TO: SMCTD BOARD

FROM: SPECIAL COUNSEL, JIM WAGSTAFFE

Re: UPDATE – CALTRAIN GOVERNANCE FOR SMCTD BOARD MEETING - JUNE 7, 2023

Date: June 7, 2023

I. Summary

This report will briefly summarize the historic basis for SMCTD serving as the Managing Agency for Caltrain, along with a description of the salient aspects of the MOU and the rights and contemplated future steps thereunder. It then provides a report on the status of the payments described in the MOU, along with describing certain management requests made by Caltrain's Executive Director and the current status of matters relating to those requests. Finally, the report will summarize the status of ongoing implementation of the MOU, including the status of the contemplated collateral agreements (i.e., the Release, the Escrow agreement, the Amended Real Property Agreement between the parties, and Shared Services Agreement).

II. The Historic Basis for SMCTD Serving as the Managing Agency and its General Manager Serving as the Executive Director for Caltrain

The genesis of the governance and reimbursement discussions for Caltrain can be traced to the late 1980's, when the City and County of San Francisco (CCSF), the Santa Clara VTA (VTA) and the San Mateo County Transit District (SMCTD) jointly decided it was essential they acquire from the Southern Pacific the Right of Way (ROW) to preserve and continue operation of the Peninsula Commute Service. However, as the ROW acquisition proceeded in 1991, CCSF and VTA declined to fund their share of the ROW purchase and contributed nothing. SMCTD then stepped up and advanced from its reserves the two shares attributable to CCSF and VTA and arranged for the San Mateo County Transportation Authority to cover the SMCTD share in order to secure the payment of the entire local match of $82 million to close the ROW purchase.

In written contracts and public statements, CCSF and VTA expressed their commitment to SMCTD being repaid from non-local sources for its substantial Additional Contribution on their behalf. Furthermore, and in recognition of SMCTD's leadership and financial contribution, all three partners in Caltrain provided binding contractual assurances that SMCTD would remain the Managing Agency until repaid, and that SMCTD's General Manager would also serve as the Caltrain Executive Director.

III. Efforts and Agreements to Obtain Some Reimbursement for SMCTD's Additional Contribution

When reimbursement was not forthcoming, in 2008, and pursuant to an agreement between the parties, CCSF and VTA "sold" to SMCTD the right to remain the managing agency "unless and until it no longer chooses to do so" in exchange for a $38.2 million reduction in the amounts still owed for the Additional Contribution. (2008 Amendment to Real Property Ownership Agreement – "2008 RPOA", Recital Section G).

Under the 2008 RPOA, CCSF and VTA promised to use their best efforts to obtain reimbursement of the $53.3 million still owed, including working with MTC to obtain gas tax spillover funds to achieve the reimbursement. (2008 RPOA, Sec. 3.3(C)) As it turned out, however, a decade later (and because the spillover funds did not reach the total), the repayment remained $19.8 million short.

IV. Governance and Reimbursement Disputes and Resolution in August 2022 MOU

Despite the fact that SMCTD had not been fully repaid, representatives of CCSF and VTA nevertheless began raising major "governance" concerns directed at diluting or eliminating SMCTD's historic role as Managing Agency. In particular, this included concerns that Caltrain did not have its "own" Executive Director or control over the Rail Division employees. As then-existing members of the SMCTD Board can acknowledge, this process over governance issues was hotly contested, generated expensive analyses, and involved countless meetings and negotiations.

After extensive negotiation and compromise, the parties reached a binding MOU in August 2022 designed to balance the competing concerns relating to governance and reimbursement. The pertinent terms of the MOU can be summarized as follows:

- The JPB would have sole authority over the selection, hiring, compensation and termination of the Caltrain ED who would be fully accountable to the JPB. However, for CalPERS and other purposes, the ED would remain an employee of SMCTD and the appointment and termination of the ED would be subject to a majority vote of the JPB, provided that the majority consists of at least one Director appointed from each county.

- The Caltrain ED would have "sole authority" over the hiring, performance review, compensation and termination of Rail Division employees (with five new direct report positions, one Chief of Staff and four directors), but again leaving them as SMCTD employees, and with such "sole authority" delimited this time by contractual language stating it is "subject only to SMCTD's salary ordinance and employee manual and policies."

- Except as so provided, SMCTD remains the Managing Agency, i.e., employing all staff, supporting the Railroad and the Caltrain ED through provision of fully or partially shared services in the areas of Human Resources, Contracts and Procurements, Information Technology, Civil Rights, Accounting and Treasury, Communications, Government and External Affairs, Finance and Budgets, Real Estate, and Grants.

- SMCTD is to be reimbursed as follows:

  - $19.8 million (return of principal) with $200,000 from CCSF (already paid) and $19.6 million from MTC (after payment of which SMCTD would reconvey its interest in title to the right of way, give up its equity conversion interests previously provided to secure repayment, and release any claims against CCSF and VTA for payment of the Additional Contributions).

  - Within 12 months (i.e., by August 4, 2023) CCSF and VTA would deposit $15.2 million ($6,080,000 and $9,120,000 respectively) into an escrow for the delay in payment and SMCTD having assigned certain of the Managing Agency responsibilities; with such money being paid to SMCTD upon MTC's payment or written acknowledgement from SMCTD that MTC had satisfied its commitment.

- In the event, CCSF and VTA do not timely deposit the required amounts into the escrow, the changes to the Managing Agency arrangement (as set forth in the MOU) shall "revert" to the terms of the prior agreements, i.e., SMCTD would be the fully acting Managing Agent for the Railroad (so-called "hammer" clause).

- The JPB and SMCTD would indemnify each other for actions for which they are responsible.

- The MOU provides a timeline for negotiation of amendments to the RPOA and JPA (see below) to conform to the MOU, address inconsistencies, ambiguities, and uncodified practices.

- The MOU also provides a timeline for the JPB and SMCTD to negotiate and execute an agreement that governs the provision of fully and partially shared services.

V. Status of Payments Required Under the MOU

In connection with the signing of the MOU, CCSF has already paid its $200,000 share of the $19.8 million due. And as to the remaining $19.6 million payment due from the MTC, SMCTD has already received $12.6 million (via irrevocable allocation) and anticipates the final irrevocable allocation of $7 million to be received in the not-too distant future. As to the anticipated $15.2 million to be deposited in escrow by CCSF and VTA by early August, SMCTD has been told by Caltrain's General Counsel, James Harrison, that he expects these payments to be made. Specifically, VTA apparently has inquired about the terms of the escrow and CCSF has indicated it will make its payments in two tranches, one in June and one in August. Of course, actual receipt will await the deadline in approximately two months (with reversion under the "hammer" clause if the payments are not deposited and then paid to SMCTD).

VI. Management Requests Made by Caltrain's Executive Director

Since the MOU was signed, Caltrain ED Michelle Bouchard communicated a request that she be authorized to add a Caltrain direct report Chief Safety Officer position (to be budgeted and paid entirely by the JPB). Because such a dedicated rail safety officer position (reporting directly to the Caltrain ED) would contribute to an improved safety program and be in conformity with guidance issued by the FTA, SMCTD staff recommended this request be honored. At the SMCTD February 1, 2023 board meeting (by a near-unanimous vote) SMCTD's General Manager, April Chan, was given authority to agree to the adding of this new position – even though it was not expressly included in the MOU (but allowed if agreed to by both parties).

Thereafter, Ms. Bouchard again approached Ms. Chan stating that it was her belief that she is authorized as the Caltrain ED unilaterally to *hire and fire* rail employees, as well as make "direct appointments" without going through the normal process or obtaining the consent of SMCTD's General Manager. The issue presented was whether such a change is mandated by the MOU which does state that the positions in question are ones the ED has sole authority to hire and fire (MOU, Sec. 1.D). However, the MOU also expressly provides that such authority is "subject only to SMCTD's salary ordinance and employee manual and policies." (MOU, Sec. 1.D). Notably, SMCTD's employee manual and policies provide that such employees *serve at the pleasure of the SMCTD General Manager.* Moreover, the MOU carefully did not include the "subject only to SMCTD's employee manual" solely as to one employee, the ED herself. (MOU, Sec. 1.B).

Due to the conflicting interpretations of the MOU, Mr. Harrison (on behalf of the JPB) and Special Governance Counsel for SMCTD (Jim Wagstaffe and Jim Hartnett) engaged in a productive dialogue to address the matter. Initially, Mr. Harrison pushed for a confirmation of unfettered discretion for the ED, while SMCTD Special Counsel emphasized that these persons remain SMCTD employees and need to be subject to the terms of the District's employee manual and policies. (MOU, Secs. 2.B., i, ii, iii, iv and v). Of course, both sides recognized that in almost all cases, matters will work out due to the joint agreement of the ED and SMCTD's General Manager. However, the challenge in these negotiations was what to do if, in fact, there is a disagreement as to whether the policies are being followed upon the requested exercise of authority.

As the parties discussed this question, there was no genuine dispute that the Caltrain ED has "sole discretion" over the ultimate employment decisions listed in the MOU for the top Rail employees. However, and as SMCTD's counsel emphasized, this "discretion" necessarily can be exercised only once it has been verified and determined that the processes followed and leading up to those ultimate decisions are in full accord with SMCTD's policies and procedures. In that sense, the District's General Manager must be the one who determines whether the employee manual and policies have been followed. In other words, this sole discretion is encumbered by the District's determination that its policies leading up to each decision have been followed.[1]

Through the back-and-forth between counsel, along with a meeting between the respective Chairs of the two boards, it appears that the parties have formulated a solution. In essence (and as can be confirmed with modest revisions to the SMCTD policies) when the Caltrain ED exercises "sole discretion" concerning a Rail Division employment decision, notice would be given to the SMCTD General Manager for the purposes of "verifying" compliance with SMCTD's policies. If, after this process, there was an ongoing dispute regarding such compliance, it would be brought to the two Chairs for discussion. And only if agreement still proved elusive, would the matter then be brought to ad hoc committees for the JPB and SMCTD for final resolution.

Also as set forth in the Joint Memo to CalPERS, among the many SMCTD policies that will continue to govern Rail employees, the following are examples:

- *Policy 2-001*: District Employees and filling of vacancies. The Memo describes the policy as one which "sets forth the process by which all SMCTD vacancies, including those in the Rail Division, must be filled", including that all "candidates must be approved by [SMCTD] Human Resources Director or designee before an offer of employment is made."

[1] This characterization is consistent with the recent joint Memo from Joan Cassman, SMCTD's General Counsel, and James Harrison to CalPERS emphasizing that the recent governance changes under the MOU do not alter the fact that these Rail employees (i) remain SMCTD employees subject to its control, and (ii) remain directly subject to the SMCTD salary ordinance and employment policies.

- *Policy 2-002*: Job Offers Policy. The Memo describes that "SMCTD Human Resources Department establishes recommended salary ranges for all job openings, makes all offers…" (and) "SMCTD policies further dictate how and when Rail Division employees get paid, when they are eligible for salary increases, and when managers, including the Caltrain ED can offer or provide additional duty pay to employees."

- *Policy 02-003*: Organizational Structure, Position Classification and Compensation Policy, and *Policy 5-001:* The Memo states: "Finally, other SMCTD policies establish how Rail Division employees must conduct themselves, and how they operate within the work environment.

VII. Status of Other Implementing Agreements Described in the MOU

A. Release Agreement

The MOU calls for a Release Agreement upon SMCTD being paid the $19.6 million by MTC. (MOU, Sec. 3.A.iv). Mr. Harrison provided SMCTD's counsel with a draft that was acceptable but for its purported release of claims going beyond the obligation to reimburse SMCTD for its Additional Contributions. After limited back and forth, Mr. Harrison agreed, and the Release Agreement now appears ready for execution upon receipt of the MTC money.

B. The Escrow Agreement

As described above, the MOU calls for payments by August 4, 2023 totaling $15.2 million and, thus, anticipates an escrow. (MOU, Sec. 3.B, C). Mr. Harrison also provided counsel for the three member agencies with a draft Escrow Agreement. The parties made certain clarifying suggestions (e.g. re interest and deposit accounts, timing for return of such money if the MTC payment is not received or confirmed). As with the Release Agreement, it appears that any differences have been resolved and the escrow can be opened as contemplated by the MOU.

C. The Revised RPOA

Again, as described above, the MOU also calls for the parties first to try to negotiate a revised RPOA (and thereafter a revised JPA) to conform it to the MOU and address any "inconsistencies and ambiguities" in the current agreement. (MOU, Sec. 5). Since any revised RPOA becomes a nullity if the $15.2 million is not deposited into the escrow by August 4, 2023, and matters revert to the existing JPA , RPOA and 2008 RPOA (MOU, Sec. 4.A), there was no urgency or even need to negotiate detailed and disputed terms – with the exception of executing a revised RPOA that expressly conformed to the MOU. This is exactly what SMCTD drafted and proposed. While counsel for the JPB eventually shared two parallel drafts of a revised RPOA (that addressed multiple subjects that would be mooted if the $15.2 million payment is not made), the parties have not yet agreed on a final version of this document. Under the circumstances and as a practical matter, the execution of such a revised RPOA likely will await the August 4, 2023 date, and then may not be necessary at all since the parties will turn to addressing the delineated issues for a revised JPA.

D. Shared Services

The JPB and SMCTD agreed to negotiate a shared services agreement regarding the partially and fully shared services provided to the JPB by SMCTD. The agreement is to cover the scope of the services and how the services will be evaluated and adjusted in the future by mutual agreement. (MOU, Sec. 2.G) The parties are to enter into the agreement within three months after the $15.2 million is deposited into the escrow (with full deposits likely by August 4, 2023) but, as with other specified agreements, failure to meet that deadline does not constitute grounds for voiding the MOU.

We have provided legal guidance to the SMCTD General Manager on this subject, and we understand discussions have commenced, including between staff and General Counsel.

VIII. Conclusion

As SMCTD awaits the August 4, 2023 date, the parties will finalize the implementing agreements (Release and Escrow), continue the process of addressing an agreement governing the provision of partially and fully shared services, and await whether the required payments will be made into the escrow as contemplated.