once again, to explain this, you are not dealing with an auctionable market. You are dealing with a market where people are bidding and asking for their own account and therefore you would have to, to have had the selling, you would have to have people who are willing to stand up and buy bonds as well as the sellers, and the market has been characterized by the fact that it is a thin market, as we have indicated.

[746] Q. Has it always been thin? A. What?

Q. Has the market in Ports always been thin? A. No.

Q. When did it become thin? A. You could say probably it started last April, May.

Q. And it has remained thin ever since? A. Relative to what it had been prior to that.

Q. You said that you had heard of the covenant and it was generally considered as security for bondholders in that it prevented the diversion of Port Authority earnings to mass rail transit. Is that correct? A. That is correct.

Q. Are you familiar with the terms of the covenant? A. In a general manner.

Q. Do you advise people about its meaning? A. No. We are not in the advisory business.

Excerpts from Testimony of Austin F. Fitzgerald

Q. How long have you known that it covered rail transit?

A. Since 1962.

Q. Did you read it at that time? A. As a covenant in terms of reading through the [747] entire thing? I glanced at it in terms of that.

Q. Have you discussed your testimony in this case with anyone? A. Yes.

Q. With whom? A. With the counsel for the United States Trust.

Q. I think you have testified you committed less capital to Ports when you became aware of the possibility of repeal. We have referred to that before. Are your inventories in municipals of all kinds? Heavier or lighter today than they were in 1973? A. You will have to give me time to think back and reflect a little on this.

Q. Please. If the date is troublesome, take it back to 1972.

Let me make it easier for you. At least I will try to make it easier. Have your inventories become lighter generally lately? A. I could be facetious either way about that.

Q. Answer whichever question you find you want to do.

Mr. Landis: Maybe he can't find either.

A. In general I would say they would be probably lower, but not to a great degree. In other words—

Q. Generally lower, then, is your answer. [748] A. Yes, that is in this specific area.

Q. Municipal bonds. A. Municipal dollar bonds.

Q. Municipal dollar bonds. A. Yes. T 744-4 to 748-5.

* * *

[752] Q. Are municipal bonds regarded as secure investments, Grade A? A. Most of them are.

Excerpts from Testimony of Austin F. Fitzgerald

Q. So that a high quality municipal bond has advantages of both the tax-free yield and high security. Is that right?

A. Would you repeat the question, please?

Q. A high-grade municipal bond has the advantages both of a tax-free yield and high security. A. Yes. T 752-11 to 752-20.

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Excerpts from Testimony of Gordon Fowler

【761】 GORDON BLACKFORD FOWLER, 21 Cliffmore Road, West Hartford, Connecticut, sworn.

Direct Examination By Mr. Landis:

Q. By whom are you employed, Mr. Fowler? A. I am an employee of the Connecticut General Life Insurance Company located in Bloomfield, Connecticut.

Q. What is your capacity? A. I am a secretary in the bond department, responsible for public debt investments.

Q. And what is your educational background commencing with your college education? A. I have an A.B. Degree from Princeton University and an M.S. degree from Columbia University School of Business.

Q. In what areas of study? A. Business administration and in economics at Princeton.

Q. Where have you employed since your education? A. Following Columbia, I went to work for Connecticut Mutual Life Insurance Company in **【762】** Hartford, Connecticut, in a non-investment capacity.

The following year, I changed employment and went to work for Aetna Insurance Company, located at 55 Elm Street in Hartford.

In 1962, Aetna was acquired by the Connecticut General Life Insurance Company and in 1964, the Aetna's investment department was merged into that of Connecticut General's.

At that time, I came on the payroll of Connecticut General Life Insurance Company and I worked there ever since.

Q. What did you do at Aetna and since Aetna was merged into Connecticut General at Connecticut General.

A. While I was at Aetna I was in municipal bonds, as

Excerpts from Testimony of Gordon Fowler

an analyst, and on joining Connecticut General, I became a senior analyst responsible for municipal bonds.

Q. When you say municipal bonds, what did that entail?

A. Well, that at the time involved reviewing new bond issues and making recommendations for purchases and sale of such securities.

Subsequently, I became an officer of [763] Connecticut General in 1968. At that time, I became responsible for making the decisions and executing purchases and sales of those bonds.

Q. When did you attain your present capacity? A. In 1972, I became a secretary of the corporation.

Q. What are your responsibilities in that capacity? A. I am responsible for public fixed-income securities. This includes corporate bonds, municipal bonds, U.S. governments and its agencies; the total amount would be about a billion one, under my supervision, of which 500 million are municipals—500 million are corporates and 100 million governments.

Q. Does Connecticut General or Aetna presently own any Port Authority bonds? A. Yes, we do.

Q. When were those purchases made? A. The initial purchases of bonds we hold now were made in 1968.

At that time, we purchased 875,000. Each year since then to 1973, we added to those holdings and at the end of 1973 we held a total in all [764] companies of \$9,450,000.

Q. Were those purchases made in the secondary market or upon original issue? A. With the exception of 3 million 40th series bonds, substantially all were made in the secondary market.

Q. In your purchases between 1968 and 1973 in the secondary market, were you aware of the existence of the 1962 covenant? A. Yes, I was.

Excerpts from Testimony of Gordon Fowler

Q. Did the existence of the covenant affect your decision to purchase those bonds? A. I relied on it at the time I purchased the bonds, yes.

Q. Now, with respect to the 1973 purchase of bonds, did you purchase those bonds with knowledge of the 1973 prospective repeal of the 1962 covenant? A. Yes, I did.

Q. Would you explain that decision? A. Well, the 40th series bonds which we purchased were not covered by the covenant. However, of approximately a billion seven, thereabouts, of outstanding Port Authority bonds, were protected by the covenant and it to me was [765] unreasonable to expect that these bonds would be fully retired in the immediate future or even the foreseeable future and therefore the 40th series bonds were indirectly protected by the covenant.

Q. With respect to all the purchases you described, would you have purchased any of those bonds without the protection of the covenant? A. I can't say for certain we would not have purchased them, but if we had, it would have been at a much lower price for the given coupons.

Q. Since the 1974 repeal of the covenant, have you purchased any other Port Authority bonds? A. No, we have not.

Q. Did you take action with regard to the bonds that you held? A. We sold two million of our 40th series bonds at cost in the first part of 1974.

Q. Why did you decide to sell these bonds at that time? A. The likelihood of the repeal being effective—not being effective, but occurring, was of concern to us.

Q. What would that entail in regard to those bonds? [766] A. Well, we were concerned with respect to our entire holdings, that if the repeal were effective, that the earnings of the Authority will be diluted by additional passenger rail facilities.

Excerpts from Testimony of Gordon Fowler

Q. Did you try to sell any other bonds of the Port Authority at or since that time? A. No, we have not. We have principally tried to sell those 40th series bonds. Had we had an opportunity to sell bonds without incurring a substantial loss, we would have been favorably inclined to do so, however.

Q. Did you try to sell the bonds of the 40th series, that you still hold? A. Yes, we did. We tried to sell the remaining one million.

Q. I gather you were not able to? A. No, we were not.

Q. Why was that? A. The price of the bonds had deteriorated to such a low level that we were unwilling to take the loss if we were required to sell them.

Q. I gather then you continue to hold substantial amounts of Port Authority bonds. A. That's correct, we still hold \$7,450,000 [767] worth.

Q. What is the reason, justification, for continuing to hold those bonds, if there is one? A. Well, we are optimistic, but the repeal will not be substantiated or the Court will not allow the repeal to become effective and we are unwilling at this time to take the loss if we were required to sell the bonds.

Q. Since the 1974 repeal of the covenant, have you purchased any moral obligation bonds? In the State of New York, or New Jersey and their agencies or subdivisions? A. No, we have not.

Q. What is the reason for that? A. It is the general feeling that if the Legislature of the two states would renege on their obligations with respect to the Port Authority covenant, we have no reason to believe that they would live up to the moral obligation, which is not a legal obligation. T 761-3 to 767-22.

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Excerpts from Testimony of Gordon Fowler

【769】 Cross-Examination by Mr. Laulicht

* * *

Q. Now, as I read S-26, in 1971, Aetna purchased a net total of \$2,150,000 worth of Port Authority bonds. Is that correct? A. No, let's see—we held—you are talking about 1971?

Q. Yes. A. We owned a million eight at the beginning of the year and we had two million nine—okay, two million nine hundred fifty. The difference there is two million one hundred fifty thousand.

Q. Now, in making your decisions—and I take it you were responsible for the decision to buy that \$2 million worth? A. That's correct.

Q. In making those decisions, did you rely on research reports that were in the files of Connecticut General? A. We principally relied on the official statements. We do get various research reports and the time—I 【770】 don't have a specific recollection of relying on it directly.

Q. Well, if a research report comes in from Hornblower and Weeks, that would come in to your office would it not, Mr. Fowler? A. Yes, it would.

Q. Would you normally read it? A. Generally, yes.

Mr. Laulicht: I would like to offer as S-27, a document which has been marked originally as P-102. I take it this comes from the files of Connecticut General. It does come from the files of Connecticut General, according to Plaintiff's Counsel.

Is that the type of report.

Mr. Landis: I object to it.

The Court: Let him ask the question first.

Q. Is that the type of report that would come to your office? A. Yes, it would come either to myself or my associate who works with me on municipals. T 769-7 to 770-22.

* * *

Excerpts from Testimony of Gordon Fowler

[775] Q. Did you or have you read Dun & Bradstreet Reports about the Port Authority? A. Pretty much as in the same fashion as this Hornblower Report. I have looked at them from time to time, but have no specific recollection of any given report.

Q. Mr. Fowler, in making your decisions with respect to what bonds to buy, do you rely on anything other than the official statements relating to those bonds? A. We principally rely on those.

[776] Q. Yes, and what else do you rely on? A. Well, obviously to the extent those reports are available we look at them at the time.

Q. Anything else? A. Well, I would say those are the major things.

The Court: You have an astrologer, or something?

The Witness: No.

There is, of course—there is the oral-type communication an investment banker might convey.

Q. Do you know anything about the rating system that Dun & Bradstreet used to employ? A. Not a whole lot, no.

[777] Q. Do you know what a rating of 0-7 would have meant for Dun & Bradstreet in February of 1972? A. My recollection was that that was a fairly respectable rating, but until Dun & Bradstreet took over Moody's, I really have not relied on Dun & Bradstreet type ratings. Even now I don't rely on Moody ratings.

The Court: How about S & P?

The Witness: S & P, I don't rely on them. We do our own analysis, but I would possibly give S & P a slightly better score at this point.

Excerpts from Testimony of Gordon Fowler

The Court: But you rely principally upon your own analytical work?

The Witness: That's correct.

The Court: In making your investment decisions?

The Witness: That's correct.

The Court: Plus such information you get from members of the investment banking community in whom you have confidence?

The Witness: That's right.

By Mr. Laulicht:

Q. Now, in light of your statement that [778] you just made that you don't rely on Moody's, but you could rely on Standard & Poor's— A. I'm sorry but I didn't say that.

The Court: He didn't say that. He just said he would give S & P a better rating than Moody's. That's all.

Q. I'm sorry for misstating it, but in light of what you just said can you explain to me how it is that you have at least two Moody's reports with respect to the 40th and 41st series according to the exhibit list, and you don't have a Standard & Poor's report. A. That's because we subscribe to a service put out by Moody's Investors Service, and I'm unaware of any similar service at Dun & Bradstreet.

Q. Well, Dun & Bradstreet is not my question. My question relates to Standard & Poor's. A. I don't mean Dun & Bradstreet, I mean Standard & Poor's. They were originally Dun & Brad. T 775-15 to 778-21.

* * *

[779] Q. Did you ever see S-29? A. Yes, it looks similar to one that's in our files.

Excerpts from Testimony of Gordon Fowler

Mr. Laulich: May I offer it now, [780] your Honor.

The Court: All right. * * * S-29 in evidence. T779-23 to 780-6.

* * *

[782] Q. Now, at the time you decided to buy \$1 million worth of Port Authority bonds in 1972 were you aware of the summary statement as it is so-called at the bottom of the first page of S-29? A. To the extent we had this report in our file, I suppose you could say that. Again, I don't remember specifically having read this prior to making that purchase.

Q. In February 1972 did you have any idea people were trying to push the Port Authority into mass transit. A. Yes.

[783] Q. And that is when you bought the bonds after having that knowledge. A. We had knowledge that there was activity in that direction, yes. T 782-14 to 783-4.

* * *

[784] The Court: Did you know prior to the time that you made the purchase of \$1 million in 1972, that the State of New York had adopted legislation containing a total repeal of the covenant which would not become effective until New Jersey had adopted similar legislation?

The Witness: At the time of purchase? I am quite confident at that time I was aware of this. I was aware of the action on the part of the New York State Legislature and Governor Rockefeller's trying to get it passed. Whether or not it was before or after the purchase, or when the purchase took place; let me put it this way: I am not exactly sure. I don't have that information with me.

Excerpts from Testimony of Gordon Fowler

Q. **【By Mr. Laulicht】** At any rate, if you did buy the bonds before that total repeal by New York in 1972, I take it from S-26 you did not go out and sell \$1 million worth of bonds or whatever you were holding at that time. A. That is correct.

Q. Can you explain that to me? Why didn't you sell your bonds at that time? A. At that time I did not think it was likely that the total repeal would be adopted by both states.

Q. What did you base that opinion on? **【785】** A. That the Governor of New York was anxious to get this done and that the New York State Legislature would go along with him was a reasonable prospect but that the previous governor of the State of New Jersey I did not think or possibly the Legislature would act or would not necessarily go along with this.

Q. Did you have any information between June of 1972 when the New York repeal was passed and November 1972 when the bi-state governors' agreement was announced with respect to what the position of New Jersey would be on the total repeal? A. I can't say at the time; the period is too short.

Q. Were you aware, Mr. Fowler, in 1972 that there was litigation relating to the covenant upon which you say you relied? A. Are you referring to litigation brought by Mr. Kheel?

Q. Yes. A. Or the firm that he was associated with?

Q. Yes. Were you aware of it at that time? A. I was aware that there was such litigation. The exact timing I can't say for certain.

Mr. Laulicht: I would like to mark S-30, the document that had been originally marked P-106.

Excerpts from Testimony of Gordon Fowler

Q. Do you remember whether you saw S-30, [786] Mr. Fowler? A. It looks similar to the report that we have in the file.

Q. Would you take a look at Page 9? Would you specifically refer to the next to the last paragraph about pending litigation concerning the covenant on which you say you relied? A. Beginning in early 1971?

Q. Yes. A. Yes.

Q. Does that paragraph refresh your recollection that you knew in or about February 1972 about the litigation challenging the constitutionality of the covenant upon which you say you relied in buying Port Authority bonds? A. You mean do I know that there was such a suit?

Q. No. Does it refresh your recollection at all that you probably knew about the lawsuit in February 1972? A. Probably, yes, sir.

Q. Is it likely that you bought that whole million dollar's worth of 38th series before February 1972 or the million dollar's worth of Port Authority bonds—let me withdraw the question and ask you whether it is likely that you had knowledge of the Kheel lawsuit [787] challenging the constitutionality of the covenant before you bought \$1 million worth of Port Authority bonds in 1972? A. Yes. As I say, I don't know when in 1972 we bought them. But it is likely that I had a knowledge of it. T 784-1 to 787-6.

* * *

Q. Now, as I read S-26 and as I understood your testimony in 1973 Connecticut General bought \$3 million worth of the 40th series of consolidated bonds; is that correct? A. That is correct.

Excerpts from Testimony of Gordon Fowler

Q. That would be after the date of issuance of those bonds which I believe was somewhere around June 20, 1973. A. I think it was on the day the bonds were marketed that we bought them directly as part of the new issue.

Q. It would have been somewhere around June 1973, I think I could represent that that is when this issue was marketed. A. Yes.

【788】 Q. It is also true that in 1973 Aetna bought \$2 million worth of 33rd series. A. That is correct.

Q. This was done at the time you were aware of the Kheel lawsuit, is that correct? A. Yes.

Q. Were you also aware that a gentleman named Brendan Byrne was running for governor in 1973? A. Yes.

Q. Were you aware prior to June 1973 when you bought \$3 million of 40th series that Mr. Byrne who was then running for governor had issued a press release in which he said: We must reopen the fight to pledge surplus Port Authority revenues to essential transit projects, something Governor Cahill has refused to do. T 787-12 to 788-16.

* * *

【789】 A. I became aware of Governor Byrne's position, but whether it was at that time or later time—I was aware of it after his election to office, I'm sure of that, but not necessarily prior to that point in time. I did not follow his campaign that closely.

Q. Were you aware in 1973 of Governor Rockefeller's position with respect to the repeal of the covenant? A. Yes, I was.

Q. What was Governor Rockefeller's position? A. He was anxious to have it repealed.

Q. How soon after Governor Byrne was elected and was now governor did you become aware of his position on the repeal? * * *

Excerpts from Testimony of Gordon Fowler

A. It was sometime prior to our sale of 40th series bonds, because it became evident that New York State was in favor of repeal, and that now with the new governor it was more likely that the New Jersey Legislature and the governor would go along with it.

Q. When did you make that sale of the consolidated bonds in 1974? A. In March.

Q. At that time did you try to dispose of [790] your other holdings? A. No. I just tried to get rid of the three million of the 40th series.

Q. Even though you thought that they were protected by the covenant as you testified? A. That is right.

Q. Can you explain that? A. Well, obviously they are not protected directly. They are only protected indirectly.

Q. And so? A. And so I was concerned based on the actions taken by the two legislatures that it might be possible to devise some sort of means to shelter the bonds that were subject to the covenant to the detriment of those that were not.

[791] Q. Were you concerned that something might be done to the covenant itself in early 1974? A. Yes, I was concerned, but the two legislatures and the governors would be successful in having it repealed.

Mr. Laulich: We will mark as S-31 a document that had been previously marked P-112 and is a Moody's Credit Report dated June 14, 1973.

Q. Mr. Fowler, do you recall reading S-31 before you bought the \$3 million worth of consolidated bonds of the Port Authority discussed in this report? A. I most likely did.

Excerpts from Testimony of Gordon Fowler

Q. Do you think it is likely you would have invested \$3 million of Connecticut General's money without reading a report like this? A. I would have read the official statement. And I would prefer to put emphasis on that rather than on these credit reports.

Q. Were you aware when you put down \$3 million that there was a discussion of the Port Authority putting up between \$250 and \$300 million of its own money on railroad mass transportation projects? A. I was aware that there were projects being discussed that would cost that much, yes.

[792] Q. Do you recall if some of the discussion at that time was to the effect that this would be done on a self-supporting basis? A. Yes.

Q. Do you recall that the reason for saying that it would be done on a self-supporting basis would be so that it would comply with the covenant? A. I believe that was correct.

Q. And in fact if the projects involving 250 or \$300 million worth of Port Authority money was certified as self-supporting over the next ten years it would comply with the covenant, would it not? A. I believe it would.

Q. Before you bought \$3 million worth of 40th series bonds that were indirectly protected, as you say, by the covenant, didn't you think that there was any way in which a Port Authority investment of \$250 million in rail transportation projects could be made self-supporting? A. Did I think that there was any way that it could be made self-supporting?

Q. Yes. A. With a subsidy.

Q. What kind of subsidy? A. From the State of New York or New Jersey.

[793] Q. And that is what you thought would happen? A. I thought that there would be a combination of federal, state and local subsidies in one form or another.

Excerpts from Testimony of Gordon Fowler

Q. That is correct. That was part of the \$650 million program, is that right, that was discussed at that time? Do you remember that? A. I do not remember that specific number.

Q. Do you have any idea of the debt service on \$250 million worth of Port Authority bonds? A. Assuming 30-year bonds?

Q. Yes. What is the annual debt service? A. About an 8 percent constant at that point.

Q. So that it would be roughly 20 to \$25 million a year? A. Yes.

Q. And you thought that is what the state and federal government would subsidize? A. If they wanted the Port Authority to get involved in it.

Q. Were you concerned that there might be a way or that there might be an effort to find a way to avoid that kind of commitment? A. Well, the fact that people were trying to repeal the covenant was indicative of the fact that there was something, either that project or some other projects **【794】** might be in the winds.

Q. And yet you went ahead and bought \$3 million of the bonds discussed in S-31. A. Certainly. The covenant protected us.

Q. What does the covenant protect you from, Mr. Fowler? A. It protects us from the Port Authority incurring additional rail passenger transit deficits.

Q. Unless they are certified. A. They can't certify a deficit, to my knowledge.

Q. Yes, but it is possible to certify an operation as self-supporting, is it not, even though it may run a deficit? Or do you feel that there was no way that that would happen?

Excerpts from Testimony of Gordon Fowler

A. Do you mean that the Authority would in this manner certify something as being operated on a profitable or self-sustaining basis, not that it would be operated at a deficit?

Q. That is correct. A. We have to put some reliance—we put a good deal of reliance on the good faith.

Q. Of the Port Authority? A. Of the Port Authority.

Q. That is one of the reasons why you now have \$7½ million worth of their bonds, that you have [795] some faith and reliance in the Port Authority. A. In being honest people, yes. T 789-1 to 795-2.

* * *

[799] Q. You say you attempted to sell more of the 40th issue but were unable to do so? A. We sold two million out of our three million and we tried to sell the remaining million.

Q. You were unable to do so? A. We were unable to do so without taking a loss.

Q. What price did you sell the two million you did sell at? A. Par.

Q. When was that ? A. In March of 1974.

Q. Tell us what particular provision in the covenant you relied on? A. Well, my general understanding of the covenant is, what is in the official statement, and part of it that is most important to me is that the mass rail [800] deficit is limited as to future projects. T 799-10 to 800-1.

Excerpts from Testimony of Gordon Fowler

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Q. Are you familiar with the Consolidated Bond Resolution of October 9, 1962 of the Port Authority? A. I have read it and have an understanding of sorts of it, yes, sir.

Q How about the series resolutions **[801]** establishing particular issues of Port Authority Bonds? Are you familiar with those resolutions? A. Not all of them, no.

Q. Are you familiar with those of the 40th series?
A. Yes, I have read it. T 800-21 to 801-5.

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**Excerpts from Transcript of
Hearing, February 11, 1975**

[823] Mr. Sovern: Yes. I am reading from the New York Times dated February 11, 1975, which reports the bid and asked prices of the two bonds as they were yesterday.

The Port 6 was bid 87 and the Mass Port 6 was bid 89. T 823-7 to 823-12.

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[840] Mr. Sovern: We turn now to the **[841]** Armstrong deposition transcript, your Honor. And we propose to offer a few limited extracts from the transcripts along with some exhibits.

It is our purpose, first, to offer from Volume I—

Mr. Landis: Your Honor, if I may interrupt at this point, I think I may save a lot of time, because I think under the rule that we are entitled to have the entire deposition marked in if they propose to offer excerpts from it. Then I would—

The Court: Oh, no, that is not the rule. That is not what the rule is.

Mr. Landis: I read any party may offer any other parts in the rule.

The Court: Yes, such as—

Mr. Landis: Rule 4:16-1(d).

Mr. Sovern: I am sure your Honor knows that that is not the practice under that rule with respect to the deposition of a witness.

Mr. Landis: Well, the only case that we were able to find indicates that it is the practice.

[842] The Court: Rule 4:15?

Mr. Landis: 4:16-1, your Honor, and it is part (d). It is the last phrase that I am talking about.

The Court: Well, you don't get to offer the whole deposition.

*Excerpts from Transcript of
Hearing, February 11, 1975*

Mr. Landis: I believe any other parts means the whole.

The Court: No, you introduce any other part which ought, in fairness, to be considered with the part introduced.

Mr. Landis: I am not talking about that phrase, your Honor. I am talking about the last phrase, your Honor, I am talking about the last phrase, any part in the offer.

Mr. Sovern: That is intended to be modified by the passage that the Judge just read.

Mr. Meyner: It is not.

Mr. Landis: I don't think so at all. I have a case that I can read—

The Court: Well, I am telling you that this been the practice, that a party offering his adversary his party's deposition [843] is not subject to having the whole of the deposition introduced, only so much as is necessary to make it fair and make sense or the meaning in which the portion is introduced clear. T 840-25 to 843-6.

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[850] Mr. Sovern: I would like next, your Honor, to read into the record a paragraph from a letter of January 24, 1975, from Mark K. Sisitsky to Murray Laulich. I am reading from paragraph 6 at page 2 of that letter.

The Trust Company holds in discretionary account \$2,570,000 par value of series 40 and \$385,000 par value of series 41. T 850-13 to 850-21.