☆ ☆ ☆ AMTRAK REFORM COUNCIL ☆ ☆ ☆

RFILtr05

November 12, 1999

The Honorable Tommy G. Thompson
Chairman, National Railroad Passenger Corporation
60 Massachusetts Avenue, N.E.
Washington, DC 20002

Re: Recommendations For Improvement

Dear Governor Thompson:

The Amtrak Reform Council (Council) has a statutory charge to evaluate Amtrak's operations and to make recommendations for improvement to the corporation, to assist Amtrak in its efforts to meet the goals of the Amtrak Reform and Accountability Act. With the delay in the introduction of Acela Express, Amtrak's need for improvement in near- to mid-term net revenues has been accelerated.

In keeping with this mandate, the Council has considered and approved a number of recommendations. I am pleased to forward to you the following recommendations for Amtrak's consideration and possible action.

1. Mail & Express ("M/E")

Earlier this year, the Council initiated discussions among the Council, Amtrak, and – in separate meetings – United Parcel Service (UPS) and the U.S. Postal Service (USPS). These meetings, together with a presentation to the Council by Mr. Ed Ellis, Amtrak's Vice President for Mail and Express, made it clear that a systematic effort to increase Amtrak's market share of mail and express traffic may offer potential improvements in Amtrak's net revenues and profitability. The Council further understands that additional meetings between Amtrak and UPS have confirmed the potential for substantial rapid growth of express revenues.

Before recommending that Amtrak significantly increase its Mail and Express business, however, the Council is requesting Amtrak to provide information on the historical and anticipated profitability of Mail and Express business. In the future, the Council would like such information in the form of separate income (profit and loss) statements on a monthly, quarterly and annual basis for Mail and Express. The Council understands that separate, historical

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income statements for Mail and Express were not prepared and are not available for past periods. Accordingly, to assist the Council in making its recommendations as quickly as possible, the Council would like to see all recent analyses prepared by Amtrak determining the profit contribution of Mail and Express. [1]

At this point, the **recommendations the Council tentatively is considering are subject to confirmation by the income statements and other financial information the Council is requesting, including confirmation that the Mail and Express business is sufficiently profitable to warrant the investment and other resources needed.** The recommendations currently under consideration by the Council (and which may be supplemented at a later date) are that Amtrak should take prompt and effective action to do the following **IF, AND ONLY IF, AMTRAK MAKES A DETERMINATION THAT MAIL AND EXPRESS ARE SUFFICIENTLY PROFITABLE**:

- Increase Mail and/or Express revenues by augmenting its inter-modal staff, either through contracting or hiring, with high-quality personnel.

- Add appropriate Mail and/or Express equipment to its fleet through the most cost-effective and flexible mechanisms possible, which might include (a) conversion of existing Amtrak equipment no longer suitable for carrying passengers, (b) using equipment owned by other companies which may be available on a traditional railroad per diem basis, (c) leasing equipment on a short term basis, and/or (d) having the firms desiring mail and express services lease, finance, or participate in the financing of, the needed equipment.

- Set up the Mail and Express business as a separate strategic business unit for planning and financial reporting purposes, with transparent accounting of its revenues and expenses, including clear distinctions and accountability of Mail and Express's (i) direct costs, (ii) costs of the route or region allocated to the Mail and Express business, and (iii) system-wide overhead costs allocated to the Mail and Express business.

With regard to this third recommendation, the Council is not recommending necessarily that the Mail and Express Group be removed organizationally from the Intercity Business Unit, nor that it be established as a corporate subsidiary within that unit. Amtrak's Board and management should decide the corporate structure and reporting relationship of Mail and Express to other Amtrak strategic business units. The Council's interest is that Mail and Express businesses have **transparent accountability** by being **financially segregated** from Amtrak's core passenger business units.

[1] Such income statements and special analyses may be prepared on whatever alternative income statement preparation methodologies Amtrak has already completed including, but not limited to, (i) an avoidable cost basis; (ii) a variable cost basis, and (iii) a fully allocated cost basis. The Council wants to receive **separate income statements** for **Mail** and for **Express** and special analyses that would help the Council understand the relative profitabilities of various lines of Mail and Express business.

Consistent with the Council's request for additional financial information concerning Mail and Express, Amtrak should immediately take at least the minimal steps necessary to permit the development of a clear and accurate income statement, balance sheet, and capital plan for the Mail and Express Group. These documents should be integrated into Amtrak's five-year strategic business plan, and into the normal business planning process.

2. Northeast Corridor (NEC) Fixed Plant

As the Council has learned about issues related to the operation of Amtrak's new Acela Express service, it has become clear that the condition of the fixed plant of the Northeast Corridor (NEC) from Washington, DC, to Boston, MA, is one of the most critical factors that may limit the ability of the new equipment to operate at design speeds. Speed is a factor critical to optimizing the ridership and financial benefits to Amtrak from the Acela investment as well as maintaining existing train traffic on the NEC. There is a need for the expenditure of substantial sums for the replacement and upgrading of aging systems (such as electrification south of New York and improvements to signaling and communications) and the renewal of major infrastructure (such as the eastern approaches to Penn Station in New York). This is in addition to the ongoing requirements for normalized maintenance of track, structures electrification, communications and signaling. The Council believes that this situation requires that special attention be given to the planning and execution of capital programs to maintain and improve the NEC fixed plant.

While we are sure that these facts are well known to the Corporation and its Northeast Corridor Business Unit (NECBU), we believe that in order to make the size and scope of these issues clearer to, and more tractable for, Amtrak's Board and the Congress, that the operations of the Northeast Corridor fixed plant (NECFP) should be set up as a profit center within the Northeast Corridor Business Unit. At this point, the Council is not recommending that the NECFP be organizationally removed from the NECBU, but Amtrak should take the minimal steps necessary to permit the development of a clear and accurate income statement, balance sheet, and capital plan for the NECFP. These documents should be integrated into Amtrak's five-year strategic business plan, and into the normal business planning process.

3. Inclusion of Plans of Corrective Actions (PCAs) in Strategic Business Plan

The Acela Express delay has demonstrated clearly that, as in any business, there is a substantial potential for unforeseen or uncontrollable events having major consequences upon the timing of Amtrak's forecasts for improvements in net revenues associated with operations. In mid-summer 1999, the Office of the Inspector General of the Department of Transportation and the General Accounting Office released assessments of Amtrak's current and projected financial performance based on thorough analyses of Amtrak's October 12, 1998 Strategic Business Plan. Both of those analyses made it clear that there are significant levels of risk (of non-achievement) associated with Amtrak's forecasts of revenue improvements and cost containment for a number of business plan actions.

Amtrak should, as part of its normal strategic and annual business planning processes, identify risks of not achieving its business plan objectives along with opportunities to exceed its business plan objectives. Once the risks and opportunities have been identified, Amtrak should develop, as part of its normal business planning processes, plans of corrective action, which are approved by its management and Board of Directors as part of the overall business plan, and which Amtrak's management will be ready to implement without further Board of Director approval if risks of not achieving its business plan objectives are realized.

4. Annual Cost Savings Goals

Based on the Council's regional outreach meetings, as well as direct communications with state departments of transportation, Amtrak risks losing a significant amount of commuter and subsidized Intercity passenger business unless Amtrak is able to get its unit cost structure more competitive with private sector companies. The market place in Boston (Amtrak's loss of the MBTA maintenance contract) and the Midwest (where fixed price contracts are being discussed with Amtrak) are indicative of overall resistance to increasing Amtrak charges to the states and local commuter authorities for passenger rail services provided by Amtrak. Amtrak management has to act more like a private, for-profit corporation and less like a government-owned agency providing rail service on a cost-plus basis, if Amtrak is to participate in the anticipated increase in passenger rail service along developing high speed corridors.

For the past several years, most corporations in the United States, in response to market place demands for lower unit costs, have set and achieved annual corporate objectives of improving productivity by some minimal amounts not tied to specific capital expenditures, typically in the range of 3% to 5% annually.[2] While goals of 3% to 5% annually may not seem significant, over several years, they can lead to significant productivity gains.

Often, these overall, corporate annual productivity goals are set for the corporation, but the specific actions to achieve the productivity goals are identified and taken on a decentralized, location-by-location basis. As part of Amtrak's program to achieve the financial performance goals established under the Amtrak Reform and Accountability Act, the Council believes that Amtrak similarly needs to set overall productivity goals from unspecified investments and business actions, and to then provide incentives to local managers and/or strategic business units to develop and successfully implement specific cost savings projects which they have identified.

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[2] In public news reports over the past several months, major successful corporations such as Boeing and IBM have announced ongoing and special cost reduction measures to offset lower-than-expected earnings in various sectors of their businesses. The Council believes that in Amtrak's current financial straits, similar measures are warranted.

The Council therefore recommends that Amtrak's Board and management reassess the potential for savings from reductions in Amtrak's corporate overhead, SBU staff overhead, and staffing of stations and operating business units, and, as part of this assessment, establish a clear process for benchmarking the size of Amtrak's corporate overhead compared to the corporation's overall business volume. Appropriate adjustments should then be made.

5. Develop Minimum Business Plan Objectives

Amtrak's Strategic Business Plan should identify readily measurable, key business plan objectives, including service objectives, operating objectives and financial objectives, for each year of its five-year Strategic Business Plans, that are critical for Amtrak to achieve its financial goal of operating "without Federal operating grant funds appropriated for its benefit" by Fiscal Year 2003.

Minimum Business Plan Objectives, which are identified by Amtrak as part of its Strategic Business Plan, should include, but not be limited to, measures of productivity (such as labor cost per passenger mile or seat mile, or labor cost per dollar of passenger revenue, etc.); service quality (customer satisfaction indices, on time performance percentages, etc.); operating cost ratios (ratios of operating costs to passenger revenues, ratios of operating costs to total revenues, etc.); operations (total number of injuries, injuries per million train miles, etc.); and overall financial performance (Budget Results in absolute dollar terms, cash flow from operations, etc.). The Minimum Business Plan Objectives should, to the extent possible, be based on unit measures such as costs per revenue dollar; passenger revenues per Amtrak employee or per employee hour worked; employees per million seat miles or train mile; or employee compensation paid (or charged to operating expenses) per revenue dollar received.

Ideally, the Council would like Amtrak to propose appropriate Minimum Business Plan Objectives such as benchmarks of productivity, to incorporate those Minimum Business Plan Objectives or benchmarks into its Five Year Strategic Business Plan, and to report actual financial and operating performance objectives to determine whether or not the Business Plan Objectives were met.

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I hope that you, the other members of the Board, and Amtrak's management will accept these recommendations in the constructive sense in which they are offered. As a follow up to this letter, I would like to meet with you and appropriate members of our organizations to discuss these ideas and the best ways to incorporate our recommendations into Amtrak's Strategic Planning Process and other business initiatives.

Should there be any questions about the recommendations or their application, please do not hesitate to contact Tom Till, the Council's Executive Director, who may be reached at 202-366-

0598. To arrange a meeting, which I suggest be held in late November or early December, please call Deirdre O'Sullivan at (202) 366-0631.

With warm regards I am,

Very truly yours,

Gil Carmichael

Gilbert E. Carmichael
Chairman

cc: Amtrak's Board of Directors
All Members and Staff, Amtrak Reform Council
Concerned Congressional Offices