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**BEFORE THE COMMITTEE ON COMMERCE, SCIENCE, AND  
TRANSPORTATION**

**U.S. SENATE**

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Testimony from the  
**AMTRAK REFORM COUNCIL**

Statement of  
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*The ARC is an independent federal commission established under  
the Amtrak Reform and Accountability Act of 1997 (P. L. 105-134)*

**STATEMENT OF GILBERT E. CARMICHAEL,  
CHAIRMAN OF THE AMTRAK REFORM COUNCIL  
BEFORE THE  
COMMITTEE ON COMMERCE, SCIENCE, AND  
TRANSPORTATION,  
UNITED STATES SENATE  
SEPTEMBER 26, 2000**

Mr. Chairman, thank you for inviting the Amtrak Reform Council to address your Committee's oversight hearing on Amtrak. While I am alone at the witness table, I would like to introduce other members of the Reform Council who are here today for this important hearing. These members include James Coston, appointed by Senate Minority Leader Daschle, and the newest member of the Council, Nancy Rutledge Connery, appointed by Senate Majority Leader Lott. Also present is a representative of the Federal Railroad Administration, representing the Secretary of Transportation's *ex officio* position on the Council.

Mr. Chairman, one of my key objectives as the Council's Chairman is to focus the substantial experience and insight of the Council's members on solid analyses and initiatives designed to improve intercity rail passenger service. Through the earnest efforts of the Council's members, supported by our staff, I believe we have forged a pragmatic bipartisan majority that brings a practical and realistic perspective to the issues the Congress has charged the Council to address.

As you requested, the Council has provided to the Committee a statement that addresses in detail each of the topics that you raised in your letter of invitation. This morning I will summarize for you the Council's view on Amtrak's recent performance and the Council's views on the proposed High-Speed Rail Investment Act bonds, designed to continue and expand the task of developing the federally-designated high-speed rail corridors throughout this country. My summary will include:

- Results of Amtrak's use of new authorities provided by the Reform Act;
- Comments on financial performance and Amtrak's progress toward self-sufficiency;
- A brief overview of the Council's perspective on where things stand, as context for the Council's views; and
- The Council's view of the proposed High-Speed Rail Investment bonds.

## **HOW AMTRAK HAS USED ITS NEW AUTHORITIES PROVIDED UNDER THE ACT AND WHAT COST SAVINGS THE LEGISLATIVE REFORMS HAVE ACTUALLY GENERATED**

The reforms set forth in the Amtrak Reform and Accountability Act of 1997 (“the Reform Act” or “ARAA”), among other objectives, were intended to eliminate statutory obstacles to essential Amtrak operational, financial and productivity improvements and to provide Amtrak with additional authority to operate more like a private, for-profit business. To this end, the Act, in its major provisions: (1) repealed Amtrak’s obligation to provide rail passenger service within the “basic system” defined by statute and provided Amtrak with complete authority to determine its national system of routes and services in response to the marketplace [ARAA Sec.101]; (2) repealed the specific statutory requirements for labor protection payments for route closures and work transfers and placed the disposition of this issue on the labor-management collective bargaining table [ARAA Secs. 141, 142]; and (3) repealed the statutory prohibition against contracting out work and required that this issue be placed on the collective bargaining table commencing no later than November 1, 1999 [ARAA Sec.121].

The Act also encouraged Amtrak to achieve management efficiencies and revenue enhancements. In this regard, it charged the Council with monitoring Amtrak’s efforts to achieve labor productivity improvements and required Amtrak, if it entered into an agreement with its union employees after January 1, 1997 involving work-rules intended to achieve savings, to report quarterly to the Council both the savings realized as a result of the agreement and how the savings are allocated. The Act requires the Council to submit an annual report to Congress that includes an assessment of Amtrak’s progress on the resolution of productivity issues or the status of those issues [ARAA Sec. 203].

Based on information furnished by Amtrak, it is the Council’s understanding that Amtrak has utilized its new flexibility under the Act as follows.

### **A. Modifications to the National Route System**

To assist Amtrak in identifying economically attractive route closures and realignments, as well as to assist in overall business planning, Amtrak has developed a new strategic planning methodology called the Market Based Network Analysis (MBNA). The MBNA has an associated Financial Model that estimates, for alternative packages of rail passenger services and revenues, the expected costs and profitability of a proposed route or system of routes. Using the MBNA to assess its route system, Amtrak developed a plan for realignments and extensions of its route system, which it called the Network Growth Strategy (NGS). Amtrak announced the NGS in late winter of this fiscal year. The Council has not yet had an opportunity to fully analyze it since it was not reflected in Amtrak’s FY2000 Strategic Business Plan and since many of the NGS actions have not been fully implemented.

Based on its NGS analysis, Amtrak has proposed to add additional routes and frequencies to its current service. Accordingly, no cost savings have yet resulted from the additional

flexibility provided Amtrak to determine its national service network free from statutory restrictions. After the Council completes its analysis of the NGS, it will examine Amtrak's specific route and service proposals. Under the ARAA, the Council is charged with making recommendations for changes in Amtrak's route structure based on Amtrak's criteria.

## **B. Labor Protection Payments**

Amtrak and its unions chose to address the issue of labor protection as required under the Act through binding arbitration. In a November 1999 decision, the arbitration board modified the pre-existing employee protective provisions (as regards major aspects) as follows:

- (a) Under pre-existing law, any affected Amtrak employee was entitled to wage and benefit protection for a period equal to the amount of service, not to exceed 6 years; under the arbitration award, an Amtrak employee must have two years of service to be awarded protection.
- (b) The maximum duration of employee protective benefits was reduced from 6 years to 5 years, and employees must have more years of service than previously, on a sliding scale, to reach maximum benefits. For example, an employee with 3-5 years of service would receive 12 months' benefits; an employee with 20-25 years of service would receive 48 months' benefits. (According to Amtrak, approximately 20 percent of current Amtrak employees eligible for labor protection have more than 20 years of service and would be entitled to 4-5 years of income protection for a "trigger occurrence" if unable to exercise seniority.)
- (c) The arbitration panel agreed that no employee protection would be required for the first two years of any new service commenced after the arbitration.
- (d) The issue of whether labor protection would apply to the termination of non-commuter contracts for local or state service was remanded for further negotiation and re-submission to arbitration if there is no agreement. (The arbitration panel found that Amtrak had no obligation for labor protection with respect to commuter contracts.) According to Amtrak, the issue remanded is still under negotiation and there are open issues that may be resubmitted to the arbitration panel.
- (e) The "triggers" for the imposition of employee protective benefits remained the same: (1) closure of a route or reduction in frequency below three round trips per week; or, as affects shop employees, (2) closure of a maintenance shop facility or transfer of work from the facility to another facility more than 30 miles away.
- (f) The arbitration award provided that it may be further amended by the parties through negotiation after January 1, 2000.

Despite the improvements achieved by Amtrak through the arbitration award, Amtrak's new labor protection obligations to employees, particularly those with many years of service, remain significantly higher than those of non-railroad corporations in the United States. No widespread "trigger occurrence" has taken place on Amtrak as yet that would give rise to labor protection payments. Should such an occurrence take place, there

would be cost savings generated by the arbitration award modifying Amtrak's labor protection obligations.

### **C. Contracting Out**

As of the date of the Council's first annual report to Congress (January 2000), Amtrak had not undertaken studies to determine whether contracting out any of its operations would improve its financial performance. Amtrak also had not served Section 6 notices under the Railway Labor Act placing the contracting out issue on the bargaining table, which the ARAA required Amtrak to do by November 1, 1999.

The Council is informed by Amtrak that it served Section 6 notices on June 12, 2000 placing the contracting out issue on the bargaining table. Amtrak, accordingly, considers the contracting out issue to be currently under active negotiation with unions representing Amtrak employees. Amtrak considers the specific contracting out issues it placed on the bargaining table to be confidential.

Because Amtrak has not yet contracted out work under the new authority provided in the ARAA, there are no cost savings as yet to be reported. The Act, moreover, puts no deadline on the collective bargaining process with respect to the issue of contracting out, nor does it require Amtrak and union representatives to reach agreement on the issue of contracting out.

### **D. Productivity Improvements**

Amtrak has achieved some changes in work rules in its recent agreements that have the potential to result in labor cost savings. Some of the more important changes include: contracting out Amtrak's entire Commissary operations to an outside contractor, eliminating approximately 244 positions through employee buy-outs (Amtrak has had statutory authority to contract out its food service operations since 1981); extension of the period from 4 hours to 6 hours before a second engineer must be added to an engine consist (Amtrak estimates that this will permit the elimination of over 50 positions in the short term, and another 30 positions in FY1999 and FY2000); and providing Amtrak management with additional flexibility to assign work with respect to the implementation of high speed service on the NEC (no specific savings calculations provided).

Under the ARAA, Amtrak is required to report quarterly to the Council regarding work rules savings resulting from recent agreements, including how the savings are allocated. Under recent agreements, Amtrak's labor costs have grown by approximately 10 percent above the rate of inflation since 1995. (See May 2000 GAO Report "Amtrak Will Continue to Have Difficulty Controlling Its Costs and Meeting Capital Needs" ("GAO Report") at 8.) Amtrak's stated goal is to partially (20%) offset recent wage increases through labor productivity improvements.

Amtrak submitted to the Council a set of numbers on a quarter-by-quarter basis stating a "final" total of \$21.3 million in "productivity improvements and work rules and cash

savings” for FY1999. The report did not show how the savings were allocated and provided no analysis of how the numbers were calculated. For the first three quarters of FY2000, Amtrak submitted a comparable report stating a preliminary total of \$19.5 million in “productivity improvements, work rule and cash savings from post-January 1, 1997 labor agreements.” Similarly, the report did not show how the savings were allocated nor how the numbers were calculated.

As found by both the Council (in its January 2000 report) and the General Accounting Office (in its May 2000 report), there is no way to confirm Amtrak’s productivity calculations nor to distinguish how much the stated savings are instead attributable to internal Amtrak departmental budget cuts. Amtrak has no methodology in place by which it can measure work rule savings nor does it maintain an audit trail of the information necessary to measure such changes. (See Council Report at 20; GAO Report at 27,n.14).

Moreover, as further noted by the Council and GAO reports, Amtrak currently “does not have standard measures of labor productivity for its different lines of business (e.g., intercity passenger service, commuter service).”GAO Report at 26; Council report at 20. Both the Council and the GAO believe that the development of standard measures of productivity is critical if Amtrak is to control its labor costs (which constitute over 50 percent of operating costs).<sup>1</sup> Amtrak has stated in response to the GAO Report that it intends to develop such measures (GAO Report at 5).

Under subsection 203(f) of the ARAA, Amtrak is required to make available to the Council all information that the Council needs to carry out its duties. The Council, in turn, must adopt procedures to protect against public disclosure of confidential information. Although the Council staff has negotiated a confidentiality agreement with Amtrak, Amtrak has to-date declined to provide Council staff with information (particularly relating to labor productivity) that it deems confidential. The Council is working with Amtrak to secure additional productivity data and to agree on acceptable methodologies for measuring labor cost savings and monitoring general labor productivity.

## **PROGRESS TOWARD SELF-SUFFICIENCY**

While there is a general understanding among people knowledgeable about Amtrak that Amtrak has made some improvements in its financial and operating performance, and that Amtrak has achieved many of the objectives of its strategic business plan through the first half of FY2000, Amtrak needs to achieve significantly greater improvements beginning in FY2001 for Amtrak to achieve operating self-sufficiency by FY2003 as required by the ARAA.

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<sup>1</sup> Indeed, the Council has not been able to find management or benchmarking systems in place at Amtrak to measure the productivity of any of Amtrak’s endeavors, not just the management of its work force.

## **A. Key Points From Recent Audits and Reports by the DOT/IG and the GAO.**

This hearing will undoubtedly hear in detail from Kenneth Mead, the Inspector General of the Department of Transportation, about his office's September 19, 2000, report, "2000 Assessment of Amtrak's Financial Performance and Requirements." According to an article in last Friday's Washington Post, Amtrak largely agrees with Mr. Mead's assessment, as does the Council. We would just like to highlight a few of the points that report made, from the perspective of the Council.

Starting from the DOT IG's point that Amtrak has indeed increased its ridership and revenue in 1999 and 2000, but that it must curtail its expense growth to achieve operating self-sufficiency in 2003, we would move on to quote two points:

- **"Without major corrective action, Amtrak will not achieve operating self-sufficiency in 2003."** Specifically, Amtrak needs to achieve \$737 million in savings from undefined management actions, and it needs to achieve its revenue forecasts for Acela Express and other Northeast Corridor service despite a revenue risk identified by the Inspector General's report of \$304 million.
- **"Amtrak's capital outlook is grave."** Amtrak will face serious capital shortfalls beginning in FY2001. Even assuming Amtrak's cash losses are no higher than Amtrak projects, Amtrak will face a minimum funding shortfall of \$91 million, and continued shortfalls through 2004 will total \$298 million. The Council thinks it is important to note that this capital shortfall reflects, in part, a less than optimal use by Amtrak of its TRA funds.

You also asked the Council, Mr. Chairman, to comment on the May 2000 report of the United States General Accounting Office, "Intercity Passenger Rail, Amtrak Will Continue To Have Difficulty Controlling Its Costs And Meeting Capital Needs." This report made a number of findings consistent with the Inspector General's report and findings of the Amtrak Reform Council.

- While its performance has improved in recent years, from 1995 to 1999, Amtrak's operating costs were, in total, about \$150 million more than planned.
- Amtrak has no measures of labor productivity for its lines of business (e.g., intercity passenger service, commuter service) that could help it better manage its labor costs.<sup>2</sup>
- Because future cost increases can be expected, it will be critical for Amtrak to achieve the revenue projections for such things as its high-speed rail program on the Northeast Corridor.

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<sup>2</sup> See Footnote 1

- GAO estimates Amtrak has short- and long-term capital investment needs totaling about \$9.1 billion through 2015 plus additional capital investment needs for which costs estimates have not yet been developed.
- GAO recommended that Amtrak develop measures of labor productivity for its different lines of business and a multiyear capital plan. Amtrak agreed to these recommendations.

## **B. Amtrak's Recent Financial Performance**

Although Amtrak's actual financial performance as measured by its "Budget Result" was slightly ahead of its Strategic Business Plan projections through the second quarter of its fiscal year (March 31, 2000), Amtrak was \$9.5 million below its Budget Result after the third quarter (June 30, 2000), and its financial performance for the balance of FY2000 is likely to be increasingly unfavorable relative to its FY2000 Budget due primarily to shortfalls in passenger and mail/express revenues attributable to delays in the introduction of Acela Express service and lower growth of mail/express revenues.

Amtrak's system revenues increased 7% from FY1998 to FY1999, and system revenues were up 11% in the first nine months of FY2000 relative to FY1999, which was essentially consistent with projected revenue levels in the FY2000 Strategic Business Plan. After increasing 2% in FY1999 over FY1998, ridership was up 3.5% during the first nine months of FY2000, but 1.2% below the Strategic Business Plan projection. Amtrak achieved its Business Plan revenue projections while falling short of its ridership levels due to higher average ticket prices than projected.

Total system expenses increased 7% from FY1998 to FY1999, and they were up 7% in the first nine months of FY2000 relative to FY1999, which was approximately 1% (or \$14 million) worse than projected in the FY2000 Strategic Business Plan. It is important to note, however, in comparing changes in revenues and changes in expenses, that since Amtrak's expenses exceed its revenues by a large amount, operating losses were approximately \$16 million greater than projected in the Strategic Business Plan for the first 9 months of FY2000 even though FY2000 revenues were essentially on Plan.

Amtrak's cash losses were \$54 million greater in FY1999 than FY1998. Amtrak's cash losses were \$27 million (6%) lower in the first 9 months of FY2000 than FY1999, but they are \$22 million (5%) behind its Strategic Business Plan projection.

We believe, together with the Office of the DOT Inspector General and the GAO, that while Amtrak arguably has achieved many of its Plan objectives during the past two years, most the "heavy lifting" in terms of improving the Corporation's bottom line lies ahead, with even greater need for annual improvements starting in FY2001.

Although the general trend of Amtrak's financial performance has been improving in recent months because of increased ridership – due in part to new services and to historic

levels of congestion in the aviation system, particularly in the Northeast Corridor – the delay of Acela has meant that Amtrak is going to end this year significantly (approximately \$75 million) below Plan.

## **WHERE DOES THE COUNCIL STAND AND WHAT DOES IT SEE?**

Mr. Chairman, in a recent conversation, Senator Lott told me that he wants the Council, as part of its statutory duties of making recommendations for improvements, to give the Congress a plan for a new modern national rail passenger system and to make sure we include recommendations about how to fund it. In the broader context, Mr. Chairman, I think Senator Lott's request captures the essence of what the Congress in the Reform Act asked the Council to do – regardless of whether there is ever a need for a finding as to Amtrak's self-sufficiency.

After about 18 months of full operations, Mr. Chairman, I feel that this Council has come together quite well and that it has developed a solid perspective on the situation of intercity rail passenger rail service in America today.

### **A. The Situation Today**

Mr. Chairman, we are now looking at a domestic intercity transportation picture that for the first time in many years, actually needs the rail passenger mode in many important transportation markets in this nation. Air and road congestion in critical city pairs and regions have brought us to this position.

The States, or at least a significant number of them that are faced with the need to find additional useful intercity transportation capacity, are being aggressive in their pursuit of opportunities for improved intercity rail passenger service.

The Council also sees a federal government – both executive and legislative – that has:

- Provided Amtrak, which by law is now a private, federally-chartered District of Columbia corporation, as the sole national instrument for operating and improving intercity rail passenger service in this nation today; and
- Designated 11 emerging high-speed rail corridors – to go with two already-established corridors (the Northeast Corridor and New York's Empire Corridor).

### **B. Amtrak Today, as Analyzed and Reported by the Council**

Amtrak is a conglomerate, trying to carry out many major functions in addition to its core mission. That mission is to operate a national system of intercity rail passenger, mail and express services, which is what Amtrak was established to do.

In the Acela delay, which it now seems may be coming to an end, Amtrak is facing a critical obstacle to self-sufficiency. But it is important to note that Acela – even if it achieves the results that Amtrak forecasts – will provide significantly less than half of the financial performance improvements that the DOT IG’s report says that Amtrak needs to achieve.

Its Northeast Corridor infrastructure is also a problem. The Council has recommended that Amtrak keep separate financial statements on it. If it were a separate corporate division of Amtrak, it might be able to raise its own funds in capital markets.

Amtrak has had, and continues to have, major problems achieving improvements in all areas of productivity, including its use of capital, labor, and materials. That said, the Council does not regard labor as the problem at Amtrak. The real problem is the overall structure of the corporation’s management, exacerbated by inadequate information systems, and a lack of accountability – division by division and function by function – for bottom line results. Amtrak is also subject to substantial and continuing political interference, which seriously hampers its ability to operate like a business.

Amtrak operates a fleet of passenger cars that is too old and too small. It needs new equipment to provide better service that will attract new riders and haul more mail and express traffic. The Council believes that much, if not all, of this equipment should be able to be financed by private capital markets.

It needs better infrastructure on which to operate, both in the NEC and throughout the other 12 corridors. But this is far from just Amtrak’s problem.

To do all this, our nation needs a new system of financing for rail passenger service, which means that the government should put on its policy hat and design one for it, looking both at infrastructure and equipment and the roles of government financing and private capital markets.

This brings me to the question as to how the proposed bonds fit into all of this.

## **THE PROPOSAL TO AUTHORIZE SPECIAL BONDS TO FINANCE HIGH-SPEED RAIL INVESTMENTS**

When the Council was asked by the Senate Commerce Committee to testify at this hearing on Amtrak issues, including providing the Council’s views on the proposed “High Speed Rail Investment Act” (S.1900 and H.R. 3700), I directed the staff to send a memorandum to all Council members to determine the views of each Council member as to whether the Council should support or oppose the passage of this legislation. The results of the poll are as follows. Nine of the eleven Council members supported the proposed legislation with certain modifications: (1) the Bonds can be issued by “an intercity passenger rail carrier,” which would include state high speed rail authorities, not just by Amtrak; (2) priority should be given to use the Bond funding for infrastructure

only, and should only be used for equipment if private financing is not available<sup>3</sup>; and (3) Bond funds be segregated from the operating bank accounts of Amtrak and other intercity passenger rail carriers' that might issue Bonds, and not be treated as fungible assets of these corporations. (This would be a change from the way that Amtrak dealt with the Taxpayer Relief Act funds in terms of interim use and investment.) Several Council members believe that the Council has no business taking a position on certain tax-related issues that are more appropriately issues for others to determine. An example of such issues are the Department of the Treasury's current limitations on private activity tax-exempt bonds and requirements that proceeds from tax-exempt bonds be expended within three years of the time that tax exempt bonds are issued by the States. [A summary of the specific issues proposed to the Council members as part of their "vote" is found at Attachment I].

The two remaining members had different positions. Mr. Money Penny, the Presidentially-designated member representing the views of rail labor, expressed the view that the Council should not take a position on the bonds. The Administration indicated that it was in the process of determining its position and that, when its position was determined, it would so advise the Council. As of the time of the submission of this testimony to the Committee, the Council had not received notice of the Administration's position. We are treating that as a temporary abstention.

Mr. Chairman, should these bonds not pass in this session of the Congress, it is likely that other ways could be found to finance high-speed rail, including the federally-designated high-speed rail corridors. Such proposals might best be developed, I believe, from a well-considered effort by experts in transportation policy and finance to determine a modern Intermodal Surface Transportation Policy and an accompanying array of financing mechanisms needed to fund improvements in intercity passenger rail infrastructure and equipment. The Council will be ready to participate in any such discussion and debate about how to best do the job. This effort would have to start with a comprehensive capital needs plan, which Amtrak has not provided, aside from its 25-year estimate of capital needs for the south end of the Northeast Corridor.

Is \$10 billion needed? Without a doubt. And considerably more, in fact, if we are serious about improving and expanding intercity rail passenger service. The Reform Act charges the Council with a positive mission – to recommend improvements in Amtrak and, if Amtrak cannot improve to the extent the Congress requires, to design an improved national intercity rail passenger system. The Council was established to determine the best way to improve our national rail passenger system, and we see the need for a major investment in passenger rail service over the coming years. Assuming that, in some form and at some time, \$1 billion per year for Corridor Development is provided, that amount could easily be matched by as much as \$1 billion per year for other needs. These other needs include additional funding for the NEC and the emerging corridors, enhancements to the current national rail passenger system and to Amtrak's mail and express operations, and implementation of the Network Growth Strategy.

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<sup>3</sup> The Council believes passenger equipment can be funded in large part by the private sector.

Let me preface all this by saying that – on behalf of the Council – I think we would not be doing our duty as an independent oversight agency if we did not point one thing out. The reason we are we are all facing the very difficult issues that these bonds pose – and here I quote from the Council’s first annual report – is that:

“Unlike roads and air, however, neither local or state governments nor the federal government have determined an institutional and financial solution for adding the track and equipment capacity to provide an expanded system of intercity rail passenger service. The privately-owned rail freight rights-of-way present unique issues compared to the publicly-owned and publicly-funded national systems of highways, airports, and airways. Rail rights-of-way, unlike other modes of transportation, do not have a stable funding mechanism for rail passenger corridor development.” (Amtrak Reform Council, First Annual Report, January 2000, p.1)

So we should realize that – under our current transportation policy – we are using Amtrak to do what in other modes is done by two separate and separately funded types of organizations, one focusing on infrastructure, and one focusing on transport operations. The first is exemplified by the roles of the Federal Highway Administration operating in concert with the state highway departments, the Federal Aviation Administration, and the Corps of Engineers. The role of transport operations is – in all of these other modes – carried out by operating companies that carry passengers, mail, and express. Companies in modes other than rail are not entangled with huge infrastructure funding burdens; they pay a user fee for the infrastructure and focus their attention on serving the traveling public.

I know Mr. Chairman that this committee is much concerned with the problems of the aviation system today, and we each have our own stories about the stress of contemporary airline travel. But the problems of the airlines and the aviation system are the problems of success. Each year for the past three years the airlines have been adding more intercity passengers than Amtrak carries annually in total. And they have been adding each year as many or more employees than Amtrak’s total complement of agreement employees.

The question the Council is asking is “What is the best way to get rail passenger service to begin to share in the economic bonanza that is causing problems for air and highway travel?”

Against this backdrop, the Council’s concern with this legislation has two dimensions – policy and practicality.

From an overall policy standpoint, has this approach really been thought through thoroughly? Is the mechanism of these bonds, aside from the matter of who issues them, the best way to finance passenger rail capital needs? I would think that it depends on what part of those needs you are looking at. It is almost certainly not a sound way to fund the capital needs of Amtrak the corporation. But it might well be a reasonable way

to fund long-term infrastructure improvements to the FDHSRCs. That raises these specific policy issues:

1. Is Amtrak the corporation, from all standpoints the best vehicle for issuing these bonds?
  - It does have about \$5 billion in Net Operating Loss Carryovers (NOLs), but these exist because historical government subsidies were made in the form of preferred stock investments in Amtrak by the government, which arguably should have been characterized as operating grants rather than capital investments.
  - What about Amtrak's balance sheet? Should it be burdened with \$10 billion in debt (or contingent liability debt) for improvements to the infrastructure, most of which it does not own? What will this do to Amtrak's ability to borrow in private markets?
  - Should we be loading major program and financing responsibilities on a corporation which is clearly having difficulties getting its core business to run well, and which is facing the need to achieve self-sufficiency by December 2, 2002?
2. Has there been a clear assessment of the best potential roles of public financing and private capital markets?
3. And finally, has there been any solid attempt to determine the best possible way for money to be put into the infrastructure improvements of America's private railroads in order to provide the capacity and speed improvements needed to implement the Federally-Designated High-Speed Rail Corridors? [Attachment II shows that, under the most favorable assumptions, over 30 years the taxpayers (federal and state) will pay at least \$15 billion (and possibly as much as \$18 billion) for \$10 billion of high speed rail projects].

The proposed bond mechanism in effect uses Amtrak as a sort of Fannie Mae for the infrastructure of the railroad industry. One reason for the choice is clear – the \$5 billion in NOLs that the corporation holds because of the subsidies it received previously from the government. These NOLs shelter the escrow Fund's taxable interest income needed to grow on a compounded basis and be available in 20 years to repay the bonds.

This is where issues of practicality come in. In the event that the Congress decides to pass the bond bill in this session, the Council believes that it should be done with the following amendments:

- (a) The funds primarily should be used for infrastructure improvements, with 90 percent for the FDHSRCs and 10 percent for non-FDHSRCs (the 10 percent should be allocated to non-Corridor states by DOT)

and should only be used for equipment expenditures if private-sector financing of equipment is not available;

- (b) There should be adequate criteria for evaluating and assigning priority to the candidate projects, with DOT and the states playing the major role in the initial selection of projects. Amtrak should not be in the business of choosing projects outside the NEC. Assets outside the NEC are not Amtrak's assets, nor does Amtrak have a monopoly to provide rail passenger transportation in those areas;
- (c) Effective oversight arrangements need to be in place for the projects to be funded by the bonds;
- (d) All funds, including both state contributions and bond proceeds, should be under the control of the Independent Trustee and should not be able to be borrowed by Amtrak (or any other issuer), or otherwise be entangled with its internal finances. To do so would be to create a risk of having the proceeds entangled in the internal finances of the issuer in a way that could put the bond proceeds and the bond escrow account at risk in the event of creditors' claims (in Amtrak's case, this would include the risk of default on its commercial debt obligations that Amtrak, in Appropriations testimony, has stated that it could indeed face). Moreover, discussions the Council's staff has had with financial experts experienced in bonds indicate that, when the prospectuses for these Bonds are issued, if Bond proceeds are to be mixed with Amtrak's internal funds, it could raise the perceived financial risks of the Bonds.

Mr. Chairman, thank you again for your invitation to the Council. The issues you and the Committee are addressing are critical to the future of rail passenger service in this country, which we all want responsibly and effectively to promote.

## BACKGROUND PAPER ON PROPOSED CHANGES ACCEPTED AND UNDER DISCUSSION TO S. 1900 AND H.R. 3700

### I. Issues Discussed With Amtrak and FRA, Annotated by Later Changes from the Senate Budget Committee Meeting

The Council staff met with Sandra Brown (Vice President, Government Affairs) and Bill Erkelenz (legal counsel) of Amtrak and Mark Yachmetz (Associate Administrator for Railroad Development, Federal Railroad Administration). Ken Kolson followed up by telephone on August 24 with Bill Erkelenz. On September 8<sup>th</sup>, the Council staff met with Mitch Warren of the Senate Committee on the Budget (SCOB).

- A. Update on the Status of the Legislation.** Amtrak indicated that ongoing legislative discussions surrounding the High Speed Rail Investment Act are now based on the text of H.R. 3700, not S. 1900; that Senator Lautenberg has agreed to the more restrictive provisions of H.R.3700<sup>4</sup>; and that Amtrak has agreed to support certain amendments and clarifications to H.R.3700, which are summarized below:
1. Amtrak would support the House language that (a) would allow rail passenger carriers other than Amtrak (including specially-established State entities) to issue Bonds and (b) would place a 30% cap on proceeds that could be used for any corridor, including the NEC. Amtrak noted its interpretation that the Alaska Railroad was qualified to issue bonds.<sup>5</sup> In the Budget Committee meeting, Mr. Warren indicated that the issue of additional potential issuers of the bonds had been augmented by a proposal from railway labor that Davis-Bacon provisions apply to all projects, regardless of the issuer.
  2. Amtrak would support statutory criteria for Amtrak and DOT to apply in selecting projects (criteria similar to those used by the Federal Transit Administration in approving transit grants). Amtrak also would support oversight and greater participation by the Secretary of Transportation or the DOT Inspector General in the process of selecting projects to receive Bond funding. Mr. Warren of the Budget Committee indicated that work was underway to develop criteria.
  3. Amtrak would support adoption of provisions providing for federal and state oversight of the projects funded and amounts expended by Amtrak under the Bond program, possibly using as guidance the project management oversight process from the transit industry with a private PMO (“Project Management Oversight”) contractor making sure that the funds are expended according to the applications and grant agreements executed between Amtrak and the States.
  4. Amtrak would support legislation clarifying that States could use tax-exempt project revenue bonds to fund the States’ 20% matching contributions in whole or in part.<sup>6</sup> This provision could

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<sup>4</sup> Amtrak has indicated that it is willing to be bound by the additional restrictions of H.R. 3700 (no more than 30% of funds invested in any corridor; explicit statement that there is no federal guaranty of the bonds; and any “intercity passenger rail carrier” can issue the Bonds, not just Amtrak).

<sup>5</sup> Although only 10% of the proceeds of an issue each year can be used to improve non-designated high-speed corridors under the language of the bills, Amtrak interprets the language as allowing the Alaska Railroad to issue bonds for 10% of the maximum allowable \$1 billion cap each year. Senator Stevens reads it this way too.

<sup>6</sup> Amtrak noted that states can put up their 20% shares of funding by issuing general obligation tax-exempt bonds (but the states presumably would prefer to issue project financing bonds since such bonds are not full faith and credit obligations of the

encounter U.S. Treasury Department opposition since it may open the door for others also to get implicit federal subsidies by getting authority to issue more tax-exempt project financing bonds.

5. Amtrak agreed to have a capital plan in place before any bonds are issued. Although Amtrak did not provide the specifications of the promised capital plan, Amtrak seemed to suggest that it would provide a five-year capital plan rather than a longer-term plan. It is expected that Amtrak's capital plan would be issued before the end of September.
6. Amtrak believes the 36-month period to make qualified expenditures may not be sufficient because it will take time before projects can get underway (particularly with a requirement for DOT approval of project plans, and possible requirements for Environmental Impact Statements). Chairman Shuster informed Amtrak that he thinks the 36-month period is too short. FRA noted that its experience with the Northeast Corridor Improvement Project supports the need for a longer spend-out period.<sup>7</sup> Amtrak anticipates that approximately 20% of each year's bond funds will be invested in the years that the bonds are issued. In the Budget Committee meeting the issue was raised that Treasury regulations do not permit longer than three years between issuance and expenditure for the project to be financed.
7. Amtrak reads the language of the bills as requiring a State to put up its 20% match in cash (not just to make a written commitment) prior to the issuance of any Bonds.
8. Amtrak noted that the issue of who will manage a project must be resolved in each case. The entity that would manage the project would be specified in agreements among Amtrak, the states, and any freight railroad that might be involved.
9. Amtrak will take legal measures, to the extent possible, to insulate the funds held by the independent trustee (in what Amtrak calls an Escrow Fund) from Amtrak's creditors; Amtrak does not envision that a separate taxable entity will be created; Amtrak will pick the independent trustee using a competitive process similar to the one used to select the advisor to invest the TRA funds; and Amtrak expects that the bonds will be paid off through Guaranteed Investment Contracts (GICs) purchased by the trustee. Amtrak's legal counsel said that, if necessary, perhaps the Escrow Fund could be placed in a Grantor Trust to isolate it from Amtrak's general creditors, while allowing Amtrak's tax attributes to be used to shelter taxable income otherwise earned by the Escrow Fund.<sup>8</sup>
10. When asked about how income taxes on Escrow Fund interest earnings would be paid (which Amtrak anticipates will be taxable for income tax purposes), Amtrak offered its remaining approximately \$5 billion of Net Operating Loss Carryovers<sup>9</sup> as well as future losses (due to

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states). Amtrak also noted that the current IRS Code allows States to issue tax-exempt project financing bonds for high-speed train facilities as long as such trains can travel at speeds of 150 mph or faster for appropriate portions of their trips.

<sup>7</sup> Mark Yachmetz noted during the meeting that in the approximately 19 years that funds were administered by the Northeast Corridor Improvement Project, first year funds expended never exceeded 15%, and only twice did first year funds expended exceed 10%.

<sup>8</sup> Legal structures can isolate the Escrow Fund from Amtrak, but in an Amtrak bankruptcy proceeding, creditors of Amtrak could argue that the Escrow Fund should repay Amtrak (a) for the value of any principal payments made with Amtrak funds pursuant to Amtrak's guaranty of Bond principal within three years of an Amtrak bankruptcy, and (b) for the value of Amtrak tax losses used by the Escrow Fund to shelter interest income from federal and state income tax liability within three years of an Amtrak Bankruptcy.

<sup>9</sup> Amtrak's audited financial statements report a NOL carryover balance of \$8.4 billion as of December 31, 1998, less a \$3.3 billion reduction in fiscal year 1999 due to the funding received under Taxpayer Relief Act of 1997. Since the Net Operating Loss (NOL) Carryovers represent losses funded by federal investment in Amtrak, primarily through the purchase of preferred

depreciation, etc.) to be available to shelter any taxable interest income. Presumably, the same Amtrak losses would be available to shelter any taxable interest earnings resulting from temporary investments of the Bond principal of \$1 billion per year until the funds are expended for qualified, approved projects.

11. The 5% of the proceeds that can be used for non-qualified project expenditures is expected by Amtrak to be used for “soft costs” (e.g., transaction costs; funds for oversight of projects [Project Management Oversight similar to that used for projects funded with transit grants, as proposed by OMB and DOT/IG] and other set-asides to ensure that no issue arises regarding the qualification of the Bonds).<sup>10</sup>

**B. Other Issues Discussed.** In addition to the above issues, which Amtrak represented as likely legislative amendments, other issues related to the Bonds were discussed, as indicated below:

1. When asked if certain types of project expenditures such as progressive overhauls could be funded with Bond proceeds, Amtrak indicated that they theoretically could. Amtrak, however, did not anticipate that the States would agree to use Bond funds for progressive overhauls. The FRA concurred, stating that although the States may approve using Bond funds and may provide matching State funds for capital expenditures on a Generally Accepted Accounting Principal (GAAP) basis (i.e., new, long-term assets or expenditures which rebuild or significantly increase the useful lives of assets), approving Bond funds for progressive overhauls was not likely.
2. Amtrak anticipated that the DOT or some other federal agency would have to approve project applications before Bond funds would be made available. As a result, both Amtrak and Mark Yachmetz did not think that Bond funds, unlike TRA funds, would be used for purposes that did not advance high-speed rail passenger service.
3. Freight railroads and other entities that benefit from the Bond funding would have to agree to certain requirements and restrictions pertaining to use and maintenance of the assets funded throughout the life cycle of the assets (FRA noted that there needs to be an agreement with the freight railroads in place prior to approval of the project and issuance of the Bonds).
4. The bills do not spell out how the Bond fund proceeds can be invested by Amtrak for the 36-month (or greater) temporary period before they are used to pay for qualified project expenditures. Amtrak intends to invest the money in high-yield investments, the earnings from which would go into the Escrow Fund to pay off the bonds. Amtrak estimates that the Escrow Fund will have to earn a rate of return of approximately 6.25% (rather than the 8.38% rate calculated by the Council staff, which assumed that Bond principal would be immediately spent on qualified project expenditures). This is because Amtrak assumes that a maximum of 20% of the bond funds will be expended in the first year, not more than 40% in the next year, with the balance presumably being spent in the third and following years. Before the funds are used for project expenditures, the interest earnings on the invested Bond principal will go into the Escrow

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stock, this approximately \$5 billion of NOL Carryovers may not be available in the future if there is a financial recapitalization of Amtrak. Furthermore, depending upon the income tax treatments appropriate for future federal and state funding mechanisms, Amtrak may not generate sufficient taxable losses in the future to fully offset the interest income earned by the Escrow Fund.

<sup>10</sup> The 5% could also allow the bonds to be sold at a small discount to their par value and still satisfy the statutory requirement that at least 95% of the proceeds are used for qualified investments.

Fund, allowing a lower rate of return to be required on the 20% State matching funds in the Escrow Fund.<sup>11</sup>

5. When asked, Amtrak agreed that, under the language of the current bills, it could borrow the money for all or part of the 36-month “temporary investment” period at a stated rate of interest and deposit the interest payments in the Escrow Fund. Amtrak indicated that, prior to this question, no one in the Corporation had given any thought to Amtrak’s borrowing the funds temporarily.
6. Amtrak interprets the bills as allowing a freight railroad to reimburse a state for all or part of the 20% match. Amtrak (and DOT) believe that any benefit to a freight railroad in improving its infrastructure in a high-speed corridor would also benefit Amtrak and intercity passenger service, even if only indirectly.
7. Mark Yachmetz noted that DOT was in discussions with Amtrak about the bills, but, as of August 23, DOT had taken no position yet. DOT may endorse the bills (with certain amendments), or it may not. After the meeting, he noted to the ARC staff that H.R.3700 was likely to be the last legislative opportunity to fund high-speed rail development projects until FY2003.

## **II. Staff Suggestions for Improvements to Amendments Proposed and Description of Further Amendments Believed to be Needed**

After reviewing the improvements in the proposed legislation as discussed with Amtrak and DOT, the Council staff believes that some of the proposed amendments need strengthening and additional conditions should be imposed.

### **A. Suggested Improvements to Proposed Amendments.**

1. There should be clear investment criteria for the Secretary of Transportation to use in prioritizing and approving projects, and Amtrak should be made subject to DOT reporting requirements regarding project expenditures. It would be preferable for the Secretary of Transportation to make decisions that will shape the Nation’s future passenger rail infrastructure. In addition:
  - There should be incentives for the states to increase the percentage of matching funds contributed to financing projects funded with the Bonds; this should be one of the criteria used by the Secretary in reviewing and assigning priorities to projects submitted for approval (Amtrak and DOT noted that this issue was currently under discussion, and this issue is a high priority for the Senate Budget Committee);
  - There should be incentives in place to obtain contributions from freight railroads that are beneficiaries of bond-financed projects (DOT and the Senate Budget Committee are also working on this issue).
2. Capital improvements should meet the standards of Generally Accepted Accounting Principles. The bond proceeds would therefore be used only for capital expenditures for projects funding

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<sup>11</sup> Attached to this memorandum are analyses which show the amounts that need to be earned to repay Bond principal in 20 years with Bond funds (1) immediately spent on qualified project expenditures, and (2) invested for a period of time before being spent on qualified project expenditures. These attachments, showing both after income tax and before income tax cases, confirm Amtrak’s assertion that an after-tax (or tax exempt) interest rate of approximately 6.25% for 20 years will be sufficient for the Escrow Fund to repay the loan principal in 20 years.

infrastructure improvements or equipment. Amtrak operating expenses, such as progressive overhauls or preventive maintenance, would not be eligible.

3. Amtrak should be required, on a permanent basis, to incorporate a rolling five-year capital investment expenditure plan into its Strategic Business Planning process ("rolling" means that the investment expenditure plan would be updated each year for the next five years as part of Amtrak's normal business planning process).
4. In addition to the language of H.R. 3700, which permits Amtrak and other intercity rail passenger carriers to issue Bonds, bona fide high-speed rail authorities should also be permitted to issue the Bonds. Rail labor has proposed that Davis-Bacon provisions should apply to projects financed by any issuer of the bonds.

#### B. Additional Conditions That Should Be Considered

1. DOT should be required to maintain annual oversight of the state of good repair of the assets improved with investment funds:
  - Freight railroads should be required to issue reports concerning how the funds were expended and demonstrating that they have performed normalized maintenance on the segments improved with Bond funds.
  - Amtrak should be required to provide annual reports on the financial and physical state of good repair of the NEC infrastructure, including improvements made with bond funds.
2. To ensure that Bond proceeds are not mixed with Amtrak's operating funds in any way that could entangle the proceeds with any future creditors' claims, all Bond proceeds and state contributions should be placed in separate accounts within the Escrow Fund controlled and managed by the independent trustee. The temporary investment of the Bond funds should be limited to AAA investment grade securities, possibly limited to federal government obligations.
3. The statute should require that, within the \$3 billion allocated to the NEC, the highest priority is to correct the remaining fire and life safety problems in Penn Station New York and its associated complex of tunnels. At a minimum, safety should be a principal criterion for the DOT to use in assigning priority to and selecting projects.
4. States should have the right to inspect Amtrak's financial records for Bond-funded projects.

### **III. Impact of Changes Accepted by Amtrak and those Yet to Be Considered in the Bills**

In looking at the process that has occurred during the past few weeks since the hearing by the House Ways and Means Subcommittee on Oversight, it seems that:

1. If, indeed, the bonds are intended to fund only the infrastructure improvements of the federally-designated high-speed rail corridors (the FDHSRCs, which, includes the Northeast Corridor, the Empire Corridor, and the 11 emerging high-speed rail corridors designated under ISTEA and TEA-21), there is probably a better way to structure an infrastructure improvement program (e.g., a federal-state variant of the NECIP program in which FRA, with assistance from FHWA, would work with the state DOTs and the freight railroads to upgrade infrastructure).

2. If this were the only vehicle that would ever be possible for funding the corridors, additional amendments should be considered (as discussed in Section II) that would ensure:
  - (e) Funds could only be used for infrastructure improvements to the NEC and the FDHSRCs (plus the 10 percent for non-FDHSRCs, which should be allocated by DOT);
  - (f) Adequate criteria be in place for evaluating and assigning priority to the projects, with DOT playing a direct role in initially choosing projects. Amtrak should not be in the business of choosing projects outside the NEC. Assets outside the NEC are not Amtrak's assets, nor does Amtrak have a monopoly to provide rail passenger transportation;
  - (g) Amtrak should not be eligible to manage projects, except in the NEC, and only there with the agreement of the participating states;
  - (h) Effective oversight arrangements be in place; and
  - (i) All funds, including both state contributions and bond proceeds, be under the control of the Independent Trustee and cannot be borrowed by Amtrak or otherwise be entangled with Amtrak's internal finances.

The overall impact of these changes would be to convert the original bills, which appeared to be very simple instruments for providing blanket authority without a well-defined program objective or adequate restrictions for Amtrak to issue Bonds (based on Amtrak's exclusive comparative advantage of having about \$5 billion in NOL tax carryforwards), to a bill designed to ensure that the Bonds would be used to fund the infrastructure improvements necessary to develop the FDHSRCs. The Council staff believes that a better approach would be to start with a programmatic bill designed effectively to fund the infrastructure improvements needed for the FDHSRCs and then to meld onto it any tax provisions that might be best-suited to finance the corridor development program.

The Council clearly stated in its First Annual Report that it believed that Amtrak was trying to perform too many functions to the detriment of its ability to operate a truly effective intercity passenger train operating company, and that, accordingly, major responsibilities in such areas as infrastructure improvement should be left to others. This view undergirds our assessment of the proposed Bond legislation.

## ATTACHMENT II

### REPLICATION OF JOINT COMMITTEE ON TAXATION ANALYSIS OF REVENUE ESTIMATE OF THE HIGH SPEED RAIL INVESTMENT ACT OF 2000 (\$ MILLIONS)

		Calculated Interest Rates Assuming Bonds Interest Payments Of 20% Of Annual Amounts In First Year Bonds Are Issued																			
		6.50%	6.50%	6.75%	6.55%	6.55%	6.57%	6.58%	6.59%	6.60%	6.60%	6.60%	6.60%	6.60%	6.60%	6.60%	6.60%	6.60%	6.60%	6.60%	6.60%
Fiscal Year	Bonds Issued	Fiscal Years																			
		2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
2001	1,000	13	65	68	66	66	66	66	66	66	66	66	66	66	66	66	66	66	66	66	66
2002	1,000		13	68	66	66	66	66	66	66	66	66	66	66	66	66	66	66	66	66	66
2003	1,000			14	66	66	66	66	66	66	66	66	66	66	66	66	66	66	66	66	66
2004	1,000				13	66	66	66	66	66	66	66	66	66	66	66	66	66	66	66	66
2005	1,000					13	66	66	66	66	66	66	66	66	66	66	66	66	66	66	66
2006	1,000						13	66	66	66	66	66	66	66	66	66	66	66	66	66	66
2007	1,000							13	66	66	66	66	66	66	66	66	66	66	66	66	66
2008	1,000								13	66	66	66	66	66	66	66	66	66	66	66	66
2009	1,000									13	66	66	66	66	66	66	66	66	66	66	66
2010	1,000										13	66	66	66	66	66	66	66	66	66	66
<b>Federal</b>	<b>10,000</b>	<b>13</b>	<b>78</b>	<b>149</b>	<b>210</b>	<b>275</b>	<b>342</b>	<b>408</b>	<b>474</b>	<b>541</b>	<b>607</b>	<b>660</b>									

<b>Cumulative Federal</b>	13	91	240	449	724	1,066	1,474	1,948	2,489	3,097	3,757	4,417	5,077	5,737	6,397	7,057	7,717	8,377	9,037	9,697
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<b>State</b>	2,000	200	200	200	200	200	200	200	200	200	200										
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**Federal For Selected Periods Of Time**

2001-2005	724																				
2001-2010	3,097																				
2001-2030	13,195																				

**TOTAL FEDERAL AND STATE COST IN NOMINAL DOLLARS OF SUPPORTING \$10 BILLION OF HIGH-SPEED RAIL INVESTMENT (HSRIA) BONDS**

2001-2005	1,724																				
2001-2010	5,097																				
2001-2030	15,195																				

**Calculation Of Net Present Value Cost At 6.5% Cost Of Capital For HSRIA Bonds Using Joint Committee On Taxation Methodology For Full 30 Year Period Bonds Are Outstanding**

		NPV @ 6.5%																			
Federal	5,292	13	78	149	210	275	342	408	474	541	607	660	660	660	660	660	660	660	660	660	660
State	1,438	200	200	200	200	200	200	200	200	200	200	0	0	0	0	0	0	0	0	0	0
<b>Total</b>	<b>6,730</b>	<b>213</b>	<b>278</b>	<b>349</b>	<b>410</b>	<b>475</b>	<b>542</b>	<b>608</b>	<b>674</b>	<b>741</b>	<b>807</b>	<b>660</b>									

**Calculation Of Net Present Value Cost At 6.5% Cost Of Capital For Direct \$1 Billion Grants Funded 80% Federally With 20% Matching By States**

		NPV @ 6.5%																			
Federal	5,470	160	800	800	800	800	800	800	800	800	800	640	0	0	0	0	0	0	0	0	0
State	1,368	40	200	200	200	200	200	200	200	200	200	160	0	0	0	0	0	0	0	0	0
<b>Total</b>	<b>6,838</b>	<b>200</b>	<b>1,000</b>	<b>800</b>	<b>0</b>																

**Additional Net Present Value Cost (Assuming a 6.5% Cost Of Capital) Of Direct Grants Versus HSRIA Bonds To Federal Taxpayers**

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**Total Additional Nominal Dollar Cost of HSRIA Bonds over 30 Year Life Versus Direct Grants**

Federal	5,195	[Assuming Federal Grants of \$800 million per year for 10 years]
State	0	[Assuming State Grants of \$200 million per year for 10 years].
<b>Total</b>	<b>5,195</b>	