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BEFORE THE SUBCOMMITTEE ON RAILROADS
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
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Testimony of the AMTRAK REFORM COUNCIL

Concerning Its ACTION PLAN FOR THE RESTRUCTURING AND RATIONALIZATION OF THE NATIONAL INTERCITY RAIL PASSENGER SYSTEM

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)

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Before the
House Transportation & Infrastructure Committee,
Subcommittee on Railroads
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Mr. Chairman, thank you for the opportunity to appear before this committee to discuss the future of America's rail passenger service.

I am Gil Carmichael, Chairman of the Amtrak Reform Council, and I am here together with four other Council members – Nancy Connery, Jim Coston, Wendell Cox, and Charles Moneypenny – in response to your invitation to present to you the Council's *Action Plan for the Restructuring and Rationalization of the National Intercity Rail Passenger System*. With your permission, Mr. Chairman, I will summarize my statement and submit the full statement for the record.

As Council Chairman, I can tell you that I am proud of what this group of dedicated, unpaid citizens has done over the past three years. Through thousands of hours of hard work, the Council has fashioned strong and sensible recommendations that were endorsed by 9 of the Council's 11 members, with the Secretary of Transportation abstaining. Congress has gotten its money's worth out of our efforts. On behalf of the Council, we want to thank you for the opportunity to take a major role in this important debate.

Together with the vast majority of Council members, I know that our work could not have been done without the fine efforts of our small staff. Tom Till, Mike Mates, Ken Kolson, Mary Phillips, and Deirdre O'Sullivan have given superb service over the past several years. In addition, Felton Jones has supported our efforts since this past summer. Plus, the DOT and FRA have provided offices and administrative support of vital importance.

The Council's Action Plan clearly states the spirit of the Council's recommendations:

> "The Council's view is that there should be a bright future for passenger rail service in America. But the Council believes that passenger rail service will never achieve its potential as provided and managed by Amtrak. A new and different program is needed to move forward."

In its three years of full-throttle operation, the Council found strong and growing support for a modern, improved national program of intercity rail passenger service. The Council's dialogue with the states, Amtrak, and others, together with its own analyses and deliberations, have led us to support major improvements in our national passenger program based on a sound vision.

Amtrak's performance is at odds with this vision. Over its lifetime, the increase in Amtrak's ridership has barely kept pace with the growth rate of the US population. Amtrak is burdened with debt and debt service, and its assets are in poor condition. And Amtrak's organizational structure and its management and financial systems are not those of a modern corporation.

On November 9, 2001, the Amtrak Reform Council found that Amtrak will not achieve operational self-sufficiency by December 2, 2002, as required by the Amtrak Reform and Accountability Act of 1997. Amtrak finished FY2001 with a loss of $341 million for purposes of self-sufficiency, as the test is defined by Amtrak, and a record operating loss of $1.1 billion under Generally Accepted Accounting Principles.[1]. Amtrak is no closer to self-sufficiency today than it was in 1997, a conclusion recently affirmed by the Inspector General of the US Department of Transportation, and Amtrak's announcement on February 1, 2002, that unless it receives $1.2 billion of federal funding in FY2003, it will eliminate all long-haul routes on October 1, 2002. Amtrak's actions to raise needed cash by mortgaging a portion of Penn Station and increasing its debt have weakened the company's financial condition.

Sadly, Amtrak has proven that it cannot concentrate on its core mission of running trains and running them well. Under current law, there is no one who can hold the railroad accountable. It has too much to do, and does little of it well. As it is chartered and organized today, Amtrak does not have any effective oversight of its business plans, its funding requests, or its financial and operational performance. Nor are its many business operations flexible, innovative, or responsive to customer needs. One knowledgeable commentator called Amtrak "a self-regulating monopoly"; it tries to set passenger rail policy, build and maintain a 400-mile Northeast Corridor infrastructure, raise money, and run some 300 trains a day nationwide both in the Northeast Corridor and over 20,000 miles of private railroad tracks.

The Council's Action Plan is grounded in a three-year examination of Amtrak's financial performance and management practices, and public meetings throughout the United States with state and local officials, passenger advocacy groups, commuter rail authorities, intercity bus companies, and the freight railroads that own 20,000 miles of Amtrak's present system.

A. Reform Concepts Endorsed by the Council

The Amtrak Reform Council's action plan is based on three principal concepts for reform.

a) <u>A New Business Model for Amtrak</u>. Amtrak's primary mission is the transportation of people. Today's Amtrak also establishes and administers governmental policy on rail passenger issues and is effectively the sole federal oversight body responsible for monitoring its own business plans and operations. Amtrak also owns and maintains much of the Northeast Corridor (NEC) rail infrastructure, an asset shared with commuter authorities and

[1] Based on Amtrak's unaudited financial statements. As of February 5, 2002, Amtrak had not released audited financial statements for the fiscal year.

freight carriers and having an economic significance that transcends Amtrak's operations. To correct these institutional failings, the Council recommends:

- Restructuring the National Railroad Passenger Corporation (NRPC) as a small federal program agency to administer and oversee the intercity passenger rail program. In the absence of competition, a monopoly operator such as Amtrak needs government oversight. While audits of Amtrak's financial performance are regularly performed by at least three agencies, analysis and reporting functions are not a substitute for effective, hands-on oversight. Amtrak's current train operating and infrastructure functions, under the Council's plan, would be strong companies with independent boards. The NRPC would actively oversee the new train operating and infrastructure companies with respect to budget matters and approval of business plans. The NRPC would also be responsible for administering the federal program for development of high-speed rail corridors and would have the authority, at its discretion, to introduce competition for some or all Amtrak markets.

- Organizing Amtrak's responsibilities for train operations and infrastructure as separate companies. This would allow Amtrak to focus on its mission of running trains and free it from the burden of ownership for the portions of the NEC that it owns. A separate infrastructure company would ensure that funds earmarked for infrastructure improvements will be used for the intended purpose, and will better represent and balance the needs of all Corridor users and stakeholders. The NRPC would insulate both new companies from political interference. Separation also would highlight the NEC's 20-year capital needs, estimated by Amtrak to be nearly $28 billion.

b) The Option of Introducing Competition. The Council's plan permits, after a transition period, the introduction of competition through the franchising of train service and NEC maintenance through a competitive bidding process. The Council believes that, as is the case throughout our free-market economy, competition would drive down costs and improve service quality and customer satisfaction.

Competition would help minimize losses, but in all likelihood would not eliminate the need for operating subsidies. Some Amtrak services – specifically Amtrak's long-distance trains – would need to be offered on a negative bid basis, i.e., the bidder requiring the least subsidy would be awarded the franchise.

The Council has taken a strong position in favor of protecting the rights of rail labor in any franchise arrangement. Congress, of course, would be the ultimate arbiter of the specific labor-protective conditions that would be imposed by law.

c) An Adequate and Secure Source of Funding. The Council believes that long-term sources of funding are needed to meet the needs of the intercity passenger rail program.

B. The Council's Proposal

At its first working session to consider reform options, there was a consensus among the Council members that train operations and the Northeast Corridor infrastructure should be organized as separate companies and that any reform plan should include more effective government policy and program oversight. The Council then evaluated four distinct approaches for train operations: (1) national or regional operating monopolies; (2) competition for long-haul markets only; (3) competition for all markets; and (4) a regionally-managed, operationally self-sufficient rail passenger network.

The Council considers all of the options meritorious, but specifically endorses option 3, with respect to train operations. The most significant amendment makes the introduction of competition permissive rather than mandatory.[2]

The Council's proposal thus has three elements:

1. Federal Program Management and Oversight. The Council recommends that the administration and oversight of the national passenger rail program be conducted by the National Rail Passenger Corporation (NRPC),[3] which would be restructured as a small government corporation. The NRPC would operate at arm's length from Amtrak's current train operations and infrastructure, which would be organized as companies with independent boards of directors. While it may be more appropriate for these companies initially to be subsidiaries of the NRPC, over the long term they would function more appropriately as separate companies. The NRPC's board of directors would comprise representatives from congressionally-defined regions covering the entire US (the governors of each of the regions would propose candidates to the President, for nomination to the Senate), the federal government, the railroad industry, and railroad labor. NRPC would hold the statutory franchise to operate over the rights-of-way of the freight railroads at incremental cost with operating priority, and would authorize the train operating company or other service providers to operate under the franchise on its behalf.

   The Council recommends that the NRPC be modeled after the United States Railway Association (USRA), and be charged to administer and oversee the intercity passenger rail program. USRA was formed by the Congress in 1973 to plan Conrail and monitor its performance. USRA reviewed Conrail's business plans, monitored its progress in executing its plans, disbursed federal funds, and had the authority to withhold funds if Conrail did not take actions to improve its performance. USRA enforced discipline, shielded Conrail from political interference, and, by working closely with Conrail management, contributed to Conrail's success. The Council believes the passenger rail program would benefit from a similar oversight organization.

[2] A matrix summarizing the major elements of each of the proposals may be found at the end of Chapter IV.
[3] The name National Rail Passenger Corporation is retained to make clear that it is intended to be the legal successor to the existing NRPC. Under existing law, the NRPC holds Amtrak's statutory right to operate over the lines of the freight railroads at incremental cost and with operating priority, and such rights would be retained by the restructured NRPC.

The NRPC would also:

- Administer federal funds made available for intercity passenger service;
- Administer the development of high-speed rail corridors, including evaluating project proposals and prioritizing projects for design and construction;
- Oversee the business plans of the train operating and infrastructure companies;
- Divest non-NEC physical assets (e.g., stations and track) to states and localities;
- Determine whether to franchise train services and/or maintenance of the Northeast Corridor, design franchises to be offered, administer the competitive bidding process, and administer contracts with franchisees; and
- In cooperation with Congress, the states, passenger and freight railroads and the public, manage public policy issues with respect to rail passenger service.

2. <u>Train Operations.</u> There should be a separate company ("Amtrak") organized to provide train-operating services. Amtrak's train-operating services, including passenger and mail/express operations, equipment repairs, and commuter operations, should be provided by contractual arrangement with federal or state authorities. NRPC would appoint its board, which would be comparable to the board of a major transportation operating company, such as an airline. Amtrak operates a number of services today under contract with state departments of transportation and commuter authorities and these contracts to operate services franchises are a model of how franchising can work. Amtrak's responsibilities are clear and none of these services involve unfunded mandates to operate particular routes without adequate compensation. The Council recommends that contracts for train-related services require continuous improvement in specified performance measures such as cost recovery, customer satisfaction, and ridership. And train operations, mail and express, the equipment repair shops, and commuter services should each have transparent accounting. Amtrak must become more efficient either by meeting the terms of a contract or through the eventual introduction of competition.

   The Council's plan would permit a pilot project to be implemented immediately by the NRPC to gain experience with franchising. Otherwise, Amtrak would be given two to five years to "get its house in order" before competition could be introduced. During this transition period, the NRPC would design appropriate franchise units, seeking input from state authorities, the freight railroads, Amtrak and others.[4] Terms and conditions for franchising would be developed during this period and decisions made about how to manage the bidding process. Any exercise of franchise authority by the NRPC would be specific in its terms, would be based on consultation with all concerned parties, and would require that adequate capacity exist for both passenger and freight requirements before any expansion of services would be implemented.

   After the initial transition period, the NRPC would have the authority, at its discretion, to franchise some or all Amtrak train operations, including mail/express. Franchises would be offered through a competitive bidding process and would provide exclusive rights to operate passenger and mail/express service. Franchisees would operate under the NRPC statutory

[4] The Council envisions a relatively small number of franchises to avoid cherrypicking of Amtrak's routes.

franchise and would be afforded the same liability protection and access to insurance currently available to Amtrak. Ultimately, Amtrak, as the train operating company, could be privatized.

All franchisees would be subject to the Railway Labor Act, FELA,[5] and railroad retirement. Current Amtrak employees would be granted hiring preference with new franchisees to the extent that hiring is necessary. The Council recommends to Congress that in any restructuring, employees follow their work in seniority order with their collective bargaining agreements intact. Agreements would be subject to collective bargaining under the normal provisions of the Railway Labor Act. Labor protection would be provided by the NRPC under the terms of the then-existing collective bargaining agreements.

After transition, the Amtrak shops could be sold, leased to private entities, or operated or disposed of by the NRPC. Alternatively, train operators might bid to operate equipment repair shops as part of a franchise or contract with the shops for equipment maintenance. The equipment itself could be either owned by or leased to franchisees.

Federal operating subsidies to support train operations after the transition period would be available only for the long-distance trains that are Amtrak's most unprofitable operations. Shortfalls on non-national system routes, including new high-speed corridor services, would be the responsibility of the states after a transition period. The Council believes equipment capital should be funded through private financing, if possible.

3. Infrastructure. The Council recommends that Amtrak's Northeast Corridor infrastructure assets be organized as a government corporation that would control corridor operations, perform maintenance, and implement capital improvements. The company's board of directors would comprise representatives from the states along the Corridor, the US Department of Transportation, freight railroads operating on the Corridor, and the intercity passenger service provider. The Corridor would be managed as a shared regional and national asset.

   As with Amtrak's train operations, the infrastructure company would operate under a contractual agreement with the federal government. Performance standards would require continuous improvement in specified performance measures. After a two- to five-year transition period, the NRPC could authorize the NEC company to franchise its functions through competitive bidding.

   Track use fees would continue to be based on incremental costs for passenger operators with other users paying negotiated rates. Incremental cost is the standard that applies to intercity passenger services off the Corridor and for that reason is retained as the standard on the Corridor.

   Significant capital funding is needed for the NEC infrastructure. While the Northeast Corridor is operationally self-sufficient under the standards of the Reform Act, the infrastructure company will not be able to fund its own capital needs. The Council's plan

[5] Federal Employer's Liability Act.

endorses Federal funding but also expects the states to fund a portion of the need in recognition of the Corridor's importance to regional and commuter rail operations.

C. Funding Issues and Alternatives

The cost to fund intercity rail service will be considerable. Based on its FY2001 cash loss, Amtrak's federal operating subsidy could approach $600 million annually (with Amtrak currently receiving another $125 million in operating subsidies from states). Additional operating subsidies could be needed for high-speed corridors if ridership and revenue targets are overly optimistic. The Council's plan would minimize operating subsidies by creating incentives for cost containment and efficiency either through operating contracts with Amtrak or franchising. The plan also recommends that after a transition period, federal operating subsidies be limited to long-distance "national" trains; states would bear the cost of operating subsidies for corridor services, including new high-speed services.

Capital needs are even greater. The Northeast Corridor infrastructure is in need of about $1 billion annually in capital funds. According to Amtrak's estimates, the cost to develop all of the high-speed corridor projects that have been advanced by the states amounts to $70 billion, or $3.5 billion per year over twenty years. These spending levels may be unrealistic in today's budget environment.

There are no easy answers. But it is clear that given the size of the needed investment, reform of Amtrak is essential to minimizing costs and protecting the taxpayers' investment. It is also clear that all of the stakeholders in intercity passenger rail service – the federal government, the states, Amtrak and its employees, the commuter authorities on the Northeast Corridor, the freight railroads, and the public – will need to make a contribution for the program to move ahead. A number of proposals have been advanced to fund capital needs. The Council has taken no position on these proposals but supports adequate and secure sources of funding for intercity passenger rail service.

I would like to offer some additional comments about the funding issue, regarding both the entire passenger program and the NEC infrastructure.

As the Council reviewed its mandate, it became increasingly clear that the environment in which Amtrak must function began to change around the time the Amtrak Reform and Accountability Act of 1997 was signed into law. Without making any judgment, I think it is fair to say that the advent of guaranteed spending programs in transportation has limited the ability of the appropriations committee to address other worthy transportation projects. For the most part, Amtrak depends upon on the availability of federal funds as authorized by this committee and appropriated in the annual Transportation Appropriation bill. However, in recent years, appropriators have had less discretion to find resources to fund transportation programs not included in guaranteed spending programs. That has left Amtrak to compete with the Coast Guard, DOT, safety programs and a variety of independent agencies for whatever funding is left over.

Several years ago, this committee gave Amtrak a fighting chance for survival when it drafted the Amtrak Reform and Accountability Act of 1997. Remember, it was the enactment of the ARAA that allowed Amtrak to access the $2.3 billion in the Taxpayers Relief Act for a "tax refund" for capital improvements. In addition to the reforms, this legislation also provided Amtrak with an authorization of approximately $1 billion per year, on average, for five years.

For whatever reason, Amtrak chose not to ask for an appropriation equivalent to what had been authorized in the first or any succeeding year—until now. We all know the value of hindsight but it is now clear that if Amtrak had succeeded in establishing a benchmark appropriation nearer to what had been authorized, they may have been able to establish a foothold in the appropriations process that would have allowed them to address much of their infrastructure needs in that first year and subsequent years.

As a result, the pattern for Amtrak appropriations was set in 1998 and after four years the total average appropriation received by Amtrak is actually closer to about half of that amount included in the authorization legislation written by this committee. While no one will ever know if that additional appropriation would have forestalled the bleak financial condition we find Amtrak in today, it certainly would have helped address some of the important capital projects that could have reduced costs or minimized the estimated $3 billion backlog of "state of good repair" needs in the Northeast Corridor. Frankly, Mr. Chairman, I was a little surprised to hear Amtrak blame Congress for not providing enough funding in their press conference on February 1.

As you now know, the Administration's budget for fiscal year 2003 proposes $521 million for Amtrak, the same level provided in this fiscal year and continuing the pattern established in 1998. Now the federal government is facing deficits and there is intense pressure on the transportation budget to deal with aviation security, increases in Coast Guard funding and significant shortfalls in federal fuel tax revenues that fund highway programs. This is not an environment in which Amtrak will be able to reverse the appropriations trend and obtain the resources it needs to fund critical infrastructure projects in the Northeast Corridor. It was this fact, among others, that led many on the ARC to conclude that Amtrak, as the owner of the corridor, is simply not in the best position to access the capital it requires for critical improvements.

Clearly, I do not need to demonstrate to this committee how difficult it is for the federal government to address important transportation funding decisions when the bulk of these funding decisions are now set by statute. This environment dictates that we must begin to consider other alternatives to finding the capital requirements for the Northeast Corridor.

If Amtrak were relieved of its obligation, as the owner of the corridor, to provide the capital and human resources necessary to keep it in a state of good repair, it would have an immediate and positive impact on Amtrak's bottom line. We believe, as the Administration stated in its recent budget submission, that a "federal, state and private partnership" would be best suited to address the staggering capital needs now required in the corridor.

Two additional factors need to be considered when weighing the policy decision on Amtrak ownership of the Northeast Corridor. First, any company faced with the level of operating losses and debt that Amtrak has experienced will frequently feel a sense of desperation about minimizing its losses. In the past (according to the DOT/IG in its January, 2002 report), when Amtrak had a large base of capital funds (like TRA) they allocated indirect and overhead costs which were initially recorded to the company's operating expenses and then "transferred" to capital projects through the application of an overhead rate to capital project-related labor and material expenses. While this may be a legitimate accounting mechanism, it masks one of the difficulties of having an operating company that is experiencing operating losses also being responsible for making capital improvements to its infrastructure. It may be too difficult to avoid the temptation to shift operating expenses to capital projects. The result is that federal capital dollars lose their full impact when the opportunity exists for this type of accounting is employed. The other concern is also related to an operating company that is experiencing losses. In this instance, owning the NEC infrastructure may result in the company making poor financial decisions as was done when Amtrak mortgaged portions of Pennsylvania Station in New York over a 16 year period in return for three months of operating expenses. This example could be a case study for any business school in the country on how not to conduct business. These examples alone would be enough to consider separation.

So, Mr. Chairman, looking at these facts we have concluded that the current structure of Amtrak as a rail passenger operator and owner of the Northeast Corridor has not worked in the past and is a formula for disaster if it is allowed to continue without restructuring. With Amtrak being unable to obtain the funding necessary for corridor improvements, the corridor will continue to deteriorate and ultimately will become a safety threat to the hundreds of thousands of people that use it every day. If the status quo continues, it is only a matter of time before we reach a crisis point and the infrastructure requirements will require a heavy toll on the federal government. At a time when the federal government is preparing to make major investments in homeland security, it should not walk away from confronting the safety issues in one of its critical transportation assets.

There are no easy solutions to restructuring Amtrak and our goal should be to take a step back and look at the system as a whole and make a determination on what works best for the various components of the system. That is what we have tried to do. No matter what the Congress decides to do about Amtrak one thing is very clear—the Northeast Corridor will continue to exist, with or without Amtrak, and the first objective of the federal government must be to take steps to assure that a proper level of investment is achieved through federal and state governments and possibly the private sector. It is in everyone's best interest to place the responsibility of the corridor in a position where it has the best chance to access funds, and where it will have the least impact on the financial performance and financing requirements – for both operating and capital – of the new train operating company. Based on historical funding patterns, particularly in recent years, having Amtrak as the owner of the NEC may be the worst outcome.

D. Potential Sources of Funding the NEC

Separating the Northeast Corridor infrastructure – both organizationally and financially – from Amtrak's nationwide train operations is another way of closing the gap between the subsidy needs of Amtrak's train operations and the uncommitted funds available in the budget. The other side of this coin is that leaving most of the Northeast Corridor under the ownership and funding of Amtrak will continue the inadequate funding and perpetuate the deterioration of this vital NEC infrastructure. There is little or no chance that Amtrak will be able to get the capital it needs to maintain and improve the NEC out of appropriated funds.

Indeed, there is no single source that could provide all the necessary capital for the NEC. Thus, the Congress should look at a variety of sources, which may include:

- A federal appropriation, perhaps through a new Northeast Corridor Improvement Program account to address some of the life/safety projects that must be addressed. Congress has already appropriated $100 million for the New York tunnels and could help address others;

- TIFIA and/or RRIF may be employed to entice a Regional Transmission Organization in partnership with the new National Rail Passenger Corporation and the states to undertake one of the major infrastructure projects south of New York, the replacement of the electric traction system. Amtrak is already considering entering into a long term lease or ownership arrangement with a northeast RTO in exchange for rebuilding the catenary system and allowing construction of more electric transmission lines to meet the needs of electric customers in the northeast. Such an arrangement would resolve what all estimates suggest to be a $800 million project off the table.

- Expanding the flexibility provisions in current transportation trust funds to include the NEC projects that would reduce congestion on other modes.

- Federal transportation funds are often used for civil works projects that are under the Army Corps of Engineers. There is some precedent for the Corps to undertake bridge projects that are over navigable waters.

- Expand the NEC states role through a broader based ownership-control institutional mechanism. NEC states already invest state and federal transit funds in corridor segments of specific value to their regions to enhance essential commuter services.

- Federal and/or state tax incentives might be developed to encourage the private sector to make investments in the corridor. Freight users of the corridor may be more willing to undertake projects that have a common benefit if there were investment tax credits they could take advantage of or if bond measure were enacted to raise the capital for corridor projects.

The point of this is that there are many different combinations of things that may be done to deal with the high priority capital projects other than just asking Congress to appropriate more money. It will take hard work and require the cooperation of multiple parties but it can be done.

E. Conclusion

Mr. Chairman, the Council believes its recommendations are strong and sound. The chronic difficulties that Amtrak experiences – year in and year out – are not due principally to lack of funding. They spring primarily from an organization that is obsolete, that cannot do all the things that it is charged to do, that will not consider recommendations for change, and that desperately needs to be redesigned.

For these reasons, the Council strongly recommends that the Congress first adopt badly needed institutional reforms before providing major new funding for passenger rail service.

The Council has submitted its recommendations to the Congress. We are sure that other reasonable reforms will be proposed. The most important thing is that reform is no longer an option, Mr. Chairman. Reform is an imperative.

We stand ready to answer questions and address issues that the Congress might want to pursue. The Council thanks you, Mr. Chairman, for the opportunity to address the Committee.