United States General Accounting Office

GAO

Report to the Chairman, Committee on Transportation and Infrastructure, House of Representatives

September 2002

INTERCITY PASSENGER RAIL

Potential Financial Issues in the Event That Amtrak Undergoes Liquidation

G A O

Accountability * Integrity * Reliability

GAO-02-871

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Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

September 20, 2002

The Honorable Don Young
Chairman, Committee on Transportation
and Infrastructure
House of Representatives

Dear Mr. Chairman:

The National Railroad Passenger Corporation (Amtrak), the nation's intercity passenger rail operator, was created by Congress in 1970 after the nation's railroads found passenger service to be unprofitable. It is a private corporation. Its financial condition has never been strong and it has been on the edge of bankruptcy several times. In 2001, Amtrak lost about $1.2 billion and had to mortgage a portion of Pennsylvania Station in New York City to generate enough cash to meet its expenses. Early this year, Amtrak stated that federal financial assistance would have to more than double (to $1.2 billion) for the corporation to survive. Most recently, in July 2002, the Department of Transportation approved a loan of $100 million to Amtrak because the railroad was running out of cash. Amtrak plans to seek additional funds to allow it to survive through the fiscal year. Given Amtrak's worsening financial condition and the potential for intercity passenger rail to play a larger role in our nation's transportation system, there is growing agreement that the mission, funding, and structure of the current approach to providing intercity passenger rail merits reexamination.[1]

The Amtrak Reform and Accountability Act of 1997 prohibits Amtrak from using federal funds for operating expenses after 2002, except for an amount equal to excess Railroad Retirement Tax Act payments.[2] The act further requires that Amtrak prepare "an action plan for the complete liquidation" of the railroad and submit it to Congress if the Amtrak Reform Council (the Council—an independent oversight body created by the act)

[1]Among other things, Congress will need to consider whether and how intercity passenger rail can complement other modes of transportation as part of our national transportation network. See U.S. General Accounting Office, *Intercity Passenger Rail: Congress Faces Critical Decisions in Developing a National Policy*, GAO-02-522T (Washington, D.C.: Apr. 11, 2002).

[2]Amtrak participates in the railroad retirement system, under which each participating railroad pays a portion of the total railroad retirement benefit costs for industry employees.

were to find that Amtrak would require federal operating assistance beyond 2002.[3] In November 2001, the Council made such a finding. Subsequently, the 2002 Department of Defense emergency supplemental appropriations act prohibited Amtrak from spending appropriated funds or its own revenues to prepare the liquidation action plan. In the absence of a liquidation action plan from Amtrak, you asked us to update the financial information in our 1998 report on financial and transportation issues associated with an Amtrak liquidation.[4] As a result, this report provides information on the potential direct financial issues associated with (1) the federal government, Amtrak employees, and other creditors and (2) the railroad retirement and unemployment systems, in the event that Amtrak were to be liquidated.[5]

This report does not discuss the likelihood or advisability of liquidating Amtrak. Nor does it purport to substitute for a detailed liquidation analysis that would have to proceed from any such formal action. Liquidation is an extreme action, and bankruptcy law seeks, among other things, to protect the public interest in maintaining continued rail service. Since 1976, only two Class I railroads (the nation's largest railroads) have ceased operations because of bankruptcy, and only one—the Chicago, Rock Island, and Pacific Railroad—was liquidated (in 1980). If Amtrak filed for bankruptcy, the trustee appointed to handle the bankruptcy could attempt to reorganize the corporation and continue transportation services rather than immediately liquidate it. An important consequence of any Amtrak bankruptcy is that the trustee and the Bankruptcy Court would be making decisions about Amtrak's future, rather than the corporation or Congress, through the oversight process. Because of the difficulty in predicting how Amtrak might be reorganized and because of your interest, we focused on the financial issues that would ensue if Amtrak were liquidated.

Consistent with your request, this report focuses on the potential direct financial issues of an Amtrak liquidation on Amtrak creditors and owners.

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[3]The act also required the Amtrak Reform Council to develop and submit to Congress an action plan for a restructured and rationalized national intercity passenger rail system. Congress was not required to act on either plan.

[4]*Intercity Passenger Rail: Issues Associated with a Possible Amtrak Liquidation*, GAO/RCED-98-60 (Washington, D.C.: Mar. 2, 1998).

[5]For purposes of this report, the "railroad retirement account" refers to amounts included in the Railroad Retirement Account, the Social Security Equivalent Benefit Account, and the National Railroad Retirement Investment Trust created by the Railroad Retirement and Survivors' Improvement Act of 2001.

The report does not discuss secondary issues, such as possible damage to a creditor if it does not collect amounts owed to it by Amtrak, or loss of business or increased unemployment insurance claims if a vendor has to reduce its workforce because of Amtrak's liquidation. In addition, the report does not discuss the effects of the cessation of intercity passenger rail service, or the effects on commuter and freight rail service that rely on access to Amtrak's tracks or rely on Amtrak to operate their trains. For example, commuter railroads would be adversely affected if they did not have access to tracks and stations owned by Amtrak, and if they had to absorb infrastructure costs previously borne by Amtrak. Additionally, commuter rail operators that contract with Amtrak to provide service would have to find new operators—a potentially time-consuming and expensive proposition. Finally, several commuter and freight railroads that use Amtrak's Northeast Corridor (running from Boston to Washington, D.C.) face harm to their businesses to the extent that they are unable to retain access to the corridor. Several of these issues are discussed in more detail in our recent testimony before this committee's Subcommittee on Railroads, and in our 1998 report on financial and transportation issues that could result from an Amtrak liquidation.[6]

To carry out our work, we reviewed laws related to Amtrak and bankruptcy and analyzed financial information provided by Amtrak on its assets, liabilities, and ownership interests. As agreed with your office, we did not attempt to determine the market value of Amtrak's assets had it been liquidated. We also asked the Railroad Retirement Board (Board) to estimate the potential financial impacts of an Amtrak liquidation on the railroad retirement and unemployment systems.[7] We did not independently verify the information provided by Amtrak or the analysis performed by the Railroad Retirement Board. We assumed Amtrak's liquidation as if it occurred on December 31, 2001 (the latest data available at the time of our review).

[6]See GAO-02-522T and GAO/RCED-98-60.

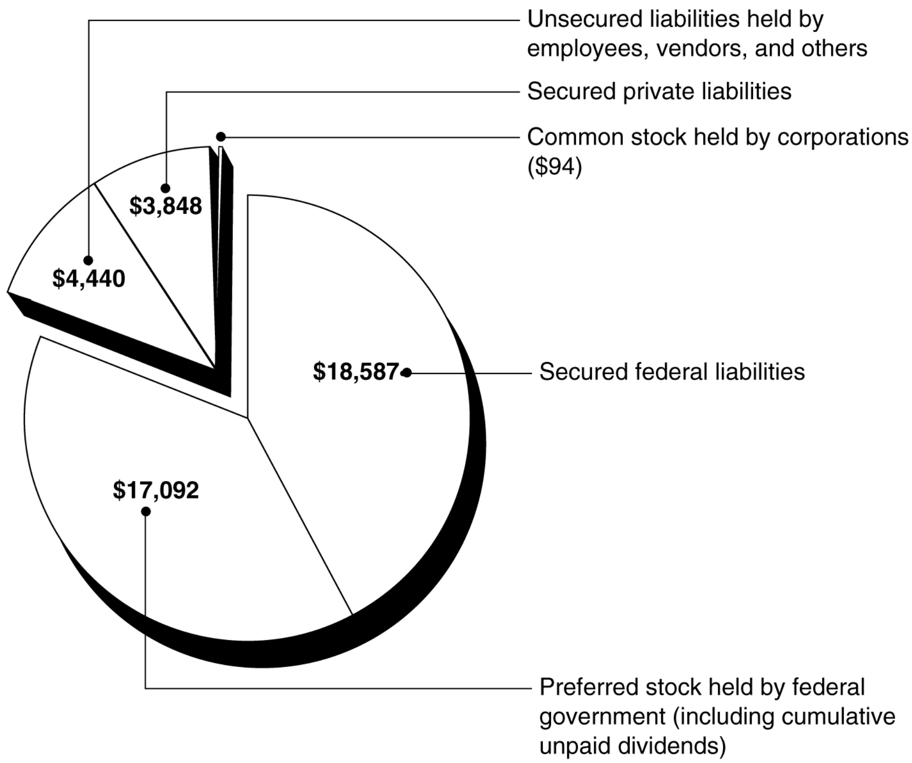
[7]The Board, which administers the railroad retirement and unemployment systems for Amtrak and other railroads, is an independent agency of the federal government established in the 1930s. In 2001, preliminary estimates showed that these systems covered about 272,000 active workers, of which Amtrak had about 10 percent (or about 27,300 employees). Active workers are those workers with at least one reported service month during 2001 and, in Amtrak's case, whose last reported employer was Amtrak. Active workers can include temporary workers as well as employees who worked for more than one railroad employer, including Amtrak.

Results in Brief

If Amtrak had been liquidated on December 31, 2001, secured creditors and unsecured creditors—including the federal government and Amtrak employees—and stockholders would have had about $44 billion in potential claims against and ownership interests in Amtrak's estate. (See fig. 1.) The federal government would have been by far the largest claimant, accounting for about 80 percent of the value of all creditor claims and ownership interests. It would have had about $14.2 billion in secured claims against real property, primarily property making up the Northeast Corridor, and about $4.4 billion in claims against equipment. It also would have had an ownership interest totaling about $17.1 billion in Amtrak preferred stock and cumulative unpaid dividends. Of the $4.4 billion in unsecured creditor claims, the largest category would have been Amtrak's employees, with potential claims of about $3.2 billion for payments that Amtrak would owe to terminated employees. (These payments, stemming from collective bargaining agreements, are called "labor protection payments.") It is unlikely that secured and unsecured creditors' claims would have been fully satisfied, because—other than the Northeast Corridor—Amtrak's assets available to satisfy these claims and interests (such as equipment and materials and supplies) are old, have little value, or appear unlikely to have a value equal to the claims against them. The market value of Amtrak's most valuable asset (the Northeast Corridor) has not been tested. While the corridor has substantial value, it is subject to easements and has billions of dollars of deferred maintenance. Furthermore, it is not likely that the stockholders would have received any payment for their ownership interest.

Figure 1: Creditor Claims and Stockholder Interests in the Event That Amtrak Had Been Liquidated on December 31, 2001

Dollars in millions



Note: Stockholder interests are different from creditor claims. Stockholders receive funds only after secured, unsecured, and administrative expenses relating to liquidating the estate are satisfied. The amount of the stockholder interest consists of the total of the recorded value of the stock (common and preferred) plus cumulative unpaid preferred stock dividends.

Source: GAO's analysis of Amtrak's data.

An Amtrak liquidation would have adversely affected participants in the railroad retirement and unemployment systems. If all Amtrak employees had lost their jobs on December 31, 2001, and were not reemployed in the railroad industry, the railroad retirement system would have lost over $400 million in annual contributions from Amtrak payroll taxes (about 9 percent of total receipts). The Railroad Retirement Board estimated that the railroad retirement account would begin to decline in 2006 and would be in a deficit by 2024 if no actions were taken to increase payroll taxes or reduce benefits. To forestall this deficit, the Board estimated that the rates contained in the tier II tax rate schedule (tier II taxes are taxes paid by employers and employees that pay railroad pension benefits over and above social security levels) would have to be increased by 1.64 percentage points. As a result, payroll taxes paid by employers and employees would have had to increase to 22.1 percent in 2002 (an increase of 8 percent over the 20.5 percent rate planned if Amtrak did not undergo liquidation). In 2023, the year before the deficit, payroll taxes were estimated to be 24.6 percent, about 7 percent greater than the 23.0 percent rate planned if Amtrak did not undergo liquidation. The financial impact on the railroad unemployment system would have been more immediate, but short-term. According to the Railroad Retirement Board, the unemployment account would have been exhausted in 2002, the unemployment account would have had to borrow $338 million from the railroad retirement account, and unemployment taxes would have had to increase from 4 percent to 12.5 percent between 2002 and 2004 for the system to maintain its financial health. Amtrak's railroad unemployment insurance–related costs would have been borne by other rail employers.

In commenting on a draft of this report, Amtrak stated that it was in general agreement with the report and that the report fairly represented the costs and ramifications of an Amtrak liquidation. However, Amtrak believed that there would be material consequences of liquidation about which the report was silent, including the substantial burden a liquidation could have on commuter and freight railroads, especially on the Northeast Corridor. In Amtrak's estimation, liquidating Amtrak could increase these railroads' operating and capital costs by about $600 million annually. We acknowledged the potential financial and operational impact on commuter and freight railroads both in the draft report on which Amtrak commented and in this final report. Amtrak also commented that the interest of the preferred stock holder would be about $6 billion more than the $10.9 billion we originally included in the draft report. This represents cumulative preferred stock dividends that were not declared or paid between 1981 and 1997. We noted that this $6 billion was not expressly disclosed in Amtrak's financial statements, and we brought this to Amtrak's, and its external auditor's, attention for possible future disclosure. We amended our report to recognize the preferred stock dividends. The Department of Transportation and Railroad Retirement Board did not express an overall opinion about the draft report. Rather, they offered technical comments designed to clarify specific points in the report. With few exceptions, these comments were incorporated into the report.

Background

Amtrak was established by the Rail Passenger Service Act of 1970. Amtrak operates a 22,000-mile network, primarily over freight railroad tracks, providing service to 46 states and the District of Columbia. (See fig. 2.) In fiscal year 2001, Amtrak served about 23.5 million intercity rail passengers over 43 routes. In addition, Amtrak is the contract operator of seven commuter rail systems. These commuter rail systems served about 63.4 million passengers in fiscal year 2001. Amtrak owns a variety of assets, most notably about 650 miles of track, primarily along the Northeast Corridor. The corridor is used by eight commuter railroads (operated by state and local governments) that serve about 1.2 million passengers each workday, and six freight railroads operating 38 trains per day. Amtrak also owns passenger stations, rail shops, and rail equipment, including passenger cars and locomotives. From fiscal year 1971 through fiscal year 2002, the federal government has provided Amtrak with over $25 billion in operating and capital subsidies.[8] In July 2002, Amtrak employment was about 23,000 people.

[8]In 2001 dollars, Congress has provided Amtrak with about $40 billion from 1971 to 2002.

Figure 2: Amtrak's Route System, as of August 2002

Source: Amtrak.

The railroad retirement system provides retirement and disability benefits to the nation's retired railroad workers and their survivors (including those of Amtrak), while the railroad unemployment system pays a portion of lost wages to railroad employees who lose their jobs or are sick. In fiscal year 2001, the Railroad Retirement Board paid about $8.4 billion (net of recoveries) in retirement and survivors' benefits to about 700,000 beneficiaries, and about $95 million in unemployment and sickness benefits to about 40,000 railroad workers. Railroad retirement payroll taxes are made up of tier I and tier II taxes, and are used to pay tier I, tier

II, and supplemental annuity benefits.[9] Employers and employees pay tier I taxes at the same rate as social security taxes, and benefits are based on combined railroad and nonrailroad service. Tier I benefit amounts are generally the same as those paid under the Social Security Act. Tier II taxes are used to finance railroad retirement pension benefits over and above social security levels. Under the Railroad Retirement and Survivors' Improvement Act of 2001, employer tier II tax rates are set at 15.6 percent and 14.2 percent for 2002 and 2003, respectively. Beginning in 2004, tier II tax rates will be determined based on the calculation of an assets-to-benefits payout ratio. Employee tier II taxes are 4.9 percent for 2002 and 2003, and then capped at 4.9 percent thereafter. The act did not change tier I tax rates.

Should Congress decide to liquidate Amtrak as part of a restructuring of intercity passenger rail service or should Amtrak's financial condition force it to file for bankruptcy, Amtrak must do so under chapter 11 of the Bankruptcy Code. This chapter contains provisions regarding the management and reorganization of debtors, including railroads, and specifies the circumstances under which a railroad may be liquidated. Among other things, chapter 11 seeks to protect the public interest in maintaining continued rail service. However, a railroad may be liquidated upon the request of an interested party (such as a creditor) if the court determines liquidation to be in the public interest.[10] A railroad must be liquidated if a plan for reorganizing it has not been confirmed within 5 years of its filing for bankruptcy. An appointed trustee plays a key role and, subject to the court's review, directs the railroad and its affairs during bankruptcy. In liquidation, the trustee administers the distribution of the railroad's assets in accordance with the Bankruptcy Code. (See app. I for a discussion of the significant aspects of the railroad bankruptcy process.)

[9]The Railroad Retirement Act provides for a supplemental annuity for certain employees who performed railroad service in at least one month prior to October 1, 1981. This annuity was funded entirely through a work-hour tax on employers and was paid from a separate Railroad Retirement Supplemental Account. The Railroad Retirement and Survivors' Improvement Act of 2001 repealed both the tax and the supplemental account. However, supplemental annuities will continue to be paid to those who are eligible, from the railroad retirement account.

[10]In addition, three or more of Amtrak's creditors whose unsecured claims total at least $10,000 could file a petition for Amtrak to be placed in bankruptcy involuntarily.

Creditor Claims and Ownership Interests Were Not Likely to Have Been Satisfied if Amtrak Had Been Liquidated

If Amtrak had been liquidated on December 31, 2001, secured and unsecured creditors,[11] including the federal government and Amtrak's employees, and stockholders (preferred and common) would have had about $44 billion in potential claims against and ownership interests in Amtrak's estate. The federal government would have been by far the largest secured creditor (for property and equipment) and would have had the largest stockholder interest (in preferred stock), together representing about 80 percent (about $35.7 billion) of the $44 billion amount. Of the $4.4 billion in unsecured claims, Amtrak's employees would have had potential claims for about $3.2 billion in labor protection payments (payments that Amtrak would owe to terminated employees stemming from collective bargaining agreements). Amtrak's employees would also have had other unsecured claims for such things as vacation pay and injury claims, and retirees would have had claims for post-retirement medical benefits.

It is not likely that secured and unsecured creditors' claims and would have been fully satisfied, because Amtrak's assets—other than the Northeast Corridor—available to satisfy these claims and interests (such as equipment and materials and supplies) are old, have little value, or might not have a value equal to the claims against them. The market value of Amtrak's most valuable asset (the Northeast Corridor) has not been tested. While the Corridor has substantial value, it is subject to easements and has billions of dollars of deferred maintenance. Furthermore, it is not likely that the stockholders would have received any payment for their ownership interest.

Secured Creditors' Claims Would Not Likely Have Been Satisfied

Amtrak's secured creditors would have had about $22.4 billion in claims against the recorded amount of its property and equipment as of December 31, 2001.[12] (See table 1.) In general, secured creditors are able to attach the property and equipment that were pledged as collateral to secure Amtrak's debt to pay their claims. To the extent that individual secured creditors' claims exceed the liquidation proceeds of specifically

[11]For purposes of this report, secured claims include claims supported by collateral (such as passenger cars and locomotives) or representing capital lease obligations.

[12]Amtrak's creditors include lessors. For financial reporting purposes, most Amtrak leases are classified as capital leases, and the leased property and equipment are reported as Amtrak assets, with a related lease liability obligation. In general, Amtrak does not own the leased property and equipment but rather has the rights to use them under the terms of the lease.

pledged property and equipment, the excess outstanding indebtedness would become unsecured claims.

Table 1: Secured Liabilities and Lease Obligations in the Event That Amtrak Had Been Liquidated on December 31, 2001

Dollars in millions

Type of security	Potential claims	Percent of total
Federal government:		
Real property	$14,211	63%
Passenger cars and locomotives	4,376	20
Subtotal	**$18,587**	**83%**
Private lenders:		
Passenger cars and other rolling stock	1,526	7
Locomotives	941	4
High-speed train sets	625	3
Mail and express freight cars	34	[a]
Subtotal equipment	**$3,126**	**14%**
Northeast Corridor improvements	673	3
Other property	49	[a]
Subtotal property	**$722**	**3%**
Total	**$22,435**	**100%**

[a]Less than 1 percent.

Source: GAO's analysis of Amtrak's data.

Among all of Amtrak's secured creditors, the U.S. government would have had the largest claim to payments from the sale of Amtrak's assets in liquidation. Federal secured claims would have been on Amtrak's real property (up to $14.2 billion) and equipment ($4.4 billion) for a combined total of 83 percent of all secured creditor claims. These claims largely arise from two promissory notes issued by Amtrak and held by the federal government. The first note represents a secured interest on Amtrak's real property (primarily Amtrak's Northeast Corridor) and matures in about 970 years (December 31, 2975). In June 2001, in conjunction with Amtrak's mortgage of a portion of Pennsylvania Station in New York City, the federal government strengthened its position regarding this note by making the principal and interest due and payable if Amtrak files for bankruptcy and is liquidated or if Amtrak defaults under the mortgage.[13] Prior to that date, acceleration of the due date would have required enactment of a statute requiring immediate payment, and there would have been no interest payable unless the due date had been accelerated.[14]

On the basis of information provided by the Federal Railroad Administration, we calculate that if Amtrak had been liquidated on December 31, 2001, about $14.2 billion in principal and interest would have been due and payable on the note.[15] Satisfaction of this claim from the sale of the secured assets would depend on the market value of the property—the amount due is limited to the fair market value of the property. The market value of the Northeast Corridor has not been tested; furthermore, commuter and freight railroad easements, about $4 billion in deferred maintenance, and the extent to which this property could be used for telecommunications and other utilities could affect its ultimate value. In the event of liquidation, the federal government could pursue several options, including transferring ownership of these assets to an entity or entities that would allow continued rail use.

The second federal note is secured by a lien on Amtrak's passenger cars and locomotives. This note matures on November 1, 2082, with successive 99-year renewal terms. If Amtrak had been liquidated on December 31,

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[13]In the event of liquidation, the trustee may file a plan that could cure all defaults and reinstate the original maturity date of the note, and the bankruptcy court would then consider whether to approve such a plan. For purposes of this report, however, we examined the potential claims against Amtrak in the event of Amtrak's bankruptcy, or other default, leading to liquidation. In this event, the acceleration clause of the note would take effect.

[14]We discussed with the Federal Railroad Administration their concern about the applicability of section 365(e)(1) of Title 11 of the United States Code to the acceleration clause in this note. This provision prohibits the acceleration of debt due to (1) insolvency or financial condition of the debtor, (2) commencement of a bankruptcy case, or (3) appointment of a trustee. However, this section of the Bankruptcy Code pertains to executory contracts and unexpired leases. The Chief Counsel of the Federal Railroad Administration believes, and we agree, that this section of the Code should not apply to make the acceleration clause unenforceable, because it is found within a note. Pursuant to legislative history of the Bankruptcy Code, notes are not considered to be executory contracts. (See H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 347 (1977).)

[15]In 1998, we reported that this note had a balance of about $3.8 billion that represented principal only. The bulk of the difference between this amount and the $14.2 billion that would have been due had Amtrak been liquidated on December 31, 2001, is the accrual of interest from the date of the note in 1976, which would be due in a liquidation under the new acceleration provision.

2001, this note would have been accelerated, and about $4.4 billion in principal and interest would have become immediately payable.[16] Similar to its actions regarding the first note, the federal government acted in 2001 to strengthen its claim. Federal Railroad Administration officials told us that the lien securing the original note required the government to subordinate its lien on the equipment acquired by Amtrak after 1983 (the date of the original note) in individual transactions to the security interest of Amtrak's equipment creditors in these transactions. This was done to assist Amtrak in obtaining financing from the private sector. Amtrak's June 2001 mortgage of Pennsylvania Station amended the original real property mortgage discussed above to provide the federal government with a security interest in all other real and personal property held by Amtrak as of June 20, 2001, that was not otherwise encumbered, and any real and personal property acquired by Amtrak after that date.[17] Although the amendment to the mortgage strengthened the federal government's security interest in otherwise unencumbered property, it did not change its priority with respect to other secured creditors of Amtrak's equipment. This, in addition to the fact that the equipment is old, with limited market value in liquidation, means that the federal government would probably not have realized much, if anything, from the second federal note had Amtrak been liquidated on December 31, 2001.

The majority of the non-U.S. government lenders' secured property claims would have been associated with passenger cars and equipment ($1.5 billion), locomotives ($941 million), and Northeast Corridor property ($673 million).[18] It is not likely these creditors' claims would have been fully satisfied in liquidation, because a substantial portion of Amtrak's equipment is old and may not have had a value equal to the outstanding loan amount. As of March 2002,[19] approximately 36 percent of Amtrak's

[16]This amount is about four times greater than the $1.1 billion we reported in 1998. The value of this note increased primarily because of interest accrued under the acceleration provision. The amount reported in 1998 did not include accrued interest. The value of this note in 1998, including both principal and accrued interest, would have been $3.7 billion.

[17]Excluded from this security interest was equipment previously subject to the original note (or previously released from the lien associated with that note) and certain property held by the Chicago Union Station Company—an Amtrak subsidiary.

[18]The latter primarily includes Amtrak's mortgage of a portion of Pennsylvania Station (about $296 million outstanding on December 31, 2001) and high-speed rail maintenance facilities ($178 million).

[19]Information as of December 31, 2001, was not available.

active equipment—that is, passenger cars, locomotives, mail/baggage/express cars, and auto carriers—had an average age of 20 years or more. Age was even more of a factor when looking at certain equipment types. For example, about 63 percent of Amtrak's passenger car fleet and about 34 percent of its locomotives had an average age of 20 years or more. Old equipment, even if well maintained, could potentially limit the proceeds obtained in a liquidation. This problem could be compounded if a substantial amount of equipment were placed on the market at the same time. In contrast, some non-U.S. government lenders' claims on Amtrak's real property could be more valuable than claims on equipment. That is because stations and maintenance facilities could be refurbished to provide continuing use for either their intended or alternative purposes.

Amtrak's recent acquisition of new passenger cars and locomotives and its efforts to update facilities have resulted in a significant increase in the level of private debt. From September 1997 (the date at which we measured liabilities in our 1998 report on a possible Amtrak liquidation) to December 2001, Amtrak's private secured creditor claims for both property and equipment increased by 245 percent, from $1.1 billion to $3.8 billion. For the most part, Amtrak's private-sector financing of equipment and property acquisitions comes from debt and long-term leases. However, in recent years Amtrak has sold some of its equipment and leased it back—through what are called sale-leaseback arrangements. Under these arrangements, the buyer holds title to the equipment and Amtrak receives cash, as well as possession of the equipment. As of December 31, 2001, about 24 percent of Amtrak's outstanding private debt liability ($924 million) was in sale-leaseback arrangements. (See table 2.) This debt primarily relates to four sale-leaseback transactions Amtrak entered into in fiscal year 2000, involving about 600 passenger cars. In the event of liquidation, because the lessors involved in these transactions own the equipment, their secured creditor position remains intact. In addition, in conjunction with these transactions, a total of about $830 million of Amtrak's sale proceeds were put into a trust account and recorded as assets on Amtrak's financial records. Because these funds were specifically earmarked to service the original debt liability associated with the sale-leaseback arrangements, in liquidation they would not necessarily be available to satisfy general creditors' claims.

Table 2: Outstanding Liabilities to Non-U.S. Government Lenders, by Type of Loan and Asset Category, as of December 31, 2001

Dollars in millions

Type of loan	Amount	Percent of total
Capital leases:		
Equipment	$2,136	56%
Equipment (sale-leasebacks)	924	24
Real property	405	10
Other debt:		
Mortgages (real property)	317	8
Construction-in-process (equipment)	66	2
Total	**$3,848**	**100%**

Note: Does not include amounts owed the U.S. government.

Source: GAO's analysis of Amtrak's data.

In response to your interest, we found that 68 percent of Amtrak's outstanding debt as of December 31, 2001—other than debt held by the U.S. government—was held by, or at least initially was connected with, foreign participants. (See table 3.) Foreign interests accounted for about 72 percent of debt on equipment and 50 percent of debt on property.

Table 3: Outstanding Liabilities for Equipment and Property, by Foreign and Domestic Participating Interest, as of December 31, 2001

Dollars in millions

Description	Loan balance	Percent within asset category	Percent of total debt
Equipment:			
Foreign	$2,240	72%	58%
Domestic	886	28	23
Subtotal	**$3,126**	**100%**	**81%**
Property:			
Foreign	364	50	10
Domestic	358	50	9
Subtotal	**$722**	**100%**	**19%**
Total	**$3,848**		**100%**

Note: Does not include amounts due the U.S. government.

Source: GAO's analysis of Amtrak's data.

Employees and Other Unsecured Creditors Would Also Likely Have Had Unsatisfied Claims

As of December 31, 2001, Amtrak's data showed that unsecured liabilities totaled about $4.4 billion. (See table 4.) About 70 percent of this amount would have been for labor protection payments if Amtrak had been liquidated. The largest remaining obligations were for materials and services provided by vendors ($304 million), unpaid employees' wages and vacation and sick pay ($278 million), and injury claims from passengers, employees, and others ($218 million). In the event of liquidation, the payment of unsecured creditors' claims would have been even more doubtful than those of secured creditors.[20]

Table 4: Unsecured Liabilities in the Event That Amtrak Had Been Liquidated on December 31, 2001

Dollars in millions

Potential claimant	Nature of payment owed	Amount owed
Employees	Labor protection payments due for job loss under collective bargaining agreements	$3,168
Vendors	Accrued expenses for goods and services	304
Employees	Unpaid wages, vacation pay, and sick leave	278
Injured passengers, employees, and others	Estimated payments for claims filed for personal injury and wrongful deaths resulting from Amtrak's operations	218[a]
Landlords	Rent due for station and office space under noncancellable, long-term leases	201
Retired employees and employees eligible to retire	Postretirement medical benefits	150
Passengers	Refunds for cash paid for reservations in advance of travel	67
Environmental Protection Agency, local governments	Estimated cost for environmental cleanup work	32[b]
Line of credit providers	Security for contract performance and for repayment of short-term cash loans for operating expenses	11[c]
Commuter agencies, railroads, and other customers	Refunds for advances and overpayments for services such as maintenance-of-way work performed by Amtrak	9
Railroad Retirement Board	Railroad unemployment tax payments	2
Total		**$4,440**

[a]According to Amtrak, this amount is based on an actuarial estimate of actual and potential claims that might be filed. This includes claims filed under the Federal Employers' Liability Act.

[b]Estimate based on instances in which Amtrak has been identified as responsible for cleanup costs.

[c]This item is part of a $270 million line of credit that Amtrak maintains with various lenders. This line of credit is used to secure the performance of contracts Amtrak enters into, as well as to pay operating expenses.

Source: GAO's analysis of Amtrak's data.

[20]Certain unsecured claims are granted priority status under the Bankruptcy Code and would be provided for before other unsecured claims. Priority unsecured claims would include administrative claims for postpetition expenses of the estate, wages and contributions to employee benefit plans, claims for personal injury or wrongful death, labor protection claims, and claims against the Railroad Unemployment Insurance Account. (See app. I.)

The amount of labor protection payments represents the biggest difference between the unsecured creditor claims that were included in our 1998 report on this issue and current estimates. In 1998, we reported that labor protection obligations as of September 1997 could have been about $6 billion if Amtrak had been liquidated, or about $2.9 billion more than the amount that Amtrak estimates could have been due on December 31, 2001. This difference stems from changes made by the Amtrak Reform and Accountability Act of 1997. The act eliminated the statutory right to labor protection, made labor protection subject to collective bargaining, and required Amtrak to negotiate new labor protection arrangements with its employees. After Amtrak and unions could not reach agreement, an October 1999 arbitration decision (1) capped labor protection payments at a 5-year maximum (rather than 6 years, as under the statutory labor protection arrangement); (2) made employees who had less than 2 years of service ineligible for payments; and (3) based payments on a sliding scale that provided less payout for each year worked than did the previous system. (See table 5.) Amtrak indicated that $1.8 billion of the cost difference between 1997 and 2001 is attributable to these changes. Another $950 million in the difference between the earlier and current estimates is attributable to management employees who were no longer eligible for labor protection after 1997. According to Amtrak, management eligibility for labor protection ended in 1997 because management employees were not represented by a formal labor organization and, therefore, could not bargain for new labor protection arrangements as required by the Amtrak Reform and Accountability Act of 1997. Amtrak officials noted that the act provided for no process to determine substitute protection for these employees.[21]

[21]Amtrak estimates that labor protection costs for management would have been about $583 million had it been liquidated on December 31, 2001, and had management employees been entitled to labor protection payments. On December 31, 2001, Amtrak had approximately 2,700 individuals defined as management employees (called “nonagreement employees” by Amtrak).

Table 5: Estimated Cost of Labor Protection, as of December 31, 2001

Dollars in millions

Years employed by Amtrak	Number of employees[a]	Total estimated cost (wages and benefits)
Fewer than 2	1,804	**$0**[b]
2 to 3	1,106	**32**
3 to 5	2,087	**134**
5 to 10	2,464	**268**
10 to 15	3,858	**606**
15 to 20	2,585	**668**
20 to 25	2,180	**594**
26 or more	2,452	**866**
Total	**18,536**	**$3,168**

[a]Amounts do not include employees on furlough at December 31, 2001 (approximately 500 employees), management employees (approximately 2,700 employees), or employees in commuter rail service (approximately 2,600 employees). According to Amtrak, these employees are not eligible for labor protection. Amounts also exclude employees doing work for which Amtrak is reimbursed, such as maintaining railcars for transit agencies (410 employees). In June 2002, an arbitration panel ruled that Amtrak is not responsible for labor protection for these employees if they lose their jobs.

[b]Employees with fewer than 2 years of service are not eligible for labor protection payments.

Source: GAO's analysis of Amtrak's data.

Included in Amtrak's estimate of labor protection costs is about $70 million for 423 employees who work on trains that receive state financial support. In June 2002, an arbitration panel determined that Amtrak would be responsible for labor protection payments for these employees should they lose their jobs because Amtrak decides to discontinue state-supported train service. However, the panel determined that Amtrak's potential liability would be only one-third of the amount provided to employees on other routes if discontinuation of such service were solely a state's decision.

Satisfying more than a small amount of unsecured creditor claims in liquidation would be difficult at best. Unsecured creditors depend entirely on the proceeds from the sale of Amtrak's available assets that remain after secured assets are sold to satisfy secured creditor interests. As of December 31, 2001, all of Amtrak's rolling stock was encumbered by liens and would not have been available to satisfy unsecured creditor claims. In addition, it is uncertain whether Amtrak's real property, such as that on the Northeast Corridor, would be available for sale to satisfy unsecured creditor claims either. That is because the federal mortgage on this real property would become due and payable if Amtrak filed for bankruptcy and were liquidated. In this event, the federal government could take ownership of this property in lieu of foreclosure. To the extent that the value of the Northeast Corridor is insufficient to fully satisfy the federal security interest, the assets of the Northeast Corridor would be unavailable to satisfy unsecured creditor claims.

Unsecured creditors would likely have to rely on other sources of payment, such as the sale of receivables due to Amtrak (for example, amounts due from travel agents and credit card companies that participate in the sale of Amtrak's tickets) or the sale of materials and supplies (for example, spare parts and fuel). As of December 31, 2001, these other assets totaled about $218 million. Amtrak estimates that between $59 million and $90.7 million of its receivables (65 to 100 percent of their value) might be recovered in cash. In contrast, much of Amtrak's spare parts inventory is unique to Amtrak's operations, and Amtrak estimates that only about 35 percent ($44.5 million) of the $127.1 million on Amtrak's balance sheet for materials and supplies might be recovered. Given this situation, it is likely that unsecured creditors would receive little for their claims.

Shareholders Would Have Been Unlikely to Receive Money for Stock Holdings

The U.S. government holds all of Amtrak's preferred stock, and four corporations hold Amtrak's common stock.[22] The preferred and common stock had recorded values of about $10.9 billion and $94 million, respectively, as of December 31, 2001. In addition, in accordance with Amtrak's enabling legislation and its articles of incorporation, preferred stock holders were entitled to an annual cumulative dividend of at least 6 percent until 1997, when the statute was amended to eliminate the requirement that preferred stock holders are entitled to dividends.[23] Although no dividend has ever been declared or paid, Amtrak has calculated the cumulative unpaid preferred stock dividends from 1981 to 1997 to be about $6.2 billion. In a liquidation, the amount of the preferred

[22]The federal government received preferred stock in the value of the federal operating payments and most federal capital payments that it made to Amtrak between October 1981 and December 2, 1997. The federal government is the only Amtrak preferred stock holder. When Amtrak was formed, some railroads that provided or contributed passenger equipment, crews, or other services received Amtrak common stock or a federal income tax credit. This common stock is now held by three railroads and one holding company. The Amtrak Reform and Accountability Act of 1997 requires that Amtrak redeem all of its common stock at fair market value by October 1, 2002.

[23]We note that Amtrak has not amended the sections of its articles of incorporation that correspond to the statutory change.

stock holders' interest would include all cumulative unpaid dividends. Thus, the total stockholder interest for the federal government as the sole preferred stock holder is about $17.1 billion. These stockholder interests would not get paid until after secured, unsecured, and administrative expenses relating to liquidating the estate were satisfied.

As discussed earlier, it is not likely that secured or unsecured creditor claims would have been fully satisfied had Amtrak been liquidated. The amount of the stockholder interest is the total of the recorded value of the common and preferred stock, plus the cumulative unpaid preferred stock dividends. However, in determining how much these stockholders would get paid is dependent on the value of Amtrak's assets after creditors' claims are paid, which would include (or be offset by) the amount of Amtrak's retained earnings (or cumulative losses). As of December 31, 2001, Amtrak's cumulative deficit was $16 billion, which represents its cumulative losses. As a result of these factors, it is not likely that either the federal government or common stock holders would have received any money for their stock holdings if Amtrak had been liquidated.[24]

United States Would Not Be Liable for Creditors' Claims

We have concluded that the United States would not be legally liable for either secured or unsecured creditors' claims in the event of an Amtrak liquidation. There are two primary reasons. First, the federal government is not a party to contracts between Amtrak and its creditors. Second, Amtrak is not a department, agency, or instrumentality of the U.S. government, and there is no explicit or implicit commitment by the United States to assume these obligations. Therefore, any losses experienced by Amtrak's creditors would be borne in full by the creditors themselves or their insurance companies. Nevertheless, we recognize that creditors may attempt to recover losses from the U.S. government.[25]

[24]In addition to eliminating the statutory requirement that Amtrak's articles of incorporation provide for a minimum annual cumulative preferred stock dividend of 6 percent, the Amtrak Reform and Accountability Act of 1997 expressly eliminated the liquidation preference attached to the preferred stock—that is, the preference for preferred stock holders to receive payments before common stock holders—as well as the requirement to issue such stock in the future.

[25]See our letters to Representatives Kasich and Shuster on federal liability for Amtrak's obligations (B-277814, Oct. 20, 1997). There have been no changes in statutory or decisional law that would cause us to modify the conclusions we reached in our 1997 opinion.

Liquidation Would Have Adversely Affected the Railroad Retirement and Unemployment Systems

The Railroad Retirement Board estimated that Amtrak's liquidation would have caused the railroad retirement system to run out of funds in 2024 if all Amtrak employees had lost their jobs and were not reemployed in the railroad industry.[26] To forestall this result, the Board estimated that the rates contained in the tier II tax rate schedule would have had to be increased 1.64 percentage points over those planned, resulting in a rise from 20.5 percent and 23.0 percent, respectively, to about 22.1 percent and 24.6 percent in calendar years 2002 and 2023.[27] These are between 7 and 8 percent increases. Rates would have continued to be higher in subsequent years. In addition, the railroad unemployment system would have had to borrow over $300 million to make benefit payments and remain financially solvent. (All amounts are in constant 2001 dollars, unless otherwise stated.)

Amtrak Liquidation Would Have Depleted the Railroad Retirement Fund

Since the retirement system is on a modified pay-as-you-go basis, the financial health of the system largely depends on the size of the railroad workforce, the taxes derived from this workforce, and the amount of benefits paid to retired and disabled individuals and their beneficiaries. Payroll taxes levied on employers and employees are the primary source of the retirement system's income. In 2001, Amtrak paid about $428 million in payroll taxes into the railroad retirement account (about 9 percent of the total receipts for the year).

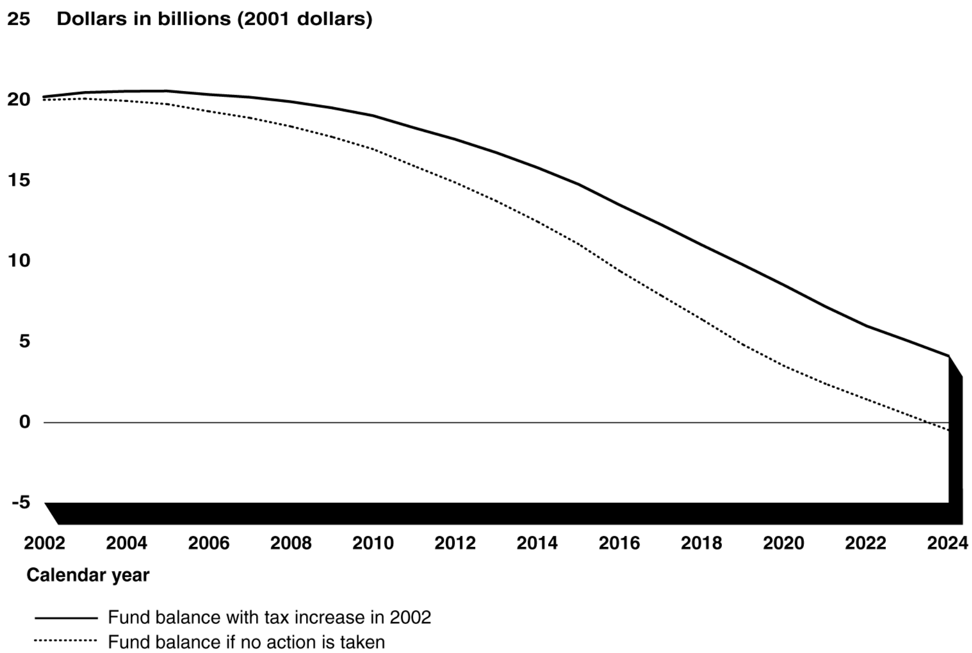
A loss of Amtrak's contribution would have had a significant financial impact on the system. The Board estimated that, if Amtrak had been liquidated on December 31, 2001, and no action had been taken to increase tier II payroll taxes beyond that already planned or to reduce benefit

[26] A 100 percent decline in Amtrak employment is consistent with a liquidation of the company. In addition, the assumption that terminated workers would not have been reemployed in the industry is consistent with the fact that industry employment has been falling over the past decade and the Railroad Retirement Board projects that employment will continue to decline.

[27] At our request, the Board estimated the minimum tax increase required to keep the fund from running a deficit. If Amtrak underwent liquidation, the Board could consider other options, such as reducing benefits or establishing tax rates that provide more long-term financial health for the retirement fund.

levels, the railroad retirement account would start to decline in 2006 and would first have a negative balance (of $742 million) in 2024.[28] (See fig. 3.)

Figure 3: Balance of Railroad Retirement Account in the Event That Amtrak Had Been Liquidated on December 31, 2001



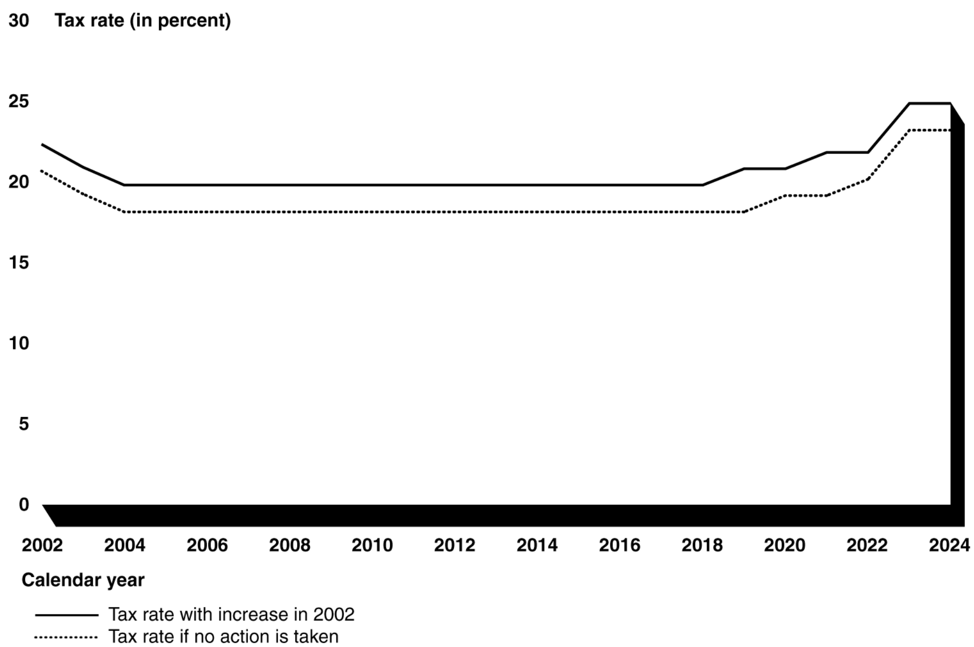
Source: GAO's analysis of the Railroad Retirement Board's data.

[28]In nominal dollars, the negative balance would be $1.2 billion. For this analysis, the Board assumed that all Amtrak employees were terminated on December 31, 2001, and that employees eligible for retirement at the time of liquidation (about 1,000 employees) actually retired. The analysis did not assume that Amtrak workers exercised flowback rights (reemployment rights for Amtrak workers who joined the corporation from other railroads when it was created). According to Amtrak, about 1,275 employees have flowback rights to other railroads. The Board's analysis considered the effects of the Railroad Retirement and Survivors' Improvement Act of 2001, enacted in December 2001. This act, among other things, increased certain benefits for widows, widowers, and employees/spouses; repealed maximum retirement benefits; and changed employer tax rates.

The financial health of some of the participants in the retirement system—such as small freight railroads and commuter rail systems—might be adversely affected to the extent that they could not increase revenue, cut costs, or otherwise absorb increases in payroll taxes that might be necessary to offset the loss of Amtrak contributions or increases in payments to Amtrak employees resulting from liquidation.

If tier II taxes had been increased immediately (that is, in 2002) to offset expected deficits beginning in 2024, the Board determined that tier II tax rates would have had to increase from a baseline of 20.5 percent of earnings (if Amtrak had not been liquidated) to about 22.1 percent in 2002—an increase of 8 percent. (See fig. 4.) The rate would have decreased somewhat in 2003 before leveling off through 2018. In all cases, the Board estimated that rates would be 1.64 percentage points greater than if Amtrak did not undergo liquidation. After 2018, the rate would have increased to about 24.6 percent in 2023 (about 7 percent greater than the baseline rate of 23.0 percent).[29] Although these actions would have kept the fund from having a negative balance, fund balances would have decreased markedly to $3.9 billion in 2024, according to the Board.[30]

Figure 4: Estimated Changes in Tax Rates in the Event That Amtrak Had Been Liquidated on December 31, 2001



Source: GAO's analysis of the Railroad Retirement Board's data.

[29]The rate would have continued to be at least 6 percent higher than otherwise planned through 2042.

[30]In nominal dollars, $6.1 billion.

An Amtrak liquidation could also have affected tier I tax revenues and benefit payments. These are the social security equivalent components of railroad retirement. The Board estimated that if Amtrak had been liquidated on December 31, 2001, tier I tax revenues would have decreased beginning in 2002 (about $200 million), and the shortfalls would have increased each year until 2024, when lost revenue would total about $310 million.[31] Similarly, the Board estimated that benefit payments would also have changed. From 2002 through 2005, benefits would have increased slightly—up to $6 million in 2002 and 2003—as the result of Amtrak employees' retiring and beginning to collect benefit payments. Beginning in 2006 benefit payments would have decreased each year until 2024, when the reduction would have been about $160 million.[32] Benefits would decrease because Amtrak employees would no longer be earning tier I service credits and therefore would not be entitled to tier I benefits. Board officials told us that an Amtrak liquidation would have had little impact on the administration of tier I taxes and benefits, since the Board would adjust (1) the amounts of monthly advances that it receives from Treasury to make expected benefit payments and (2) the annual reconciliation with the Social Security Administration and the Center for Medicare and Medicaid Services for taxes received and benefits paid (called the "financial interchange"). Social Security Administration officials agreed. They also said that the overall impact on the Social Security Trust Fund would likely have been slight, since tier I tax revenues and benefit payments make up a very small portion of total social security tax receipts and payments.

Adverse Effects on Railroad Unemployment System Would Be Short-Term

Finally, participants in the railroad unemployment system would also have been adversely affected by an Amtrak liquidation. Financial effects would have been immediate, but short-term. The Board estimated that if Amtrak had been liquidated on December 31, 2001, separated Amtrak employees would have received a total of $344 million in benefit payments during fiscal years 2002 and 2003. The cash reserves of the unemployment system would have been exhausted in 2002, and a total of $338 million would have to have been borrowed from the railroad retirement account, as permitted by statute, from 2002 through 2004 to make these benefit payments. The

[31]In nominal dollars, tax revenues would have decreased by about $200 million in 2002, and the shortfall would have been about $489 million in 2024.

[32]In nominal dollars, benefits would have increased by $6 million in 2002 and 2003, and benefit reductions would have been about $252 million in 2024.

peak loan balance would have been $349 million, including interest, with all loans repaid in 2005. In order to pay for these benefits and repay the loans, the Board would have had to require that other railroads and participants in the unemployment system increase their payroll tax contributions. According to the Board, between 2002 and 2004, the average tax rate would have had to increase from about 4 percent to 12.5 percent—before decreasing to 9.6 percent in 2005.[33]

Agency Comments and Our Evaluation

We provided a draft of this report to Amtrak, the Department of Transportation, and the Railroad Retirement Board for their review and comment. Amtrak provided its comments in a meeting with its Vice President for Financial Analysis (and others) and in a subsequent letter (see app. II). Amtrak stated that it was in general agreement with the draft report and that the report fairly represented the costs and ramifications of an Amtrak liquidation. However, Amtrak believed that there would be material consequences of liquidation about which the draft report is silent. In Amtrak's estimation, a liquidation could burden commuter and freight railroads (especially on the Northeast Corridor) with substantial operating and capital costs—about $600 million annually. We agree that the potential financial and operational impacts on commuter and freight railroads could be substantial if Amtrak were to be liquidated. We acknowledged this impact both in the draft report supplied to Amtrak for comment and in this final report.

Amtrak also believed that we did not provide sufficient information on the costs associated with administering an Amtrak liquidation. Amtrak estimated that these costs would range anywhere from $250 million to $360 million. We agree that there could be substantial costs associated with administering liquidation. However, this report is not intended to estimate the administrative costs of liquidating Amtrak.

[33]The railroad unemployment system is financed exclusively by contributions from railroad employers, on the basis of the taxable earnings of their employees. For 2002, the tax rates range from 3.15 percent (including a 2.5 percent surcharge) to a maximum of 12 percent on employees' monthly earnings of up to $1,100. If the balance of the system's account is less than zero, the maximum rate is 12.5 percent. In performing its analysis, the Board assumed that all terminated Amtrak employees had exhausted their unemployment benefits and had not received labor protection benefits. According to the Federal Railroad Administration, any unemployment insurance benefits received by Amtrak employees as the result of liquidation would have reduced their potential labor protection claims by the same amount.

Finally, in our meeting, Amtrak officials noted that the interest of the preferred stock holder (the U.S. government) would be about $6 billion more than the $10.9 billion we originally estimated in the draft report. This figure represents the cumulative dividends on this stock between 1981 and 1997 that Amtrak never declared or paid. In Amtrak's opinion, although the Amtrak Reform and Accountability Act of 1997 eliminated the statutory requirement for these dividends after 1997, it did not abrogate the $6 billion in cumulative dividends during that period—an amount that Amtrak believes would increase preferred stock holder interest in a liquidation. We noted that this $6 billion was not expressly disclosed in Amtrak's financial statements, including its draft 2001 financial statements, and brought this to Amtrak's, and its external auditor's, attention for possible future disclosure. We agree that upon liquidation the preferred stock holder interest would include the $6 billion in cumulative dividends. As a result, we have revised this final report to include the $6 billion both in the total amount of potential creditor claims and stockholder interests were Amtrak to have been liquidated as of December 31, 2001, and in those sections of the report discussing preferred stock holder interests. Amtrak offered additional clarifying, editorial, and technical comments that were incorporated as appropriate.

The Department of Transportation, in oral comments made by Federal Railroad Administration officials, including the Associate Administrator for Railroad Development, did not express an overall opinion about the report. Instead, it offered comments designed to clarify specific points in the draft report. These included clarification that the lien securing the original equipment note required the federal government to subordinate its interest on the equipment acquired by Amtrak after 1983 in individual transactions to the security interests of Amtrak's equipment creditors in these transactions; that is, the subordination was not discretionary. It also included clarification that any unemployment insurance benefits received by Amtrak employees as the result of a liquidation would reduce their labor protection claims by an equal amount. With few exceptions we incorporated these comments into our report.

The Railroad Retirement Board provided comments by E-mail from its General Counsel. These comments were largely clarifying and technical in nature and, with few exceptions, were incorporated into the report. One of the more significant was the comment that railroad unemployment insurance claims are accorded priority in bankruptcy and that, in liquidation, Amtrak's railroad unemployment insurance costs would be borne by other rail employers.

Scope and Methodology

To identify the potential financial issues of an Amtrak liquidation on the federal government, Amtrak employees, and other creditors, we obtained information from Amtrak about potential secured and unsecured creditor claims and equity interests held by preferred and common stock holders, analyzed Amtrak's records regarding property and equipment leases and debt instruments, and discussed labor protection issues with Amtrak officials. We also reviewed copies of federal mortgages and liens held on Amtrak property and equipment, and discussed with Federal Railroad Administration officials how the federal interest in Amtrak's assets had changed since we reported on this issue in 1998. We reviewed a draft Amtrak analysis of the cost of liquidating the corporation, prepared in March 2002. We obtained information on various aspects of this analysis from Amtrak, including how certain cost estimates were determined.

We assumed that Amtrak liquidation had occurred on December 31, 2001, which was the latest date for which Amtrak had information on its assets and liabilities at the time of our review. We updated financial information in this report to take into account adjustments made by Amtrak through August 2002 as the result of its annual audit. However, the audit report had not been issued as of early September 2002.[34] (Amtrak's fiscal year ends on September 30.)

To assess how the railroad retirement and unemployment systems might be affected by liquidation, we asked the Railroad Retirement Board to estimate the potential financial effects of a 100 percent decline in Amtrak employment on the railroad retirement and unemployment systems. Additionally, the Board assumed that terminated workers would not be reemployed in the railroad industry. We chose these assumptions because a 100 percent decline in Amtrak employment is consistent with a liquidation of the company. In addition, the assumption that terminated workers would not be reemployed in the industry is consistent with the fact that industry employment has generally been falling over the past decade, and the Railroad Retirement Board projects that industry employment will continue to decline. This analysis included consideration of changes in the system stemming from the Railroad Retirement and Survivors' Improvement Act of 2001. We discussed with Board officials both the results of this analysis and the assumptions used to prepare it.

[34]By law, Amtrak is required to submit its audited financial statements to Congress by February 15. We note that it is highly unusual that Amtrak had not issued audited financial statements nearly 7 months after they were due. This was of significant concern to us but was beyond the scope of this report.

We did not independently estimate the costs associated with Amtrak's liquidation, including developing or obtaining estimates of the market value of Amtrak's assets. Nor did we independently verify the Board's analysis of the financial effects on the railroad retirement and unemployment systems from a potential Amtrak liquidation. We also did not attempt to quantify the costs of indirect effects, if any, such as changes in highway and aviation congestion, air quality, or energy consumption associated with Amtrak's liquidation. We performed our work from January 2002 to September 2002 in accordance with generally accepted government auditing standards.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 21 days from the report date. At that time, we will send copies of this report to congressional committees with responsibilities for intercity passenger rail issues; the President of Amtrak; the Secretary of Transportation; the Administrator, Federal Railroad Administration; and the Director, Office of Management and Budget. We also will make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions about this report, please contact either James Ratzenberger at ratzenbergerj@gao.gov or me at heckerj@gao.gov. Alternatively, we may be reached at (202) 512-2834. Key contributors to this report included John Fretwell, Richard Jorgenson, Oscar Mardis, Chanetta Ramey Reed, James Ratzenberger, Peggy Smith, and Stacey Thompson.

Sincerely yours,

JayEtta Z. Hecker
Director, Physical Infrastructure Issues

Appendix I: Significant Aspects of the Railroad Bankruptcy Process

Chapter 11 of the Bankruptcy Code, which generally sets out the procedures for reorganization, would govern an Amtrak bankruptcy. For the most part, the provisions of chapter 11 applicable to corporate reorganizations would apply to Amtrak, as would several additional provisions applicable only to railroads. Because of the historical importance of railroads to the economy and the public, bankruptcy law seeks, among other things, to protect the public interest in continued rail service. In applying certain sections of the Bankruptcy Code, the court and an appointed trustee of Amtrak's estate would be required to consider the public interest as well as the interests of Amtrak, its creditors, and its stockholders. A trustee must be appointed in all railroad cases.

Amtrak could initiate a bankruptcy proceeding by filing a voluntary petition for bankruptcy when authorized by its board of directors. In addition, three or more of Amtrak's creditors whose unsecured claims totaled at least $10,000 could file an involuntary petition.[35] After a petition was filed, a trustee would be appointed. This individual would be chosen from a list of five disinterested persons willing and qualified to serve. The Secretary of Transportation would submit this list to the U.S. Trustee (an official in the Department of Justice) for the region in which the petition was filed. The trustee would become the administrator of the debtor's estate and, with court approval, would be likely to hire attorneys, accountants, appraisers, and other professionals who would be disinterested persons to assist with the administration of the estate.

Once appointed, the trustee, with court oversight, rather than Amtrak's board of directors would make decisions about the railroad's operations and financial commitments.[36] The trustee would have to decide quickly whether Amtrak could continue to maintain adequate staff for operations. In addition, the trustee would have to decide whether Amtrak would need rolling stock equipment, such as passenger cars and locomotives, subject to creditors' interests for its operations, and if so, would have to obtain any financing necessary to maintain possession of such equipment. Unless the trustee "cured" any default—that is, continued payments—and agreed

[35]An unsecured claim is one not supported or backed by collateral.

[36]With limited exceptions, Amtrak would continue to be subject to otherwise applicable federal, state, and local regulations. For example, the Federal Railroad Administration's safety regulations would continue to apply to Amtrak. However, any order of a federal, state, or local regulatory body resulting in a financial obligation or expenditure from the estate would have to be approved by the court.

to perform obligations associated with Amtrak's rolling stock equipment within 60 days of the bankruptcy petition, creditors with an interest in the equipment, such as lessors and secured lenders, could repossess it.[37]

Furthermore, the trustee would have to decide whether to assume or reject Amtrak's obligations under executory contracts and unexpired leases.[38] To assume a contract or lease on which Amtrak was in default, the trustee would have to (1) cure the default or provide adequate assurance that it would be cured,[39] (2) compensate the other party or assure the other party of compensation for actual pecuniary losses resulting from the default, and (3) provide adequate assurance of future performance.[40] In this context, a trustee could try to negotiate more favorable terms than under Amtrak's existing contracts and leases. However, the availability of cash for the costs associated with contracts and leases would again be a critical element in the trustee's decisionmaking. Although payments on assumed contracts or leases would be expenses of the estate, payments due on rejected contracts and leases, as well as any damages and penalties, would give rise to general unsecured claims.

In addition, the trustee would have to decide whether to avoid—that is, set aside—certain transactions between Amtrak and its creditors. Generally, the trustee could set aside Amtrak's transfers of money or property for preexisting debts made within 90 days of the bankruptcy petition, as long as Amtrak was insolvent at the time of the transfer and the creditor received more as a result of the transfer than it would receive in a bankruptcy proceeding. However, the trustee would not have unlimited

[37]In most chapter 11 cases, the filing of a bankruptcy petition prevents creditors from enforcing claims, foreclosing or repossessing collateral, or otherwise exercising control over the debtor's property. However, in railroad cases, the Bankruptcy Code provides an exception for rolling stock equipment or accessories used on rolling stock equipment.

[38]An executory contract is one in which substantially unperformed obligations remain on both sides, such that one party's failure to perform would be a breach of contract excusing performance by the other party.

[39]The trustee would not be required to cure a default attributed solely to a contract or lease provision that provides that the commencement of a bankruptcy case constitutes a default.

[40]In general, the trustee could assume or reject such contracts or leases at any time prior to the confirmation of a reorganization plan, unless the court ordered otherwise. However, the trustee would have to assume or reject real estate leases within 60 days of the bankruptcy petition. If the trustee failed to do so, the leases would be considered rejected, and the leased property would have to be immediately surrendered to the lessor.

authority in this area. For example, the trustee could not set aside a transfer that was intended by Amtrak and a creditor to be a contemporaneous exchange for new value and that was in fact a substantially contemporaneous exchange.

Although the trustee would have considerable authority over Amtrak's operations and financial commitments, neither the trustee nor the court could unilaterally impose changes in the wages or working conditions of Amtrak's employees who are covered by collective bargaining agreements.[41] The employees could voluntarily agree to such changes, perhaps in an effort to avoid or forestall liquidation. Otherwise, the trustee would have to seek changes in wages and working conditions by following procedures specified in the Railway Labor Act, including those for notice, mediation, and binding arbitration with the consent of the parties.

Perhaps the trustee's most significant responsibility would be to develop a plan of reorganization. The provisions of chapter 11 applicable to reorganization plans would, for the most part, apply to Amtrak. Therefore, among other things, a reorganization plan would have to (1) designate classes of claims (other than certain priority claims) and interests;[42] (2) specify the unimpaired classes of claims or interests; (3) explain how the plan would treat impaired classes of claims or interests;[43] and (4) provide adequate means for its implementation. Furthermore, the plan would have to indicate whether and how rail service would be continued or terminated, and could provide for the transfer or abandonment of operating lines. Notably, the trustee could propose a plan to liquidate all or substantially all of Amtrak's assets.

Certain unsecured claims would have to be accorded priority in an Amtrak reorganization plan, as in any corporate reorganization plan. For example, administrative claims, such as those for postpetition expenses of the estate and reasonable compensation for the trustee and professionals

[41]This provision of chapter 11 of the Bankruptcy Code applies only to railroads.

[42]Classes of claims would include secured claims, administrative claims, priority unsecured claims, and general unsecured claims. Substantially similar claims and interests could be classified together and treated similarly; typically, each secured claim is classified separately.

[43]A class of claims or interests would be considered "impaired" under a plan if the plan altered the legal, equitable, or contractual rights of the holders of the claims or interests. Among other things, a plan could provide for payment of a claim in full over time, or partial payment, in satisfaction of a claim.

engaged by the trustee, would have to be paid in full on the effective date of the plan, unless the holder of a claim agreed to an alternative arrangement. Other priority unsecured claims, such as those for wages and contributions to employee benefit plans,[44] would also have to be paid in full on the effective date of the plan, unless each class of claimants accepted a plan providing for deferred payments. In addition, under Bankruptcy Code provisions specifically applicable to railroads, claims for personal injury or wrongful death arising out of Amtrak's operations, either before or after the filing of a bankruptcy petition, would have to be treated as administrative claims. Furthermore, certain trade claims arising no more than 6 months prior to the bankruptcy petition would also have priority.[45] Finally, the court could require the payment of amounts due other railroads for the shared use of lines or cars, known as "interline service."

After full disclosure of its contents, Amtrak's creditors and shareholders would vote on the plan of reorganization.[46] Because the United States is a creditor and stockholder of Amtrak, the Secretary of the Treasury would accept or reject the plan on behalf of the United States. According to the Federal Railroad Administration, the Attorney General and the Secretary of Transportation would be consulted. However, a plan of reorganization could not be implemented unless confirmed by the court. To confirm the plan, the court would have to find, among other things, either that each class of impaired claims or interests had accepted it or that the plan did not discriminate unfairly, and was fair and equitable, with respect to each class of impaired claims or interests that had not accepted it.

[44]The Bankruptcy Code provides priority status for (1) employees' claims for wages (including labor protection) accrued within 90 days of the bankruptcy petition, up to $4,000 per claimant, and (2) employees' claims for contributions to employee benefit plans, such as pension, health insurance, and life insurance plans, for services rendered within 180 days of the bankruptcy petition, up to a statutory maximum.

[45]The claims must be for materials or services used in the ordinary course of business; the claimant must have expected payment out of Amtrak's current operating receipts; and a current debt fund must exist.

[46]A class of claims accepts a reorganization plan if more than half of the creditors in that class and those holding two-thirds of the amount of the claims in the class vote in its favor. A class of interests accepts a plan if those holding two-thirds of the amount of the interests in the class vote in its favor. Classes of claims and interests that are not impaired under the plan, and the members of such classes, are presumed to have accepted it.

In addition, under provisions of the Bankruptcy Code specifically applicable to railroad cases, the court would have to find that each Amtrak creditor or shareholder would receive or retain no less under the plan than it would receive or retain if all of Amtrak's operating lines were sold and the proceeds of such sale, and other estate property, were distributed under a chapter 7 liquidation. Finally, the court would have to find that Amtrak's prospective earnings would adequately cover any fixed charges, and that the plan was consistent with the public interest. If more than one reorganization plan met these requirements, the court would be required to confirm the plan most likely to maintain adequate rail service in the public interest. Following confirmation of a reorganization plan, Amtrak would be discharged from its debts.

If an Amtrak reorganization plan were not confirmed within 5 years of the bankruptcy petition, the court would have to order liquidation. However, the court could order liquidation earlier, upon the request of a party in interest, after notice and hearing, if it determined liquidation to be in the public interest. Under such circumstances, the trustee would distribute the assets of the estate as though the case were a liquidation under chapter 7. Because the case would not be converted to a proceeding under chapter 7, relevant provisions of chapter 11 applicable to railroads would continue to apply.

In a liquidation, the trustee would turn over collateral or make payments to the proper secured creditors,[47] convert remaining property to cash, and distribute the proceeds to the unsecured creditors in accordance with the distribution scheme contained in chapter 7. Proceeds would be distributed in the following order: priority unsecured claims, including those

[47] An oversecured creditor has a security interest whose value exceeds the amount of the underlying debt. Such a creditor would generally be entitled to the full amount of its claim, including interest, not to exceed the value of its interest. An undersecured creditor has an interest that is less than the amount of the underlying debt. Such a creditor would have a secured claim to the extent of the value of its interest and an unsecured claim for the remainder.

discussed above, in specified order; general unsecured claims, timely and tardily filed; fines, penalties, and damages that are not compensation for pecuniary loss; and postpetition interest on claims previously paid. Claims of a higher priority would have to be provided for before claims of a lower priority. In addition, in most cases, if the holders of claims in a class could not be paid in full, claims would have to be paid on a pro rata basis.

Appendix II: Comments from the National Railroad Passenger Corporation

NATIONAL RAILROAD PASSENGER CORPORATION
60 Massachusetts Avenue, NE, Washington, DC

AMTRAK

September 9, 2002

Ms. JayEtta Z. Hecker
Director, Physical Infrastructure Issues
U.S. General Accounting Office
Washington, DC 20548

Dear Ms. Hecker:

Amtrak is in general agreement with GAO Report No. GAO-02-871, entitled "Intercity Passenger Rail: Potential Financial Issues if Amtrak Undergoes Liquidation." Given the scope of the request, the report fairly represents the costs and complex ramifications of a theoretical liquidation of Amtrak. However, there are some material consequences to an Amtrak liquidation that the GAO was asked to not comment on. Amtrak strongly feels that two of these consequences deserve clarification and comment so that all aspects of a liquidation can be understood.

First and foremost, if Amtrak were to cease operations due to a liquidation, the operational and financial burden placed on the numerous commuter and freight railroads that rely on Amtrak for items such as dispatching, crews, maintenance and right-of-way on the Northeast Corridor ("NEC") would be tremendous. Amtrak estimates that even after downgrading the level of utility and NEC operations and subsequent degrading of the quality of the track infrastructure[1], the shift in cost to the commuter agencies and freights will still be substantial. To the commuter agencies, the annual operating and capital cost would be $592.3 million. The $592.3 million figure includes $258.7 million for capital backlog costs[2]. Reduce this by the $123.3 million in fees paid to Amtrak and the net additional cost to the commuter agencies is $469 million. Similarly, freight railroads would have to absorb $37.4 million in annual operating costs, $55.4 million in ongoing capital costs, $39.5 million in capital backlog costs, less the $14.9 million in access fees paid, for a total of $117.4 million annually.

[1] With the elimination of Amtrak service on the NEC, operating and capital costs would decrease overall before they were allocated between the remaining commuter and freight users. Key reductions in the NEC infrastructure include: 27 percent of track miles are eliminated on the corridor; speeds are reduced 12 percent as track is changed from class 7 to class 4 tracks; 20 percent reduction in electric catenary maintenance; 26 percent reduction in various support facilities; 46 percent reduction in yard operations; 40-50 percent reduction in station facilities expenses.

[2] Excluding the capital backlog cost, the increase to commuters is estimated at $333.6 million for operating and ongoing capital only.

AMTRAK

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Second, the report is silent on the substantial costs associated with administering a liquidation of a Company as large as Amtrak. Amtrak has estimated that the administrative costs of a liquidation (for such items as legal fees, direct operating costs of shutting down the infrastructure, security costs and fees associated with liquidating Amtrak's remaining assets) at $250 to $360 million.

Over the past few years, Amtrak and the GAO have worked closely on the development of a number of reports covering many different facets of Amtrak and intercity rail passenger service. Amtrak appreciates the work of the GAO's staff, particularly their careful attention to detail, professionalism and their consultative process. This report is the result of a significant amount of labor, and notwithstanding the few comments above, Amtrak commends the GAO for the quality and thoroughness of this report.

Sincerely,

Joe McHugh
Vice President
Government Affairs

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