HB 127 COMMENTARY

IS IT TIME TO RESTRUCTURE THE ALASKA RAILROAD CORPORATION?

HB 127 seeks to make a fundamental change in the operation of Alaska Railroad Corporation (ARRC) despite the fact that the current operational structure has worked very well for the past 24 years and has produced substantial benefits for the State of Alaska since the State acquired the Alaska Railroad from the Federal Government in 1985. In ARRC as currently formulated, the State has a well-run, self-sustaining transportation instrumentality that provides safe, economical, and efficient transportation to residents, businesses, visitors, and military installations in the State. In the past 24 years since transfer, ARRC has been profitable for 20 of those years, made hundreds of millions of dollars in capital improvements to the railroad's track infrastructure, facilities and railcar/locomotive fleet and has grown to have an asset value approaching $1 billion. All of this was accomplished without ongoing State appropriations.

The enormous success of the present ARRC model did not occur by accident. Rather, it was the result of an essential policy decision made by the decision makers within the State of Alaska after several years of studies, debate, discussions and careful consideration as to the type of entity that would operate the railroad under state ownership.

Alaska Railroad Perspective: Government Agency or Business?

During the 60 years prior to the transfer of the Alaska Railroad to the State in 1985, the Federal Government operated the railroad primarily from a governmental perspective as a typical, inefficient federal bureaucracy within the Federal Railroad Administration (FRA) that required yearly injections of tax payer dollars to meet its operating and capital expenses. Historically, the role of the railroad was subject to considerable confusion. At various times it was a frontier development tool, a part of the national defense system, a vehicle for implementing federal policies, a resource recovery mechanism, a repository for surplus federal material, a means of social service delivery and, on occasion, a market place railroad. The lack of a clear set of goals placed a severe limitation on the railroad's ability to satisfy any one of these purposes adequately. As a consequence, except for a few years during World War II and the pipeline construction, the Alaska Railroad lost money every year.

Moreover, because the Alaska Railroad was subject to the federal capital budget/appropriation process, it was never able to obtain sufficient capital money to fund such necessary items as annual cross-tie replacement, track surfacing, major equipment repair/refurbishing, new equipment acquisitions, building repair, etc. The Federal Government always seemed to have better, more politically motivated things to do with its money. As a result of the lack of capital investment, the physical plant of the railroad deteriorated, operating expenses increased and service levels declined.

At the time of transfer, there was an estimated $100,000,000 in deferred maintenance associated with the property.

By 1979, it became apparent that the Alaska Railroad had become a fiscal and political liability for the FRA and it approached the State of Alaska with a proposal to transfer the railroad to the State. The State responded that while it regarded the railroad as an integral part of Alaska's transportation infrastructure, it was hesitant to involve itself directly in the operation of the railroad which had historically operated at significant annual losses. In 1980, the State commenced an in-depth assessment of the multitude of issues related to the transfer proposal. It retained experts to advise it and commissioned reports and studies to be prepared as to what would be the best organizational alternative for the Alaska Railroad under state ownership, one that would not perpetuate the financial failures of the federally owned railroad.

With this goal in mind and based upon input from several experts, the State made the critical policy decision that a state owned railroad had to be governed by a business orientation rather than a government agency perspective in order to prevent the railroad from becoming entrenched as another state bureaucracy. Based upon studies prepared by such entities as the Harvard Business School and the University of Alaska Institute of Social and Economic Research, the State decision makers determined that each potential organizational structure should be measured by the extent to which it satisfied the following criteria:

1. Freedom from—and equal legal standing with—government to take advantage of management and market opportunities.

2. Ability to access and obtain private and public capital funds.

3. Management freedom for the railroad's operational decisions within established policies.

4. Clear-cut lines of management responsibility and accountability for decisions which are made.

5. Marketing freedom within established policies and budgetary constraints.

6. Clear decision-making authority without a cumbersome and bureaucratic process.

7. Management capability to make long-term commitments within established policies.

8. Management freedom to negotiate solutions to problems and to take advantage of service opportunities.

9. Industrial development capability on railroad land.

10. Performance-based personnel management including the direct ability to hire, fire, promote, train, supervise and direct required railroad employees.

11. Ability to provide financial and other incentives for performance.

Using the above criteria, the 13th Alaska Legislature determined that the organizational structure that would provide the best chance for a viable state owned railroad was a public corporation that (1) would be exclusively responsible for the management of the financial and legal operations of the Alaska Railroad, (2) would have the ability to raise capital from the private sector, (3) would carry out its responsibilities on a self-sustaining basis, and (4) would provide for prudent operation of the railroad according to sound business management practices, i.e. the Alaska Railroad Corporation as it is currently structured under AS 42.40. The 13th Alaska Legislature specifically exempted ARRC from the Executive Budget Act in order to satisfy the abovementioned organization criteria and to assure that the railroad would have the flexibility to operate from a business perspective.

Proposed HB 127 seeks to place ARRC under the Executive Budget Act. If adopted, this legislation will turn the railroad into a line agency of the State that will be unable to respond quickly to business opportunities and may even have to compete for state operating and capital funds with other agencies. This organizational structure was expressly rejected by the 13th Legislature because the same limitations and problems encountered by the Alaska Railroad as a federal agency would also be present with the railroad as a state agency.

The in-depth assessment of the Alaska Railroad conducted during the five years before transfer determined that the majority of the federally owned railroad's financial problems were due to the requirement that the railroad follow federal budgeting procedures rather than allowing its management to develop operating and capital programs on the same basis as a privately owned railroad. Specifically, the federal budget procedures requirement caused the following problems:

1. Obtaining needed capital appropriations was difficult and usually political, providing the Alaska Railroad with little assurance that required funds would be available when needed. The funding by appropriation mechanism made it impossible for the railroad to realistically plan and budget for more than a year in advance. The lack of needed capital also caused the railroad's physical plant to deteriorate, which increased operating costs and made it more difficult for the railroad to compete for new business.

2. Eliminated the flexibility management needed to take advantage of new business opportunities. Alaska's economic activity is dynamic, which means that rail service needs the ability to change frequently during a fiscal year. Under the funding by appropriation mechanism, the federally owned railroad lost numerous business opportunities because, needing congressional

appropriations, it could not make business commitments quickly enough to meet the potential customer's needs.

3. Compliance with the bureaucratic federal budget procedures created an expensive and time consuming burden on the Alaska Railroad. The railroad was required to spend time trying to force its operation into a format that was designed for federal agencies. This resulted in a substantial amount of nonproductive time being expended in preparing reports, budget submittals, etc. that had no significant management value.

Considerable State Oversight Exists in Current Business Model

Although the exemption of ARRC from the Executive Budget Act solved the major problems that plagued the federally owned railroad, the 13th Legislature nonetheless recognized that because the railroad was publicly owned, it was important to maintain significant State oversight over ARRC's operation and management practices. This oversight is accomplished by the following requirements:

1. The ARRC Board of Directors is responsible for providing an annual report of the operations and financial condition of the corporation to the Governor, making it available to the legislature as well.

2. The ARRC Board of Directors is responsible for initiating both a financial and performance audit each year. As required by statute, the financial audit is performed by an independent certified public accountant. Copies are provided to the Governor and the Legislature each year. In addition, a recognized railroad management expert conducts the annual performance audit to ensure ARRC is managed and operated effectively and efficiently.

3. ARRC must file an oversight report with the Legislature and Governor before it undertakes expansion, reduction, or diversification of train services that represents a significant and permanent change in service level.

4. Legislative approval is required for certain corporate actions, such as disposing of the Railroad's entire interest in land, leasing land for longer than 55 years, or selling tax exempt bonds.

5. The Legislative Budget and Audit Committee regularly reviews ARRC's operation and management practices.

6. ARRC's procurement procedures are required to be substantially equivalent to state procurement requirements.

7. ARRC employees and directors are subject to the Executive Branch Ethics Act.

8. The Commissioners of the Alaska Department of Transportation and Public Facilities and the Department of Commerce, Community and Economic Development both serve on ARRC's board of directors.

9. ARRC's spill prevention and response plans are filed with and regulated by the state. ARRC is required by state law to show sufficient financial responsibility to respond to spills.

10. ARRC must provide public notice before entering into leases or other disposals of an interest in land.

Conclusion

The rationale for exempting ARRC from the Executive Budget Act is as valid today as it was 24 years ago. In exempting ARRC from the Executive Budget Act, the 13th Legislature understood the need for the state-owned railroad to operate as an independent business, free from political concerns and the unnecessary cost of bureaucratic attachments. They understood that railroad business, safety, and environmental decisions have to be made based on the facts and merits of the situation, and not unnecessarily biased or encumbered by political considerations. They understood that dependence on appropriations from the State would automatically slow down day-to-day decision-making in a very complex and dynamic transportation business where customers depend on the railroad's ability to respond quickly to market demands.

In short, the ARRC business model, as it exists today, works very well and, as a result, ARRC has never requested State dollars for its operation. We firmly believe that the Legislature should be proud that this business is providing a valuable service to Alaska's economy, satisfying its customers, and paying its own way. The Alaska Legislature should not undermine ARRC's continuing viability by injecting the Executive Budget Act into its operations. ARRC needs to be at the very top of its game if it is to someday support a new pipeline, Department of Defense development, growing tourist numbers, a future need for commuter rail support, and/or expansion into Canada or ultimately north beyond Fairbanks. HB 127 threatens that readiness to take on growth and development within the state, a hallmark of ARRC's history and track record.