U.S. Department of Transportation
Office of the Secretary of Transportation

Inspector General

Office of Inspector General
Washington, DC 20590

June 17, 2008

The Honorable Patty Murray
Chairman
Subcommittee on Transportation,
Housing and Urban Development, and
Related Agencies
Committee on Appropriations
United States Senate
Washington, DC 20510

Dear Chairman Murray:

This letter presents our assessment of the costs of Amtrak's recently settled labor agreements and Amtrak's ability to pay those costs, as requested by your staff. Based on Amtrak's latest financial information, we continue to believe, as we testified before your subcommittee on April 3, 2008, that Amtrak could accommodate the fiscal year (FY) 2009 share of retroactive wages included in those agreements within its projected cash balance without additional appropriations.

Summary

We continue to believe that for FY 2009, Amtrak needs $475 million for operations, $675 million for capital, and $266 million for debt service (see table 1 on the following page).

The estimate of the total cost of new labor agreements, once all bargaining groups have ratified is $435.6 million, an increase of $23.4 million over Amtrak's March estimate. Since March, these estimates were revised upward to reflect the actual payout amounts of a portion of the retroactive pay for the employees of 15 of the 19 union negotiating groups, as well as for the recently agreed upon terms of the retroactive payments for the remaining 4 negotiating groups.

Table 1. Amtrak Performance and Federal Appropriations ($ millions)					
	FY 2007	FY 2008		FY 2009	
Grant Category	Actual	Appropriated	Forecast	Request	OIG Recommends
Operating	$486	$475	$481	$525	$475
Capital	$495	$565	$564	$801	$675
Debt service	$277	$285	$285	$345	$266
Retroactive wages for labor settlement				$114*	$0
Total	**$1,258**	**$1,325**	**$1,330**	**$1,785**	**$1,416**

Sources: Amtrak and April 3, 2008, Office of Inspector General (OIG) Testimony.

* While this payment was not included in Amtrak's request, it recognized that the decision to fund this amount lies with Congress.

The terms of the new labor agreements, which were modeled on the recommendations of Presidential Emergency Board (PEB) 242, include: (1) retroactive pay for the period Amtrak employees worked without an agreement (FYs 2002 to 2007) at Class 1 freight railroad pay rates, (2) wage increases of 4 percent in FY 2008 and 4.5 percent in FY 2009, (3) employee contributions of 15 percent of Amtrak's cost to AmPlan, Amtrak's health benefits plan for union employees, and (4) no work rule changes (see Enclosure 1 for a background on and summary of the PEB recommendations).

Retroactive wage payments will be made in two installments under 15 of the 19 agreements, with 40 percent due in FY 2008 and 60 percent due within 1 year of the first payment. The remaining four agreements call for 100 percent of the retroactive wage payments to be made in FY 2008. The Amtrak Board of Directors has the sole discretion to decide whether Amtrak has sufficient funds to make the FY 2009 payment. If the Board were to decide that Amtrak did not have sufficient funds to make this payment, both sides would become eligible for self-help, that is, a strike or management lockout.

The FY 2009 cash payout for retroactive pay and management compression estimate is $122.9 million, an increase of $8.9 million over Amtrak's January estimate. Amtrak did not request these amounts in its FY 2009 Grant and Legislative Request. We believe this amount can be accommodated within Amtrak's projected FY 2008 year-end cash balance of $293.2 million. As discussed later, this assumes an FY 2009 operating grant of $475 million. Furthermore, we do not believe it is necessary to make the $46.8 million unspent portion of the Efficiency Grants available to be used to pay labor settlement costs.

Amtrak's Labor Settlement Costs Increased Slightly Since January

The current estimate of the total costs related to the labor settlement for FYs 2008 and 2009 is $435.6 million (see table 2 below). This is made up of $261.9 million for retroactive wage payments, $169.0 million for FYs 2008 and 2009 wage increases, and $4.7 million for management salary increases to address wage compression issues resulting from the labor agreement. All of these estimates are net of changes to health benefit costs.

Table 2. Labor Settlement Costs ($ millions)			
Settlement Costs	**Paid in FY 2008**	**Paid in FY 2009**	**Total**
Retroactive Pay			
FY 2002 through 2007	$92.0	$119.8	$211.8
FY 2008	$25.5	$24.6	$50.1
Total Retroactive Pay	*$117.5*	*$144.4*	*$261.9*
Management Compression			
FY 2008	$1.6		$1.6
FY 2009		$3.1	$3.1
Total Management Compression	*$1.6*	*$3.1*	*$4.7*
Wage Increases			
FY 2008	$51.6		$51.6
FY 2009		$117.4	$117.4
Total Wage Impact	*$51.6*	*$117.4*	*$169.0*
Total	**$170.7**	**$264.9**	**$435.6**

Source: OIG analysis of Amtrak data.

The January labor settlement costs estimates we cited in our April 3, 2008, testimony were based on Amtrak's higher level analysis of aggregate labor costs, not estimates for individual employees. These revised estimates reflect actual amounts of $99.8 million already paid out in FY 2008 for retroactive wages and $144.4 million scheduled to be paid in FY 2009, plus the estimated amount of $17.7 million to be paid out in FY 2008 for the four negotiating groups receiving full retroactive pay in FY 2008. In addition, the revised estimates include a further refinement of the estimates of FY 2008 pay raise costs.

Our office verified that the methodology used in Amtrak's employee-by-employee retroactive wage payout calculations was consistent with the terms of the labor agreements. We did not verify the accuracy of Amtrak's underlying personnel records or calculations.

Retroactive Wage Payments

The estimate of the cost of retroactive pay for hours worked during the period from FY 2002 through FY 2007 is $211.8 million and for FY 2008 it is $50.1 million for a total of $261.9 million. This total amount will be paid to eligible employees in two installments: $117.5 million in FY 2008 and $144.4 million in FY 2009.[1] Amtrak's agreement employees covered by PEB 242 worked without a new labor agreement since the previous agreement became amendable on December 31, 1999.[2] The new labor agreements call for these employees to receive the difference between the small Harris COLA (cost of living adjustment) received during this time period and the full pay raise amount agreed to by the Class 1 freight railroads for this time period, net of health care contribution changes, as proposed by PEB 242.

The retroactive wage payments covering the time period from October 1, 2007, to the effective date of the FY 2008 pay raise are listed separately because they varied by the agreement ratification date for each negotiating group (see Enclosure 2 for the dates each group ratified their agreement). The later in the year the agreement was ratified, the greater portion of the overall FY 2008 pay raise amount is counted as retroactive wages, instead of an FY 2008 pay raise. Since 60 percent of retroactive wage payment for most negotiating groups is to be made in FY 2009, the later the agreement was ratified, the greater share of the FY 2008 pay raise amount was shifted into FY 2009.

FY 2008 and FY 2009 Pay Raises

Pay raises will cost an estimated $51.6 million in FY 2008 and $117.4 million in FY 2009. These wage increases reflect the wage increases negotiated by the Class 1 freight railroads. The agreements call for the FY 2008 pay raise to go into effect 60 days after agreement ratification. Therefore, the FY 2008 pay raise reflects only a partial year's pay raise (the remaining portion of the FY 2008 pay raise covering the time period prior to the pay raise taking effect is being paid as retroactive wages.) The FY 2009 pay raise will take effect on July 1, 2009.

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1 Of the 19 labor negotiating groups, 4 will receive their full retroactive wage amounts in FY 2008.

2 Under the Railway Labor Act, the labor agreements for these employees did not expire, but continued in force at the previous terms until the new agreements were ratified. During this time period, covered employees did not receive general wage increases, with the exception of Harris COLA adjustments, or make increased contributions to their health care costs. The Harris COLA adjustment provided an annual 0.5 percent wage increase.

In addition, Amtrak has chosen to incur an estimated $4.7 million in costs to provide managers pay raises to ensure an appropriate pay differential between managers' and their employees' salaries.

Amtrak Can Accommodate the Unbudgeted FY 2009 Settlement Payout from Its Projected Cash Balance without an Incremental Appropriation

Based on actual revenues and expenditures through April 2008 and forecasted revenues and expenses through year-end, Amtrak estimates it will end FY 2008 with a cash balance of $293.2 million. This amount is sufficient to meet its start-of-year cash requirement of $180 million[3] and the unbudgeted $122.9 million[4] cash payout in FY 2009 for retroactive pay and other costs. This is due, in part, to the retroactive wage payments not being due until May 2009.

Amtrak's Projected FY 2008 Financial Performance

Amtrak is enjoying another strong year financially in FY 2008. Based on financial results through April, Amtrak expects FY 2008 revenues to be $211.1 million above FY 2007 revenues and $111.9 million above their original FY 2008 forecast. Expenses, net of the accrual of $71.9 for retroactive payments, are forecast to end the year at $3,334.0 million, $244.4 million more than last year (net of the accrual of $190 million for retroactive wage payments) and $50.8 million more than originally budgeted for FY 2008. As a result, FY 2008 cash operating loss for ongoing programs[5] is expected to be $408 million.

In its forecast, based on its actual April financial results, Amtrak increased its end-of-year revenue forecast by $17.3 million and its expense forecast by $35.1 million. In April, we testified that we believed Amtrak's revenue and expense forecasts were overly conservative. Based on our analysis of Amtrak's revised expenses and revenues, we are comfortable with Amtrak's current forecast.

Amtrak accrued virtually the full cost of retroactive wages within its FY 2007 and FY 2008 Federal operating grants. In FY 2007, Amtrak accrued $190 million and in FY 2008 it accrued $71.9 million in retroactive wage costs. Amtrak ended

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[3] Amtrak testified before your subcommittee on April 3, 2008, that it needed $180 million on hand at the beginning of the fiscal year to be able to address anticipated cash flow needs during the beginning months of the fiscal year.

[4] Amtrak included the $24.6 million in 2008 retroactive wages to be paid in FY 2009 in its FY 2008 budget under the assumption that a settlement would have already been reached.

[5] Defined as earnings before interest, taxes, depreciation, other post employment benefits (EBITDO) and Amtrak's non-cash accrual of retroactive pay. This figure approximates Amtrak's required Federal cash operating subsidy. Amtrak's FY 2008 cash operating loss is forecasted to be $480.9 million with the inclusion of the accrual of $71.9 million for retroactive payments.

FY 2007 with a cash operating loss[6] of $486.3 million compared to its $485 million operating subsidy and forecasts an FY 2008 cash operating loss of $480.9 million compared to its $475 million operating subsidy. Therefore, only $7.2 million was not accommodated within the operating grants.

Amtrak's FY 2009 Operating Grant and Debt Service Needs

As we testified before your subcommittee in April, we believe Amtrak requires $475 million for operations and $266 million for debt service in FY 2009. Appropriations below these levels, based on the information currently available to us, could require Amtrak to draw upon its cash balance, thereby reducing the resources available to pay for the settlement costs.

We disagree with Amtrak's FY 2009 revenues, expenses, and operating reforms estimates. We believe Amtrak arbitrarily reduced its FY 2009 revenue forecasts due to concerns over an impending economic recession. This assumption is inconsistent with the Blue Chip consensus forecast call for economic growth in FY 2009. In addition, as has been widely publicized, the sharp increase in fuel prices has driven more riders to Amtrak. Finally, Amtrak did not propose any new savings from operating reforms in FY 2009.

The $266 million for debt service reflects the minimum needed to fund Amtrak's FY 2009 obligations, adjusted for the pre-payment of the $21 million on its Railroad Rehabilitation and Improvement Financing (RRIF) loan.

Amtrak's Cash Balance Requirements

As discussed earlier, Amtrak has already absorbed the expense for the retroactive wage payments within its prior and existing year's Federal operating subsidies. We believe Amtrak will have the liquidity to handle the actual cash payment of those expenses from within its projected end of FY 2008 cash balance.

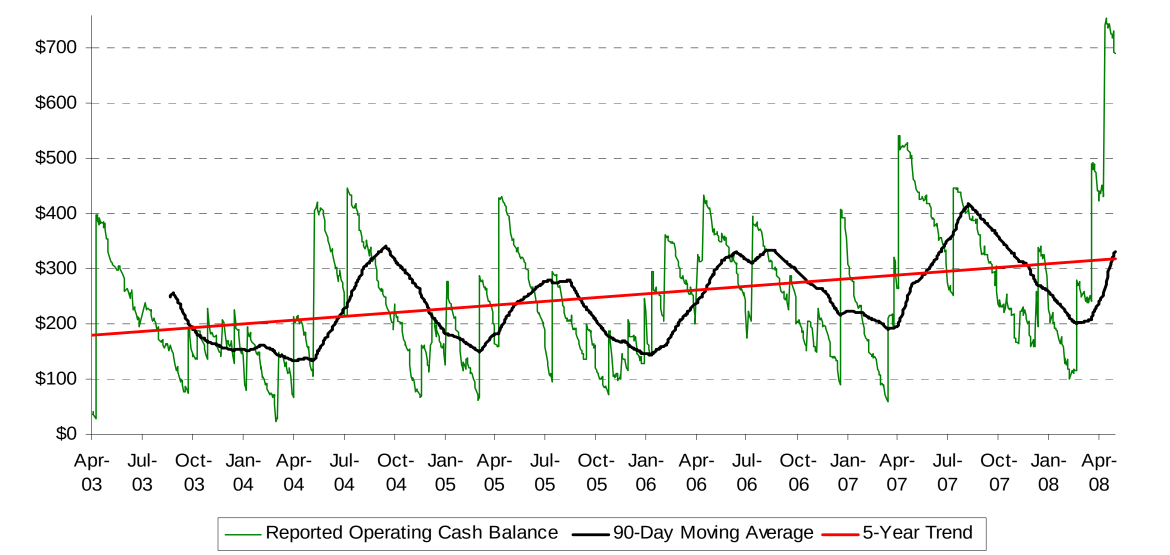
Amtrak has cyclical cash balance requirements. The 90-day moving average[7] of Amtrak's cash reserves reveals that Amtrak draws its cash down during the first half of the fiscal year. This is largely because most of the payments on Amtrak's debt are due in December and January, compounded by the fact that September and October are typically lower revenue-earning months. During the third and

[6] Defined as earnings before interest, taxes, depreciation, and other post employment benefits (EBITDO). This figure approximates Amtrak's required Federal cash operating subsidy.

[7] A simple moving average (as was used in this analysis) is a calculation of the average value of the previous *n* values. For instance, a 90-day moving average shows the average value of the previous 90 days. Moving averages are generally used to smooth short-term fluctuations in order to show longer-term trends or cycles.

fourth quarters, the cash reserve grows, peaking in the summer months that coincide with heavy travel and higher revenues. Figure 1 below presents Amtrak's daily cash balance, the 90-day moving average of the cash balance, and the 5-year cash balance trend.

Figure 1. Amtrak's Daily Cash Balance and 90-Day Moving Average ($ millions)



Source: OIG analysis of Amtrak data.

The 90-day moving average of Amtrak's cash reserves supports Amtrak's position that it requires a higher cash balance at the start of the fiscal year (Amtrak believes it needs $180 million at that point) than during the fiscal year (Amtrak believes it needs an average of $150 million during the remainder of the fiscal year).

The timing of Amtrak's second installment payment on retroactive wages reinforces the argument that Amtrak can accommodate the $122.9 million cash payout from its projected cash balance. Amtrak is not required to make the second payment until May 2009. Therefore, the $119.8 million of the cash balance we suggest can cover this payment of retroactive wages will be available to meet cash flow requirements, should they occur, during the first two quarters of FY 2009. The cash balance would then likely be replenished during the second half of the year, consistent with the typical pattern of Amtrak's cash reserves.

A continuing resolution during the first few months of FY 2009 in lieu of a final appropriations bill could conceivably impact Amtrak's cash balance, but not in a meaningful manner. This may occur if there were to be multiple short-term resolutions in FY 2009. The Federal Railroad Administration (FRA) does not always disburse to Amtrak right away the funds made available by a short-term resolution if FRA believes Amtrak has sufficient cash on hand because of the administrative burden of multiple small disbursements. Since FRA assesses Amtrak's cash needs before deciding whether to make a disbursement under a short-term continuing resolution, we believe it is unlikely that this practice would have an adverse impact on Amtrak's cash needs. In addition, a continuing resolution typically would fund Amtrak at the prior year's level, which would not be significantly below even their full FY 2009 request. Finally, a full-year appropriation or continuing resolution could be delayed until March without an adverse impact on Amtrak since Amtrak does not require cash for the second installment of the retroactive wage payment until May.

Conclusion

Based on Amtrak's latest financial information, we continue to believe that Amtrak could accommodate the $122.9 million in unbudgeted FY 2009 retroactive wages and other costs within its projected end of FY 2008 cash balance without additional appropriations. Amtrak has already absorbed virtually all the costs of all the required retroactive pay from within its FY 2007 and FY 2008 Federal operating subsidies and our analysis of Amtrak's liquidity situation led us to conclude that it will have sufficient cash available to make the payment when it comes due.

This assessment assumes Amtrak's careful management of its expenses and cash flows. For example, at the end of FY 2007, Amtrak used $60 million from its cash balance to buy out leases for coach and food service cars and to pre-pay its FY 2008 RRIF loan payment. Amtrak could choose to increase expenditures this year for its priorities, making the associated funds unavailable to be used to fund the retroactive wage settlement.

Furthermore, the revenue and expense estimates Amtrak included in its FY 2009 Legislative and Grant Request were done in a very broad brush manner. These forecasts lack the detail needed to complete an in-depth analysis of Amtrak's FY 2009 revenue forecast and expense requirements. Amtrak is in the process of completing a more detailed FY 2009 budget, which could be available as early as July. We strongly recommend that the subcommittee reexamine Amtrak's FY 2009 funding requirements in light of this more detailed, bottom-up budget projection.

We are transmitting identical copies of this letter to Chairman Olver and Ranking Members Bond and Knollenberg. If you have any questions concerning this letter, please contact me at (202) 366-1959 or David Tornquist, Assistant Inspector General for Rail and Maritime Program Audits and Economic Analysis, at (202) 366-9970.

Sincerely,

for Ted A

Calvin L. Scovel III
Inspector General

Enclosure (2)

cc: Secretary of Transportation
Chairman of Amtrak Board of Directors

Background and Summary of PEB Recommendations

On January 1, 2000, Amtrak's prior agreements with eight of its labor unions became amendable.[8] After failing to reach a negotiated agreement, several of the unions appealed to the National Mediation Board (NMB). In October 2007, the NMB recommended the parties subject themselves to arbitration after proposals developed during the mediation process had been rejected by the unions and Amtrak. When the proffer of arbitration was rejected by all parties, "self-help" became available on December 1, 2007. In order to avoid a strike that might have seriously disrupted rail movement, the President created Presidential Emergency Board (PEB) 242 to investigate and report on the dispute. The PEB delivered its report on December 30, 2007. Amtrak and union leadership signed agreements modeled largely on the PEB's recommendations in January, February, and May 2008. Of the 19 negotiating groups, 15 ratified the agreements by vote of their membership in March 2008. Ratification of the agreements for the remaining four negotiating groups is expected in June 2008.

PEB Recommendations. The PEB recommendation had three major components: prospective wage increases, retroactive wage payments, and changes to employee health benefit contributions.[9]

The recommended prospective wage increases were 4 percent in FY 2008 and 4.5 percent in FY 2009. Retroactive pay was also recommended to compensate for work performed during the period that unions worked without an agreement or raise, except for Harris COLA adjustments. The net effect of the retroactive pay from FY 2002 through FY 2007 is a 22.7 percent increase in wages over the rate that was in effect on July 1, 2002, net of the COLA adjustments that Amtrak paid. Retroactive payments are to be made only to employees who were on the payroll on December 1, 2007, and will also apply to the period during FY 2008 that passed before agreements were ratified.

Because Amtrak raised concerns about its ability to shoulder the cost of a single lump-sum retroactive wage payment, the PEB recommended that the payment be made in two parts: 40 percent is to be paid within 60 days of ratification of the agreements, and the remaining 60 percent is to be paid in FY 2009 on or before the 1-year anniversary date of the first payment.

The final major component of the PEB recommendations involved employee contributions to Amtrak's health plan, AmPlan. The PEB recommended that employee contributions to the plan be set at 15 percent of total annual costs to

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8 Under the Railway Labor Act, agreements do not expire.

9 The PEB also recommended a 20-percent increase in the daily meal allowance provided for work away from home, from $29.50 per day to $35.40 per day.

Amtrak. Furthermore, the FY 2010 contributions are to be capped at either the level of the FY 2009 contribution or $200, whichever is greater, until a new agreement alters the level of employee contribution.

Amtrak sought changes to work rules to allow the company greater flexibility with regard to contracting out, scheduling work, and assigning work to employees out of craft or class. The PEB did not recommend that any of these work rule changes be adopted, in part because Amtrak was unable to provide an estimate of savings that would result from these work rule changes.

Contingency Clause. Each of the agreements also contains an article stating that payment of retroactive wages is contingent on Amtrak receiving sufficient funding and revenue to carry out the payment. Whether funding and revenue are sufficient to pay retroactive wages is at the sole discretion of Amtrak Board of Directors. Should the Board determine that insufficient funds are available, Amtrak will notify the unions within 1 day of that determination, and the parties have agreed to meet for 30 days thereafter in order to attempt to resolve any dispute. Should that dispute go unresolved, the unions have agreed to a 30-day “cooling off” period before resorting to self-help (that is, strike or lockout), for a total of 60 days before determination of insufficient funds by the Board could result in work stoppage, and by extension, disruption to intercity passenger rail service.

<table>
<tr><th colspan="5">Summary of Union Agreement Signings, Ratifications, and Affected Employees</th></tr>
<tr><th>Organization*</th><th>Date Signed</th><th>Date Ratified</th><th>First Date Beyond Retroactive Payment</th><th>Number of Employees</th></tr>
<tr><td>BMWE</td><td rowspan="9">01/18/08</td><td rowspan="10">03/10/08</td><td rowspan="11">04/01/08</td><td>1,595</td></tr>
<tr><td>IBEW</td><td>1,075</td></tr>
<tr><td>IAMAW</td><td>480</td></tr>
<tr><td>BRS</td><td>567</td></tr>
<tr><td>JCC</td><td>1,764</td></tr>
<tr><td>ATDA</td><td>152</td></tr>
<tr><td>SEIU-NCFO</td><td>273</td></tr>
<tr><td>ARASA (MoE)</td><td>407</td></tr>
<tr><td>ARASA (MoW)</td><td>167</td></tr>
<tr><td>UTU-Cond</td><td rowspan="2">02/12/08</td><td>1,943</td></tr>
<tr><td>UTU-Yard</td><td>03/05/08</td><td>34</td></tr>
<tr><td>BLET</td><td>02/19/08</td><td rowspan="2">03/31/08</td><td rowspan="2">05/01/08</td><td>1,228</td></tr>
<tr><td>SMW</td><td rowspan="2">02/20/08</td><td>419</td></tr>
<tr><td>IBB</td><td>03/11/08</td><td>04/01/08</td><td>58</td></tr>
<tr><td colspan="4">Subtotal Settled Employees</td><td>10,162</td></tr>
<tr><td colspan="4">Unsettled Employees</td><td>5,747</td></tr>
<tr><td colspan="4">Total Agreement Employees</td><td>15,909</td></tr>
</table>

Source: Amtrak.

* BMWE - Brotherhood of Maintenance of Way Employees; IBEW - International Brotherhood of Electrical Workers; IAMAW - International Association of Machinists and Aerospace Workers; BRS - Brotherhood of Railroad Signalmen; JCC - Joint Council of Carmen; ATDA - American Train Dispatchers Association; SEIU-NCFO - Service Employees International Union / National Conference of Firemen and Oilers; ARASA MoE and MoW - American Railway and Airway Supervisors Associations (maintenance of equipment and maintenance of way associations), UTU Cond and Yard - United Transportation Union (Conductors and Yardmen only); BLET - Brotherhood of Locomotive Engineers and Trainmen; SMW - Sheet Metal Workers International Association; IBB - International Brotherhood of Boilermakers.