

**NATIONAL RAILROAD PASSENGER CORPORATION**  
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**David M. Laney**  
Chairman, Board of Directors

February 17, 2005

The Honorable Richard B. Cheney  
President  
United States Senate  
S-212 U.S. Capitol  
Washington, DC 20510

The Honorable J. Dennis Hastert  
Speaker  
U.S. House of Representatives  
H-232 U.S. Capitol  
Washington, DC 20515

Dear Vice President Cheney and Speaker Hastert:

Pursuant to Section 24315(a)(1) of Title 49 U.S. Code, I am transmitting to you Amtrak's annual report to Congress which briefly reviews the progress the company has made in the past two years and outlines Amtrak's prospects beyond FY05 with and without adequate funding. In past years, Amtrak's annual report has included a grant request for the upcoming fiscal year; because Amtrak is engaged in a strategic planning process which could affect its needs for FY06, any such submission at this point would be premature. A grant request will follow as soon as a planning process permits.

Prospects for America's intercity passenger rail service have reached a critical crossroads. At current funding levels, existing operations and capital investment will have to be severely curtailed or discontinued beyond FY05; conversely, without meaningful reform, Amtrak cannot reasonably expect to attract levels of funding from any combination of federal, state, local or private sources at levels adequate and predictable enough to sustain passenger rail service in this country. The Amtrak Reform Board agrees that the President's proposed operating budget of "zero" is the right message. Status quo at Amtrak is neither viable nor acceptable. To effect needed reforms at Amtrak, however, "zero" is not the right number at this juncture.

In recent years a number of thoughtful voices have weighed in on the "reform" of Amtrak and passenger rail service in the U.S. Virtually all have recognized that passenger rail presents the promise of an alternative mode of transportation as well as increasingly valuable added capacity for national transportation networks, particularly in our most congested regions. But the promise of passenger rail can

only begin to be realized if it is more effectively structured, more efficiently operated and adequately funded over a longer term than year-to-year.

Recently, the Amtrak Reform Board began a process of analysis and planning that should result in the Board's adoption and implementation of a number of far-reaching changes, both structural and operational, and the further recommendation of legislative initiatives that, if enacted, would provide the foundation needed for the development of U.S. passenger rail service, whether or not Amtrak remains its chief steward. The process has included input from a full compliment of interested parties: the Department of Transportation, Federal Railroad Administration, DOT Office of Inspector General, the freight rail industry, the commuter rail industry, and Amtrak senior and operations management. We have also found certain recommendations developed by the Amtrak Reform Council, as well as concepts in the Bush administration's 2004 proposed legislation and certain other proposed legislation, to be particularly insightful and valuable. In coming weeks we will receive input from numerous states constituting the principal "stakeholders" in corridor operations in our most highly congested regions. We hope to have delineated at least the broad outlines of our recommendations before April.

Aside from the planning process, it is abundantly clear to Amtrak's Board and management that without adequate funding Amtrak operations and investments will have to be curtailed or eliminated in FY06. There could be no greater impetus for reform. However, the threat of insolvency or bankruptcy can undermine the stability of any business; in Amtrak's case, the disruption of the financial and operating stability Amtrak has achieved over the last two years could stop our reform effort in its tracks. Although bankruptcy might prove a reform strategy of last resort, at this point in the reform process it is precipitous and counterproductive.

The history of Amtrak since 2002 is considerably different from what preceded, as detailed in David Gunn's attached memorandum to the Board. From an organizational standpoint, highlights since 2002 include:

- The development of accounting and financial reporting systems;
- A reduction in personnel by almost 5,000;
- The development of a detailed and prioritized five-year capital plan focused on restoring the Northeast Corridor to necessary levels of reliability and safety, and on restoration of an aging fleet of rolling stock used throughout the system;
- Termination of the mail and express operation;
- Elimination or truncation of three long-distance routes;
- No new borrowings, and the scheduled repayment of the \$100 million Department of Transportation loan over a five year period begun last year;
- Increased ridership from 22.5 million in 2000 to 25.1 million in 2004; and
- Containment of the cash operating requirement at or below \$570 million.

The fact that federal financial support has grown from \$831 million in FY02 to \$1.2 billion in FY05 reflects in large part the growth of Amtrak's level of capital investment in Northeast Corridor infrastructure in an attempt to overcome decades of deferred maintenance, as well as the rehabilitation of its aged fleet of rolling stock (average age of passenger cars – 22 years).

The NEC infrastructure bears special note. The infrastructure (Boston, Providence, New Haven, New York, Newark, Philadelphia, Wilmington, Washington, D.C. – 456 miles of track, beds, ties, switches, tunnels, bridges and electrical power systems) is largely owned by Amtrak. Despite the fact that Amtrak oversees the operation, dispatching, routine maintenance and the systematic rebuilding of an infrastructure bearing the accumulated burden of at least 20 years of deferred maintenance, it is distinctly a minority user on certain portions of the NEC. By far the greatest volume of NEC traffic is represented by other users – New Jersey Transit, Southeastern Pennsylvania Transportation Authority, Maryland Rail Commuter, Massachusetts Bay Transportation Authority, Long Island Rail Road, Delaware Department of Transportation, Virginia Railway Express, Metro-North (infrastructure owned by MTA and CDOT), Shore Line East, Norfolk Southern, CSX, Providence & Worcester, Guilford Rail, Connecticut Southern, Conrail, and Canadian Pacific. Simply stated, the NEC infrastructure is an invaluable national transportation asset in the most densely populated region of the country.

Amtrak has developed and embarked on a five-year capital investment program intended to overcome the backlog of needed capital investment, a process that can continue only if properly funded. Anyone who assumes that further underinvestment in NEC infrastructure is “good medicine” for Amtrak has missed the mark. By any measure, Amtrak will be among the least affected of any passenger or freight NEC user if the NEC is further starved of needed capital investment. Amtrak need not be the entity principally responsible for the planning and implementation of the NEC infrastructure capital plan. Until there is another, better alternative however, funding of Amtrak’s NEC capital plan, and in particular its most critical capital projects, is a responsible course of action.

Aside from more specific recommendations regarding oversight, operation and investment in the NEC that we expect the Board planning process to generate, we also intend to address core issues relating to passenger service, routes and equipment throughout our corridor and long distance operations. Pervading the entire process will be issues relating to Amtrak’s structure, its present and future role in the development of U.S. passenger rail, the increasingly important emerging role of the states in corridor development, and opportunities for competition that could benefit passenger rail development.

Please be aware, however, that our recommendations will almost certainly require a transition period that will run well into FY06. Additionally, needed reforms will likely result in higher front-end restructuring costs. (Route elimination, for instance, will often incur substantially greater labor-related costs in the early years than would route continuation; but such costs can be carefully phased and managed.) And for passenger rail to have any chance of succeeding under Amtrak’s auspices or in others’ hands, legislative action is essential to remove constraints that will otherwise permanently undercut its performance in an increasingly competitive environment.

Much remains to be accomplished, but enough progress has been achieved to stabilize the operation and afford the Board the opportunity for fundamental reassessment of Amtrak’s structure, operations and role in the oversight and development of U.S. passenger rail.

We look forward to working with you, and we remain convinced that whatever course is selected in addressing the future of passenger rail service, it can only be accomplished on a solid financial footing involving the federal government, states, and where appropriate, private industry.

Sincerely,

A handwritten signature in black ink, appearing to read "David M. Laney". The signature is fluid and cursive, with a large initial "D" and a long, sweeping tail.

David M. Laney  
*Chairman, Board of Directors*

# Memo



Date February 15, 2005  
 To David M. Laney  
 From David L. Gunn  
 Department President and CEO  
 Subject Amtrak Report to Congress  
 cc Board of Directors

Message At your request, attached is a review of the events of FY04 and budget performance in FY05 that fulfills the reporting requirements of Section 24315 (a) of Title 49 U.S. Code.

## Progress-to-Date

In May of 2002, when I joined the company, the railroad was facing a cash crisis and required immediate assistance to avoid insolvency and to address the immense backlog of deferred maintenance. With concurrence from the Board of Directors, we immediately instituted numerous changes to the company and began internal reforms designed to control costs and restore the credibility that had been lost among taxpayers and stakeholders.

Much has been accomplished over the past three years. We reduced headcount and cut redundant layers of management – resulting in clearer lines of accountability and a smaller, more efficient workforce (see Table 1).

**Table 1**

<b>Headcount</b>	<b>FY 01</b>	<b>FY 02</b>	<b>FY 03</b>	<b>FY 04</b>	<b>FY05 (YTD)</b>
Management	2,762	2,427	2,320	2,402	2,434
Agreement	22,115	20,146	17,883	17,594	17,265
<b>Total</b>	<b>24,877</b>	<b>22,573</b>	<b>20,203</b>	<b>19,996</b>	<b>19,699</b>

We used money saved through our cost-cutting efforts to begin the reestablishment of a capital reinvestment program to bring the railroad to a state-of-good-repair – a program that had been all but eliminated by FY02. We defined the required capital needs – in specific detail – in our five-year strategic plan. The capital program is grounded in a “production line” approach to ensure

plant and equipment are rebuilt making the most efficient use of labor and materials, rather than the previous approach of repairing assets as they fail. In spite of the challenges inherent in ramping up such a program from essentially nothing and with less federal funding than needed to meet the plan, we have made steady progress in rebuilding plant and equipment. Tables 2-4 summarize the results of the capital program to date.

As our monthly management reports demonstrate<sup>1</sup>, the result of these initiatives is that Amtrak has contained its operating costs and operating cash subsidy requirements for two straight years – in spite of inflationary pressures in health care, fuel prices and other areas. In fact, our core operating expenses were slightly lower in FY04 than they were in FY00. We have done this while covering over \$250 million per year in debt service from earlier borrowing and without assuming any new debt since the \$100 million DOT emergency loan of July 2002.

Despite a downturn in the travel industry and numerous natural disasters that disrupted long-distance service, Amtrak ended FY04 with a ridership record after carrying more than 25 million passengers. The number of Amtrak intercity trains operated rose from 85,527 in FY00 to 101,429 in FY04.

Amtrak's decision to exit the mail and express business, which had provided little or no benefit to the company, has allowed us to focus on our basic mission of providing safe, reliable rail passenger service. With this move, Amtrak eliminated or truncated certain long-distance trains (*Kentucky Cardinal*, *Three Rivers*, and portions of the *Pennsylvanian* and *Palmetto*) and removed a number of road locomotives and switch engines from service, thus lowering maintenance costs. A large portion of the mail and express assets were sold, and the remainder are for sale.

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<sup>1</sup> Starting in July 2002, Amtrak began providing monthly reports, including a full set of financial statements, to the Board of Directors, the U.S. Department of Transportation (DOT), the Office of Management and Budget, and the key Congressional oversight committees.

**Table 2 – Infrastructure Progress**

	<b>FY00</b>	<b>FY01</b>	<b>FY02</b>	<b>FY03</b>	<b>FY04</b>	<b>FY05 Bud.</b>
Concrete ties installed (thousands)	47	0	0	104	152	183
Wood ties replaced (thousands)	83	20	16	45	59	64
Continuous welded rail /rail installed (rail miles)	20	19	8	26	240	88
Undercutting / ballast renewal (miles)	30	30	9	10	40	21
Turnouts installed (each)	42	27	47	64	142	145
Bridges re-timbered (each)	26	12	10	16	22	17
Signal cable replaced (miles)	0	4	8	23	11	2
Electric catenary hardware renewed (miles)	56	42	48	39	77	75
Bridges converted to ballasted deck (each)	14	5	3	6	14	3

**Table 3 – Equipment**

	<b>FY00</b>	<b>FY01</b>	<b>FY02</b>	<b>FY03</b>	<b>FY04</b>	<b>FY05 Bud.</b>
Wrecks rebuilt – (Locomotives/Cars)	12	17	6	22	29	26
Amfleet cars / Cab Cars remanufactured/heavy Overhauls	107	68	17	20	114	113
Superliner cars remanufactured/heavy overhauls	0	0	0	0	39	52
Horizon cars remanufactured/heavy overhauls	0	0	0	0	1	28
Surfliner cars remanufactured/heavy Overhauls	0	0	0	0	0	12
Other car remanufacture/ heavy overhauls	0	4	0	6	0	0
Baggage car overhauls	0	0	0	0	32	24
AEM-7 electric locomotive overhauls	0	0	0	7	7	6
AEM-7 electric locomotives remanufactured	5	11	13	0	0	0
HHP-8 electric locomotive overhauls	0	0	0	0	0	4
Diesel road locomotive heavy overhauls	39	33	48	44	49	50
Diesel Switcher locomotive heavy overhauls	0	0	0	0	4	14
MOW Work equipment overhauls	0	0	0	0	31	30

**Table 4 – Asset Utilization**

	<b>FY00</b>	<b>FY01</b>	<b>FY02</b>	<b>FY03</b>	<b>FY04</b>	<b>FY05 Plan</b>
Rolling Stock Scrapped/Sold (units)	8	21	140	350	92	TBD
Diesel Work Switch Engines in Service					75	61 <sup>2</sup>
Diesel Road Locomotives in Service		341	343	282	266	270
Roadrailleurs in service <sup>3</sup>	514	654	654	654	654	0
Inventory Turns	1.25	0.97	0.96	1.25	1.68	TBD
Passengers	22,517,300	23,493,783	23,406,597	24,028,119	25,053,564	25,700,000
Amtrak Intercity Trains Operated <sup>4</sup>	85,527	90,635	96,060	98,893	101,429	N/A

**Financial Challenges**

In FY04, Amtrak requested \$1.812 billion in federal funding. Congress appropriated \$1.217 billion and allowed Amtrak to defer for another year the \$100 million DOT loan. This appropriation plus \$200 million in carry-forward cash (achieved through operating savings and better management of the capital program) resulted in approximately \$1.4 billion in funding available for FY04. We ended the year with \$247 million in cash.

<sup>2</sup> As of 12/31/04 the actual was 63.

<sup>3</sup> All Roadrailler assets disposed of in FY04. Norfolk Southern acquired 504 trailers, 254 intermediate rail bogies and 75 couplermates. Balance of equipment was returned to lessors.

<sup>4</sup> This represents Amtrak intercity trains only, and does not include Amtrak operated commuter trains.

For FY05, Amtrak requested \$1.798 billion. Beginning October 1, 2004, Amtrak was required to operate within the budgetary constraints of a Continuing Resolution of \$1.2 billion. On December 8, 2004, our actual FY05 appropriation was granted in the amount of \$1.207 billion (after an across-the-board rescission). This amount was further effectively reduced by set-asides of \$6.5 million and a requirement to pay back \$20 million of the DOT loan plus interest.

With funding from the FY05 appropriations and cash carried over from FY04, we have been able to fund capital investments at a level necessary to continue the state-of-good-repair program. The approved, federally funded capital program for FY05, augmented by carry-over cash, will be approximately \$500 million. We will not have the benefit of any carry-over cash in FY06 now that our capital program is underway. The total capital budget, including funding from other sources, is slightly more than \$700 million. As you are aware, at this level Amtrak has had to make difficult cuts and deferrals to its FY05 capital budget.

The FY05 budget includes a number of large multi-year projects, which will have a significant impact on future year capital budgets. Many of these projects have been deferred for years due to the size of the project, but they can no longer be deferred. They are generally once-in-a-lifetime replacements. It is important to understand that these projects will limit the flexibility to change future capital budgets because, once begun, the company will have a contractual requirement to complete the projects. Examples of such projects are: the Connecticut River Bridges (Thames, Niantic, Connecticut); tunnel cable replacements; Wilmington High Speed Rail Material Control Facility; New York Tunnels; Shell Interlocking Replacement/Metro North Infrastructure.

The approved capital and operating budget for FY05 is extremely tight. The budget will leave the railroad with almost no cash reserves at year-end. Unforeseen developments such as infrastructure failure, adverse weather, or a continuing weak travel economy could negatively impact the budget. While we will obviously do our best to get through the year without a financial crisis, there is no margin for error. Should something happen that impacts our budget, the possibility of Amtrak facing a cash crisis in FY05 could quickly become very real.

At our current federal funding level the company must draw down its cash reserves in order to fund the approved budget. Accordingly, the company's FY05 year-end cash reserves are expected to drop to at most \$75 million. It is imprudent to operate a business of the size, complexity and operating uncertainties of Amtrak with only \$75 million of cash - an amount that would fund operations for only 20 days - without a supplemental source of emergency, short-term borrowing authority. The company's very survival is threatened as its liquidity is jeopardized by unforeseen events.

A one-time infusion of working capital will be necessary to ensure on-going liquidity. An alternative approach would be to establish a line of credit. The company does not have (and

cannot reasonably obtain) a traditional line of credit from commercial banks because such lenders are aware of the uncertainty of Amtrak's Congressional funding. Therefore, short of an infusion of working capital, the most appropriate way to address Amtrak's liquidity challenge is to grant the company a short-term line of credit from U.S. Treasury (as is currently done with Government Sponsored Enterprises (GSE'S)) in the amount of \$250 million. Borrowings would bear a Treasury rate of interest and, most importantly, would carry a requirement that the balance outstanding be zero (\$00) at least once each fiscal year. This latter provision ensures that the line of credit is only used to fund short-term cash requirements and is not used to fund permanent business needs or long-term programs, both of which are included in the appropriation process.

### **Minimal Opportunities for Reductions**

*Capital.* Some have argued that we could reduce cash requirements by making cuts to the capital program, but this would be a very risky strategy. In the past, Amtrak did infrastructure and mechanical work on a crisis or "as-needed" basis, a practice driven in large part by inadequate and unpredictable funding. The result was an inefficient use of resources (e.g., making extra crews available to address asset failures) and a growing backlog of capital needs. As documented in our capital plan, we cannot defer this work any longer. The shift to planned production and asset renewal projects may not fit well in an annual appropriations cycle, but it is the only way to control operating expenses and ensure longer-term viability of plant and equipment.

An efficient capital program cannot be turned off like a water spigot. Infrastructure and rolling stock rebuilding projects have a long-lead time for materials and contracts (e.g., in FY04, the Board approved orders of materials for high-speed switches and rail which will be installed in FY05; some equipment ordered in FY03 will not arrive until FY05). Board and DOT approval for FY06 materials purchases will need to be made by early spring of this year. In today's environment, anything done to slow or halt the production process will result in material piling up, inefficient use of labor and ultimately a less reliable railroad with increasing likelihood of major asset failures.

The operating budget and staffing in the field now assumes the implementation of the capital program. Accordingly, the operating work force in the mechanical and engineering departments has been significantly reduced, assuming the need for emergency repairs will be reduced by the capital program. Reducing the capital program would therefore increase operating expenses.

Any significant reduction in the infrastructure investment program will likely force Amtrak to suspend high-speed operations on the Northeast Corridor. This will potentially balloon the operating deficit due to erosion of revenues.

*Long-Distance Service.* Some have argued that large savings could be achieved by making large route cuts, particularly to long-distance trains. In the short term, wholesale cutting of services will not save any operating expenses; on the contrary, any savings would be more than offset by labor protection requirements and other shutdown costs. Some have suggested that we stop the overhaul of sleeping cars for our long-distance service. However, any savings from overhauls would be offset by revenue loss (FY04 sleeper revenue was \$128 million) and produce no net savings.

## **Conclusion**

As noted before, over the last couple of years we have been able to come close to our needs using a combination of federal appropriations, money saved through cost cuts (including headcount reduction) and the time needed to ramp up the capital program. The capital program is now in full swing, and we must increasingly rely on appropriations to meet our needs. We have no ability to reduce the operating deficit or fixed charges in the short run. We will have to work hard to hold the operating deficit constant given the impact of inflation, rising health care and insurance costs, and the sluggishness in the travel industry. Also, our working capital is now fully depleted.

Make no mistake, we continue to race against time to reverse 20-plus years of deferred maintenance and to bring our infrastructure back to a state-of-good-repair. For the past few years, we have attempted to attack the problems aggressively because of our commitment to safety and reliability. But the ability to operate a safe, reliable system requires an ongoing and a stable flow of capital investment.

Given Amtrak's authorization expired in late 2002, it is very likely that Congress will address reauthorization in the 109th Congress. This discussion should occur in the context of a comprehensive national transportation and rail policy that establishes a federal-state funding match for rail comparable to the other modes of transportation. The future of corridor development and intercity passenger rail rests entirely on access to a stable and reliable funding stream. Whatever is done to address the future of rail passenger service, it can only be done on the foundation of a financially secure and operationally reliable Amtrak.