

**HB**

**127**

<target><bill>HB 127</bill><subject>HB  
127</subject><comm>HFIN26</comm></target>

# FISCAL NOTE

STATE OF ALASKA  
2009 LEGISLATIVE SESSION

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Identifier (file name): HB127-CED-ARR-03-11-09 Dept. Affected: DCCED  
Title: Alaska Railroad Budget RDU:  
Component: Alaska Railroad Corporation  
Sponsor: Representative Stoltze  
Requester: House Transportation Committee Component Number: \_\_\_\_\_

## Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

	Appropriation Required	Information						
		FY 2010	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
<b>OPERATING EXPENDITURES</b>								
Personal Services	264.6		264.6	264.6	264.6	264.6	264.6	264.6
Travel	10.0		10.0	10.0	10.0	10.0	10.0	10.0
Contractual								
Supplies								
Equipment								
Land & Structures								
Grants & Claims								
Miscellaneous								
<b>TOTAL OPERATING</b>	274.6	0.0	274.6	274.6	274.6	274.6	274.6	274.6
<b>CAPITAL EXPENDITURES</b>	1,000.0							
<b>CHANGE IN REVENUES ( )</b>								

## FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts								
1003 GF Match								
1004 GF								
1005 GF/Program Receipts								
1037 GF/Mental Health								
Other (1204 Contingent)	1,274.6		274.6	274.6	274.6	274.6	274.6	274.6
<b>TOTAL</b>	1,274.6	0.0	274.6	274.6	274.6	274.6	274.6	274.6

Estimate of any current year (FY2009) cost: \_\_\_\_\_

### POSITIONS

Full-time	2		2	2	2	2	2
Part-time							
Temporary							

### ANALYSIS: *(Attach a separate page if necessary)*

The Alaska Railroad Corporation (ARRC) is a public corporation supported by revenues generated through its freight, passenger and real estate services. ARRC does not receive state subsidies for operations or capital improvements. This bill proposes to make the ARRC subject to the Executive Budget Act.

Making ARRC subject to the Executive Budget Act would have significant financial impact to the corporation, not all of which can be easily quantified at this time.

(Continued on page 2)

Prepared by: Wendy Lindskoog Phone (907) 265-2516  
Division: Alaska Railroad Corporation Date/Time 3/11/09 12:00 AM  
Approved by: Bill O'Leary Date 3/11/2009  
Vice President Finance, Alaska Railroad Corporation

FISCAL NOTE #1

STATE OF ALASKA  
2009 LEGISLATIVE SESSION

BILL NO. HB 127

**ANALYSIS CONTINUATION**

Among the larger impacts are the following:

**1. Possible loss of revenue - unquantifiable**

Due to decreased operational flexibility caused by rigid budget guidelines it is very probable that ARRC would see a loss of revenue. This loss could be quite large if significant unbudgeted revenue opportunities arise, as they often do.

**2. Increased costs for borrowed funds - unquantifiable**

This amount is currently unknown and dependent upon level of future borrowing. There would be an impact to debt pricing ARRC would receive from lenders given that future debt payments would be subject to legislative appropriation. Interest costs to the corporation would increase.

**3. Implement Accounting & Budget Systems - \$1,000.0**

The current ARRC financial system is not designed to accommodate legislative appropriation control requirements for either operating or capital activities. Modification to the existing system would be explored, but is most likely not feasible. This would require development and implementation of a new financial system for the corporation. Use of the state's budgeting system would most likely suffice, but the accounting system in use by the state would not meet ARRC's needs for financial and management reporting.

**4. ARRC personnel increased costs - \$264.6**

To appropriately comply with the requirements of the Executive Budget Act, two additional staff will be required, one for financial and accounting assistance and one for legislative and budget coordination.

**5. Increased travel increased costs - \$10.0**

Travel costs associated with Legislative budget hearings and coordination with Department of Commerce, Community and Economic Development and the Office of Management and Budget would increase Anchorage to Juneau travel significantly for the CEO, CFO, and AVP Corporate Affairs.

March 27, 2009

Representative Bill Stoltze  
Co-Chair, House Finance Committee  
Juneau, Alaska

Re: Opposition to HB 127

Dear Representative Stoltze:

My name is Jack Burton and I have worked for the Alaska Railroad for the past 45 years. For 14 of those years, I was the president of the American Federation of Government Employees, AFL-CIO Local 183 (AFGE), the ARRC's largest union, representing over 330 ARRC employees. For the past 19 years, I have also served as the labor representative on the Alaska Railroad Corporation's (ARRC) Board of Directors. I am writing on behalf of myself and the approximately 620 ARRC union employees to express our opposition to HB 127, which seeks to put ARRC under the Executive Budget Act (EBA).

First and foremost, I speak on behalf of all union employees of the ARRC when I say that we are fiercely opposed to the ARRC's being placed under the EBA because it is a direct impairment of a contractual relationship that our unions have had with the ARRC for decades, and one under which we operate now and will operate for years to come under current collective bargaining agreements. When the state bought the railroad and created the corporation to operate it, the state explicitly mandated that the employees of the railroad were to be employees of the corporation, not employees of the state. The unions were explicitly exempted from coverage by the Public Employee Relations Act (which governs the relationship between the state and its unions), and separate, independent labor laws governing the railroad's unions contracts and its bargaining with the railroad were created solely for the railroad and its unions.

Over the years, the railroad's unions have bargained in good faith with the railroad for all terms and conditions of employment, and have successfully entered into binding contracts with the railroad on each occasion, contracts that contain mutually agreed-upon wages, hours, and working conditions for union members. In doing so, the unions relied on the labor relations provisions of the corporation's statute, the railroad's financial independence from the state, and the railroad's self-sustaining ability to fulfill the promises that it made in those collective bargaining agreements.

Placing the ARRC under the EBA will drastically undermine the very foundation upon which the railroad and its unions have established their relationship and negotiated their collective bargaining agreements. None of the unions' bargaining agreements was negotiated with the understanding that their terms would be "subject to appropriation," nor did the unions ever intend any such restrictions. Instead, the unions bargained for wages that were contractually ensured by railroad-generated revenues, revenues that the unions knew they contributed to by expending their hard efforts. Placing ARRC under the EBA not only improperly subjects the wages and other terms and conditions of my members' employment to the vagaries and uncertainties of the political process, but also directly impairs the rights for which they have already bargained with the ARRC. We steadfastly oppose such an impairment of our current and future employment rights with ARRC.

In addition to the foregoing, my union members also believe that the enactment of HB 127 will violate the mandate in the federal transfer act that requires the revenues generated by ARRC to be retained and managed by ARRC for railroad and related purposes only. Subjecting ARRC to the EBA may generate litigation from employees who feel their contract rights have been violated or that railroad jobs may be lost if the Legislature has the power to divert ARRC's revenues and federal appropriations to non-railroad purposes.

As an employee of the railroad under both governmental financial control and corporate financial independence, I speak from hard-earned experience when I say that the operation of the railroad under political control was a colossal failure. I worked for the Alaska Railroad for 20 years before it was sold to the state and can tell you that a major reason that the railroad lost money every year was its inability to obtain adequate operating and capital funds under the politically charged federal budget appropriation process. The perpetual lack of funds resulted in deterioration of the railroad's track and equipment which in turn increased operating costs which led to the loss of existing business and the inability to obtain new business. It seems we were always operating in a survival mode because the politicians in congress always found better things to do with our tax dollars. We could never count on receiving sufficient funds and as a result could never plan for more than a year in advance. You will risk the same thing happening to ARRC if you put it under the EBA where funding decisions will be based upon political reasons rather good business judgment and management.

I also participated in the transfer process when the railroad was sold to the state and I testified before the Legislature on several occasions with regard to labor issues. Although there were two or three competing bills concerning the structure of the state entity that would own and operate the Alaska Railroad, every one of them required the railroad to be operated as a business as opposed to a government agency and every one of them exempted the railroad from the EBA. The Legislature was very clear that they wanted the railroad to be operated on a self sustaining basis and not require yearly infusions of tax dollars like the federally owned railroad did. Based on the experience of the federally owned railroad, they knew that injecting politics into a business operation was a recipe for disaster. The ARRC business model has worked very successfully for the past 24 years so why risk messing it up now?

Lastly, I am surprised that this bill is being seriously considered by a private sector oriented legislature. In the recent past, the Legislature has looked for ways to reduce government inefficiencies by privatizing prisons, schools, the state ferry system, motor vehicle and driver licensing, etc. etc. The enactment of HB 127 will actually increase government inefficiency by taking what is currently a profitable and self-sustaining public asset and turning it into an inefficient government bureaucracy which is exactly what the Alaska Railroad was before it was sold to the state. It makes no sense to make such a sweeping change in the absence of any concrete evidence that the ARRC business model is some how broken and needs repair.

Representative Stoltze, I am charged with representing the best interests of all of my union brothers and sisters at the ARRC. In that capacity, I cannot emphasize enough the opposition your bill faces from ARRC organized labor. We have an established, successful bargaining relationship with the ARRC under its current status, and we have no interest in being subject to the well-known political whims of the legislative appropriation process. We appreciate your bearing our opposition in mind as you consider this bill.

Sincerely,

A handwritten signature in cursive script that reads "Jack F. Burton". The signature is written in black ink and is positioned above the printed name.

Jack Burton



**DETAILED COMMENTS ON HB 127**  
Submitted by the Alaska Railroad Corporation (ARRC)

**Loss of Flexibility Needed to React to Business Changes**

- **Changes in railroad business require the ability to respond quickly with capital investment and/or operating increases.**

Unlike other public corporations such as AHFC and AIDEA, which are not primarily operating entities, ARRC operates a multifaceted freight and passenger transportation and real estate business that require it to be responsive to the needs of Alaska citizens and businesses in order to be successful. The railroad industry in America is engaged in a capital intensive business that has experienced significant changes in customers' requirements, and therefore significant changes in its infrastructure, equipment and technology. Quick action is often required to respond to customers' needs and to seize business opportunities. For ARRC, this translates into the need for the flexibility to make business decisions unencumbered by rigid yearly appropriation schedules. For example, a decision to acquire new high capacity hopper cars was made during negotiations regarding export coal, in order to make ARRC's coal customer more competitive in the world markets, as well as improve service to other customers. Because this occurred during the middle of a fiscal year, it would have been difficult if not impossible to respond in a timely manner had it been necessary to seek administrative and legislative approval.

**Effect on Borrowing and Contracts**

- **The proposed bill may impair ARRC's ability to perform its legal obligations under long term contracts and loan agreements.**

The proposed bill does not address several legal problems that may arise if ARRC is subjected to the EBA. First, ARRC has been operating as a business for the past 24 years and has incurred legal obligations under existing long term contracts to provide a wide variety of transportation services to customers under constantly changing market conditions. ARRC also has several long term loan agreements that require ARRC to make periodic interest and principal payments. None of these agreements contains language conditioning ARRC's duty to perform on its receipt of sufficient appropriations from the legislature, as is the case in a typical state contract. Even if ARRC retains all its revenues, if it cannot expend them except in strict accordance with a legislatively approved annual budget, our existing customers/lenders may have valid concerns about its continuing ability to perform as their contracts require and may assert that their contract rights have been impaired in violation of Article I, Section 15 of the Alaska Constitution.

Second, putting ARRC under the EBA may create a risk that ARRC's existing long term commercial debt could be called. All of ARRC's loan agreements contain provisions

that allow the lender to declare a default and/or accelerate the loan if, as a result of changed circumstances, the lender deems itself insecure. Our lenders may have a legitimate reason to be concerned about ARRC's ability to repay their loans if the corporation is subjected to the EBA because there is little ARRC can do to assure them that the Legislature will appropriate enough money to ARRC to make the payments required on their loans.

Putting ARRC under the EBA will also seriously impact the \$165,000,000 in outstanding FTA Formula Funds backed bonds that ARRC issued in 2006 and 2007. ARRC's outside bond counsel has advised that if HB 127 is enacted, (1) it will be viewed by the bondholders as an impairment of their rights in violation of AS 42.40.675, (2) will likely result in a down grade in the ratings of the bonds and (3) may violate the ARTA mandate that revenues generated by ARRC "be retained and managed by the stated-owned railroad for railroad and related purposes."

Third, ARRC must sometimes borrow funds to enable it to fulfill its contract obligations. While this bill leaves intact several provisions regarding borrowing by ARRC, placing the corporation under the EBA may jeopardize the borrowing ability of the corporation. It may be difficult for ARRC to assure its creditors that the legislature will appropriate sufficient money, or approve line entries in its budget, to pay the debt service on their loans.

Fourth, even if ARRC can overcome the non-appropriation risk, borrowing will likely be more costly. ARRC is able to borrow money at a lower interest rate than other tax exempt entities such as the State because ARRC currently meets the definition of a "small debt issuer" under Section 235 of the Internal Revenue Code. This provision allows banks to deduct approximately 80% of their carrying costs on loans to ARRC, which has in the past resulted in an interest rate that is 80-100 basis points lower than the usual tax exempt rate. If ARRC is subjected to the EBA, its finances would no longer be considered separate from the State's and it will no longer qualify for this important benefit. As a result, ARRC's cost of borrowing could increase markedly.

In short, subjecting ARRC to the EBA will limit ARRC's ability to enter into future long term contracts with its customers and lenders because every agreement it negotiates will have to have the caveat at the end "SUBJECT TO LEGISLATIVE APPROPRIATION." If we cannot assure our customers that we will have the funds and the authority to spend them to perform the services they require, they are likely to go elsewhere.

#### **Effect of State Fiscal Year**

- **ARRC's business is highly seasonal, and moving to the state fiscal year would split the business season.**

Business activity in Alaska is highly seasonal. Subjecting ARRC to the EBA will require it to change from its current calendar year as fiscal year, to the state fiscal year that ends on June 30. While there does not appear to be a specific mandate to this effect, the requirement to participate in the governor's budgeting process and seek legislative approvals will necessitate such a change. Prudent businesses close their fiscal year at the end of a business cycle, not during its busiest time. The railroad's "busy season" ends

around November 1, and the calendar year is therefore the most appropriate fiscal year for ARRC. Not only would the state fiscal year artificially bifurcate the business year, but it would require the corporation to spend considerable time participating in the budgeting process at the same time it is gearing up to expand operations in May. This is not an efficient use of resources.

#### Effect on Liability

- **By assuming substantial actual control over the financial and legal obligations of ARRC, the State will likely subject itself to full liability for ARRC's operations.**

A major purpose of setting up an "enterprise fund" such as ARRC is to shield the State from liability in the event the enterprise goes under or incurs a catastrophic liability. ARRC has been a defendant in numerous lawsuits since its creation, and the State of Alaska has never been made a party as a result of ARRC's actions, nor called upon to answer in damages in any of these cases. Obviously, the language of AS 42.40.500 and the arm's length nature of the corporation's past relationship with the State have had the intended effect and spared the State these liabilities. This is not likely to continue once the State injects itself so substantially into the railroad's business decision-making process. Simply put, the more control you exercise over an entity, the more likely you are to become liable for the entity's obligations.

#### Violation of Alaska Railroad Transfer Act, 45 USC 1201 et seq. (ARTA)

- **The Transfer Act specifically requires that ARRC retain control of its funds and budget. The federal government could raise this violation of ARTA as a breach in its contract with the State of Alaska transferring the railroad.**

Section 1207 of ARTA mandates that the revenues generated by ARRC be "retained and managed by the State-owned railroad for railroad and related purposes". This provision was inserted in ARTA to prevent the state from repeating the mistakes that caused the federally owned railroad to lose money in almost every year of its 60 year history. A major reason that the federal railroad lost money was that all of its funds had to be appropriated under the federal budget process which deprived the railroad of the flexibility needed to respond quickly to business opportunities and prevented it from obtaining needed capital to maintain or improve service.

This bill could infringe on that "management" right in several respects. For example, inclusion of ARRC under the EBA could have the effect of prohibiting the corporation from hiring additional employees or expending any money or incurring other obligations unless these items were included in an operations plan approved by OMB, which must in turn comport with a budget approved by the legislature. See AS 37.07.080(d). If ARRC receives excess funds from its operations (beyond what is expected and accounted for in its approved budget), it must convince the administration to propose a revision to the Legislative Budget & Audit Committee and possibly wait 45 days before expending the money. See AS 37.07.080(h). Not only does this run afoul of "management" rights provided in ARTA, but it also provides another example of the potential loss of business if ARRC is

brought under the EBA. One can foresee a multitude of business opportunities or potential employees that will not wait the time required to obtain such approvals and, accordingly, be lost to the corporation.

As noted below, there does not appear to be any requirement that all of the money generated by ARRC be paid into the state treasury. However, in light of the "appropriation" language used in the bill, the bill's intent is not entirely clear. If the design is for ARRC revenues either (1) to be "state funds" which are then appropriated back to the corporation or (2) to be held by the corporation but only expended pursuant to an approved budget, then the corporation no longer has the "management" rights required by Section 1207 of ARTA. In addition, if all of ARRC's revenues are not either appropriated back to the corporation or approved to be used in the corporation's budget, part of ARRC's revenue could be used to fund a program or project that is totally unrelated to the railroad. This too would violate the mandate of ARTA Section 1207.

### **EBA Process Adds Time and Cost Without Adding Value**

- **Participating in the budgeting process as proposed will substantially increase the costs of doing business. It is unreasonable to expect the customers to bear this additional cost.**

Subjecting ARRC to the EBA will add an unnecessary layer of expense and time consuming government bureaucracy to what is currently a profitable and self-sustaining asset. Numerous provisions throughout the EBA impose procedures with considerably different focus and detail than ARRC currently develops, such as the "agency program," "financial plan" and "operations plan." In addition, involvement of additional layers of governmental agencies (OMB, LB&A, etc.) to business sector decision-making will delay the process and therefore result in less flexibility to react to business climate changes. All of these add significant costs to ARRC's operations without adding any value. These costs will ultimately be paid by railroad customers or, worse still, by the corporation in the form of lost opportunity.

### **Inconsistency of Approach**

- **The inconsistencies found in the bill illustrate the difficulty in separating the financial management of the corporation from the operational management left to ARRC.**

The bill expressly subjects ARRC's revenues to legislative control by making the corporation subject to the EBA. Yet, it does not change the primary legislative purposes embedded throughout the Alaska Railroad Corporation Act that require the corporation (1) to be exclusively responsible for management of the financial and legal obligations of the Alaska Railroad, (2) to carry out its responsibilities on a "self-sustaining basis," and (3) to provide for the "prudent operation of the railroad according to sound business management practices." The bill requires ARRC to "request, in accordance with AS 37.07, appropriations from the legislature to carry out the provisions of this chapter". Under this bill, ARRC will have to seek an annual appropriation for all expenditures of the corporation, with all the

accompanying budget, operations plan and other documents that are generated in the governor's budgeting process. However, the EBA itself does not require ARRC revenues to be paid into the general governmental treasury<sup>11</sup> and it is unclear whether the bill contemplates this result. If ARRC is to retain its receipts, it is inconsistent to require the corporation to seek appropriations for operating and other expenditures.

**Conclusion: HB 127 Seeks to Fix Something That is Not Broken**

The most perplexing issue about HB 127 is that the impetus for the bill isn't coming from the citizens or businesses served by the railroad, or from the communities being served. Nor is it supported by any research or studies such as those provided by the Harvard Business School and University of Alaska Institute for Social and Economic Research that led the 13<sup>th</sup> Legislature to adopt the current business model that exempts ARRC from the EBA. The railroad as it exists today has provided Alaska with the best of all possible worlds-- the State owns the asset but has none of the liability associated with its operations, the railroad pays its own way as well as making a profit, and it operates an essential transportation service without any burden on the taxpayers. In short, the Alaska Railroad is working just fine as it is currently structured. It makes no sense to make so sweeping a change without any demonstrable reason.

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<sup>11</sup> Another section of the Public Finance title, AS 37.05.146, provides that ARRC receipts are not general fund receipts. Without any other section of that title being made applicable to ARRC, there is apparently no requirement that corporation funds be paid over to the state treasury.



## 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 13<sup>th</sup> Legislature took great care to insulate ARRC from unnecessary and burdensome government interference, it also recognized that under State ownership, the Alaska Railroad is a public entity that serves important public purposes. While the exemption of ARRC from the Executive Budget Act (EBA) solved the major problems that plagued the federally owned railroad, in a effort to assure accountability to the public without unnecessarily interfering with the railroad's mandate to operate freely in the competitive market place on a self-sustaining basis, the 13<sup>th</sup> Legislature imposed several significant State oversight mechanisms over ARRC's operation and management practices to replace the oversight found in the EBA. 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, extension of rail lines or issuing bonds. In addition, any exercise of the power of eminent domain by the corporation requires the approval of the Governor.

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.
11. ARRC must notify the Department of Law within 30 days before initiating any legal action.
12. The railroad is required to be operated under the jurisdiction of the Surface Transportation Board as required by the Alaska Railroad Transportation Act of 1982.

### **Conclusion**

The rationale for exempting ARRC from the EBA is as valid today as it was 24 years ago. In exempting ARRC from the EBA, 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 EBA 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.



## **COMMENTS ON HB 127**

### **Executive Summary**

**Submitted by the Alaska Railroad Corporation (ARRC)**

**Reasons why placing ARRC under the Executive Budget Act (EBA) is a bad idea:**

- **Will cause ARRC to lose the flexibility needed to respond to business opportunities. Changes in railroad business require the ability to respond quickly with capital investment and/or operating increases when customers or circumstances demand it, a condition no other state entity such as AHFC or AIDEA must contend with. The proposed bill will make it very difficult to respond to market opportunities in a timely fashion.**
- **Will cause concerns by ARRC's major customers/lenders (e.g. Flint Hills, Usibelli Coal Mine, Lynden, TOTE, Princess, Holland America, Wells Fargo Bank) as to its ability to perform under existing long term contracts. Passage of this bill may also constitute an impairment of contract rights in violation of Article I, Section 15 of the Alaska Constitution and a impairment of bondholders' rights in violation of AS 42.40 675. ARRC's existing agreements do not contain language conditioning ARRC's duty to perform on its receipt of sufficient appropriations from the legislature, as is the case in a typical state contract.**
- **Will seriously impact \$165,000,000 in outstanding FTA Formula Funds Bonds.**
- **ARRC's current fiscal year is the calendar year. Its business is highly seasonal, and moving to the state fiscal year would split the business season, something no prudent business person would do.**
- **By assuming substantial actual control over the financial and legal obligations of ARRC, the state may subject itself to full liability for ARRC's operations. The more control you assert over an entity, the more likely it is that you will be held responsible when things go wrong.**
- **May violate the federal Alaska Railroad Transfer Act (ARTA) which specifically provides that ARRC is to retain control of its funds. This provision was inserted in ARTA to prevent the state from repeating the mistakes that caused the federally owned railroad to lose money in almost every year of its 60-year history. A major reason that the federal railroad lost money was that all of its funds had to be appropriated under the federal budget process which deprived the railroad of the flexibility needed to respond quickly to business opportunities and prevented it from obtaining needed capital to maintain or improve service.**
- **EBA process adds time and cost without adding value.**
- **Bill seeks to fix something that is not broken. Putting ARRC under the EBA has been brought up numerous times by various parties since ARRC's creation. In each instance, the current "business" model was determined to be the superior choice.**

HB 127 Bullets  
03/23/09

327 W. Ship Creek Avenue  
Anchorage, Alaska 99501

MAILING ADDRESS  
P.O. Box 107500 Anchorage, Alaska. 99510-7500

TEL 907.265.2300 FAX 907.265.2416  
AlaskaRailroad.com

*Co-Chair:*  
House Finance Committee

*Chair:*  
House Finance Subcommittees for;  
Department of Public Safety  
Department of Law

*Member:*  
Legislative Council  
Legislative Budget & Audit (alt)

*Session:*  
Alaska State Capitol, Rm 515  
Juneau, AK 99801-1182  
Phone: (907) 465-1958  
Fax: (907) 465-4928

*District:*  
600 E. Railroad Ave.  
Wasilla, AK 99654

**BILL STOLTZE**  
STATE REPRESENTATIVE  
Representative\_Bill\_Stoltze@legis.state.ak.us

*Sponsor Statement*  
*For*  
*House Bill 127*

House Bill 127 would place the Alaska Railroad Corporation under the Executive Budget Act. The Alaska Railroad Corporation has been owned by the State of Alaska since 1985 and is governed by a seven member board appointed by the Governor.

The Executive Budget Act (AS 37.07) is the statute that outlines the state budget process. It has a successful history of providing transparency and accountability in public expenditures.

The Executive Budget Act outlines procedures for accountability and review by both the Executive and Legislative branches of our government. It is a very straightforward process with nothing to fear and nothing to hide.

Our budget process often involves healthy tensions between the Executive and Legislative branches, but these deliberations provide Alaskans with a better understanding of how public funds are spent. It also provides policy makers and elected officials with the information and reasonable timeframes to make necessary budget decisions.

There are numerous circumstances over the years where public corporations have been brought under the review of the Executive Budget Act. The Alaska Housing Finance Corporation (AHFC), for example, was brought under the act during the 1990's despite concerns expressed at the time by the corporation's management.

Since that time, AHFC has improved its bond rating, purchased billions of mortgages loans and is viewed nationally as an innovator in the development of affordable and energy efficient housing programs. While the rest of our nation is facing a housing crisis, Alaska's housing market is currently considered stable.

In short - the Executive Budget Act was successful in allowing AHFC to be part of the state budget process.

DISTRICT 16

BIRCHWOOD • BUTTE • CHUGIAK • EKLUTNA • FAIRVIEW LOOP  
KNIK RIVER ROAD • LAZY MOUNTAIN • PALMER • PETERS CREEK

MEMORANDUM

TO: Alaska Railroad Corporation  
FROM: Blank Rome LLP  
DATE: March 23, 2009  
RE: House Bill 127  
C/M # 811156-00301

---

We are furnishing this memorandum to provide analysis of the effects of House Bill 127 ("HB 127"), now pending in the State Legislature, on (i) the Alaska Railroad Corporation ("ARRC") Capital Grant Receipts Bonds, Series 2006 and Series 2007 (FTA Section 5307 Urbanized Area Formula Funds and Section 5309 Fixed Guideway Modernization Formula Funds) (the "Series 2006 Bonds" and "Series 2007 Bonds", respectively, and collectively, the "Bonds"), (ii) the credit ratings assigned to the Bonds, and (iii) compliance with the provisions of the Alaska Railroad Transfer Act, 45 U.S.C. §1201 et seq. ("ARTA").

**1. The Effect of HB 127 on the Bonds.**

The Bonds are revenue bonds secured solely by and payable solely from FTA Section 5307 and Section 5309 Formula Funds (collectively, the "Formula Funds") received by ARRC for the Federal Fiscal Year commencing October 1, 2006 and each Federal Fiscal Year thereafter. Thus, all Formula Funds received or receivable by ARRC are pledged under the Trust Indenture securing the Bonds ("Trust Indenture") and are required to be paid directly to the Trustee under the Trust Indenture for deposit in a trust fund designated "Grant Receipts Deposit Fund".

The Bonds and the Official Statements used in the primary offerings of the Bonds recite that the Bonds are not a debt or liability of the State of Alaska and further that the Bonds are not general obligations of ARRC and do not pledge the assets or revenues of ARRC except for the Formula Funds.

The Bondholders have been informed in the Official Statements that receipt of Formula Funds is subject to authorization and appropriation by the United States Congress, but that once Congress has acted, the Formula Funds in their entirety are paid directly to the Corporation or the Trustee and the obligation of the Corporation to pay all the Formula Funds over to the

Trustee is absolute and unconditional. This requirement, by the way, includes any Formula Funds ARRC is to receive under the recently enacted Stimulus legislation.

The Bondholders have never been told that the payment of the Formula Funds to the Trustee and of debt service on their Bonds is subject to appropriation by the State Legislature, a risk that would certainly have merited prominent disclosure had it been in the law at the time.

Should HB 127 be enacted, it will be necessary for ARRC to file a material event notice under its Continuing Disclosure Undertakings executed pursuant to SEC Rule 15c2-12 advising the Bondholders that their rights to unfettered payment of the Formula Funds to the Trustee and of debt service on the Bonds have been impaired by the enactment of a law conferring on the State Legislature the discretion to determine the amounts, if any, appropriated to the Grant Receipts Deposit Fund or allocated to pay debt service and that such payments are subject to the risks of non-appropriation and/or delayed appropriation by the State.

We note that in accordance with A.S. 42.40.675, the Trust Indenture includes the pledge made by the State in A.S. 42.40.675 not to impair the rights of the holders of the Bonds. We believe that the provisions of HB 127 would be viewed by Bondholders as an impairment of their rights to receive all of the Formula Funds for the Grant Receipts Deposit Fund to assure payment in full of debt service of the Bonds prior to application of the Formula Funds to other purposes, as required by the Indenture.

Parenthetically, A.S. 42.40.675 makes the same pledge to any federal agency contributing funds to ARRC. You will, no doubt, have ascertained whether any federal agency's rights contained in any grant agreement or other contractual obligation are impaired by HB 127.

## **2. Effect of HB 127 on Credit Ratings Assigned to the Bonds.**

At the time the Bonds were issued, each Series was insured with a policy of municipal bond insurance issued by Financial Guaranty Insurance Company ("FGIC") and the Bonds then carried insured ratings of "AAA" by Standard & Poor's Ratings Service ("S&P") and Fitch ("Fitch Ratings") and "Aaa" by Moody's Investors Service ("Moody's"). ARRC also obtained unenhanced ratings for the Bonds of "A+" by S&P, "A" by Fitch and "A1" by Moody's, based on the structure outlined in Part 1 of this Memorandum.

Since the original issuance of the Bonds, the FGIC ratings have all been downgraded and the Bonds now bear the unenhanced ratings assigned to them by S&P, Fitch and Moody's, since the unenhanced ratings are now higher than the insured ratings.

If HB 127 were to be enacted, ARRC is obligated to notify S&P, Fitch and Moody's (collectively, the "Rating Agencies") that the structure on which the unenhanced ratings were based has been altered and that the Bonds now have two levels of appropriation risk — United States Congress and State Legislature. The unenhanced ratings rely on the transfer of all Formula Funds directly to the Trustee as provided in the Indenture with no risk of delay or diversion once federally appropriated.

There is a high degree of likelihood that the Rating Agencies would take action to change the ratings downward or to at least put them on negative outlook pending a closer review of the actions of the State Legislature.

ARRC will want to consult with its independent financial advisors on the Rating Agencies and their potential actions. We advise you that our experience is that in this difficult economy, rating agencies are quick to take action on the occurrence of a negative event. It is much harder and takes much longer to raise a rating than it does to lower one.

Any rating changes will require that ARRC file a material event notice pursuant to its Continuing Disclosure Undertakings.

Material event notices of the types of adverse changes described in Part 1 of this memorandum and in this Part 2 usually lead to adverse effects in the secondary market for the Bonds and affect pricing and liquidity.

### **3. Effect of HB 127 on Compliance with ARTA.**

In the brief time we have had to review HB 127 and the relevant provisions of ARTA, we have substantial concern that HB 127 in the form now pending, violates ARTA which explicitly provides that revenues generated by ARRC, "including any amount appropriated or otherwise made available to the State-owned railroad shall be retained and managed by the State-owned railroad for railroad and related purposes." 45 U.S.C. § 1207(a)(5). This provision has always been read and applied to mean that **one hundred percent** of ARRC's revenues, whether fares, tariffs, fees or federal funds or investment income are to be kept and managed by ARRC solely for rail and related purposes. HB 127 purports to grant to the State legislature the power to determine how much, if any, of ARRC's revenues can be appropriated to ARRC in each fiscal year and that at least some of them can be deposited in the State's general fund. See HB 127, Section 3. This is clearly at odds with ARTA, which dedicates all of the money to the "State-owned railroad" (defined in ARTA to mean the authority, agency or corporation designated by the State to own, operate or manage the railroad) or, in other words, ARRC. Nothing in HB 127 indicates any recognition by the drafters of the requirement that all of the revenues of ARRC must be retained and managed by ARRC and that the Legislature cannot withhold or divert those funds to other purposes. ARTA was amended in 2004 to insert the phrase, "including any amount appropriated or otherwise made available" in Section 1207(a)(5) to make even more explicit that all revenues of ARRC from whatever source derived are to be retained and managed by ARRC.

### **Conclusion**

HB 127 in the form now pending would be viewed as impairing the rights of the holders of the Bonds, is likely to have an adverse effect on the unenhanced ratings assigned to the Bonds and appears to conflict with Section 1207(a)(5) of ARTA.



# ALASKA MINERS ASSOCIATION, INC.

3305 Arctic Blvd., #105, Anchorage, Alaska 99503 • (907) 563-9229 • FAX: (907) 563-9225 • www.alaskaminers.org

March 27, 2009

Honorable Bill Stoltze  
Honorable Mike Hawker  
House Finance Committee  
Capitol Building  
Juneau, AK 99801

RE: House Bill 127, Alaska Railroad Subject to Executive Budget Act

Dear Representatives Stoltz and Hawker,

We are writing in opposition to House Bill 127 which would place the Alaska Railroad under the Executive Budget Act.

We are concerned that placing the railroad under the Executive Budget Act (EBA) would adversely affect the operation of the railroad. The railroad needs the flexibility to respond to changes and business opportunities as they arise and it would lose that flexibility if it was under the EBA.

The Alaska Railroad has functioned very effectively for many years. It has made a profit during all but four of the past 24 years. At the same time the railroad has spent more than \$500 million to replace subgrade, upgrade the trackage, remove bottlenecks, straighten segments, etc. Much more work is needed for the railroad to be up to modern standards that will accommodate 110 car unit trains (110 tons each car) operating on a 24 hour basis. It will take many more years of focused and consistent effort to accomplish this objective. The railroad needs the flexibility to manage its business in a way that will bring this about.

There is also a concern that if the railroad was subject to the EBA, the details of operating the railroad would be driven by changes of Administration and of the Legislature, rather than being allowed to focus on a long term business model. The existing business model has worked well and we urge that it be allowed to continue in that way.

Sincerely,

Steven C. Borell, P.E.  
Executive Director

**Louanne Christian**

---

**From:** Bill OLeary [Olearyb@akrr.com]  
**Sent:** Tuesday, March 24, 2009 9:32 AM  
**To:** House Finance Legislation  
**Cc:** Hupprich, William; Lindskoog, Wendy  
**Subject:** RE: HB 127 - Impact to ARRC Bonds/ARTA

Louanne/Ben:

I understand your concern, as this is stamped as protected by attorney/client privilege. However, as the client of Blank Rome, we can (and do) waive that privilege. Is this sufficient for you to include it?

I'm copying our Associate General Counsel on this, as he may be able to further elaborate on this topic.

Thanks.  
Bill

>>> House Finance Legislation <House\_Finance\_Legislation@legis.state.ak.us> 3/24/2009 9:26:35 AM >>>

We are not comfortable including this document as it is stamped confidential. If it is no longer confidential, please resubmit it without the disclaimer. Thanks Louanne/Ben

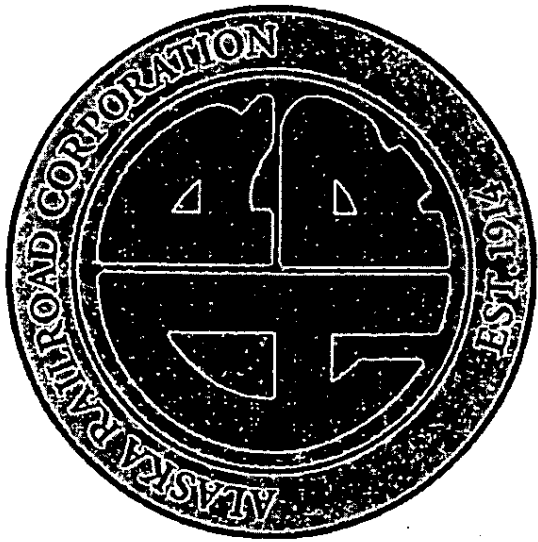
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**From:** Bill OLeary [mailto:Olearyb@akrr.com]  
**Sent:** Tuesday, March 24, 2009 7:33 AM  
**To:** Lindskoog, Wendy  
**Subject:** HB 127 - Impact to ARRC Bonds/ARTA

Wendy:

Attached is a memo from one of ARRC's bond counsel team addressing the impacts HB 127 could have on ARRC's outstanding debt and other issues. Please forward for inclusion into the HFIN package.

Thanks.  
Bill



# About the Alaska Railroad

March 2009

[AlaskaRailroad.com](http://AlaskaRailroad.com)

# ARRC Guiding Principles

## Alaska Railroad Mission

Safety... Service... Profitability

## Alaska Railroad Vision

Building a great Railroad across the Greatland.

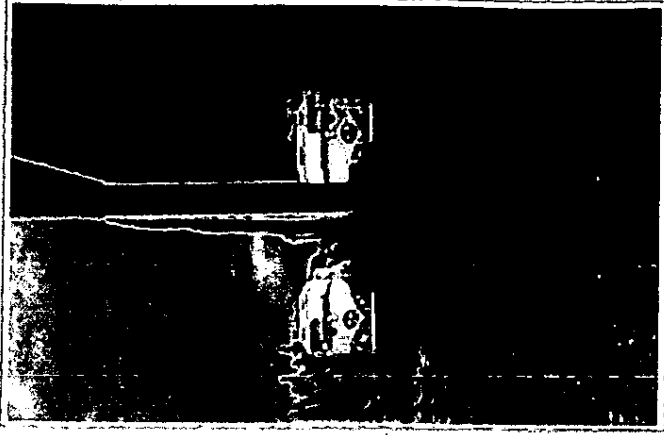
An important element in fulfilling this vision is ARRC's success since 1996 in qualifying for federal funding...an entitlement afforded by the railroad's public status and its passenger service mission. As a result, ARRC has been able to greatly accelerate long overdue mainline maintenance and upgrades.

## ARRC Core Values

- Integrity
- Service
- Excellence

## ARRC Operating Style

- Safe
- Secure
- Customer responsive
- Financially solid
- Environmentally sound
- Employee friendly corporation



*"We must provide a stable, reliable foundation that can be counted on to enhance the future economic growth of the state and the municipalities we support,"*  
**Pat Gamble, President and CEO.**



[AlaskaRailroad.com](http://AlaskaRailroad.com)

# Alaska Railroad Quick Facts

## Purchase Price (January 5, 1985)

Paid to federal government	\$ 22.3 million
Start-up costs & contributed capital	\$ 11.9 million
Total Investment-State of Alaska	\$ 34.2 million

## Organization (following State purchase)

- Independent corporation owned by State
- Managed by a seven-member board of directors. Position qualifications are spelled out in law, members appointed by the Governor.
- Mandated to be self-sustaining, responsible for all its own financial and legal obligations

## Financial Statistics (Jan. 1 - Dec. 31, 2008)

Total Assets	\$ 856 million
Total 2008 revenues	\$ 138 million
Total 2008 expenses	\$ 125.4 million
2008 net income	\$ 12.6 million
2009 net income budget	\$ 16.8 million

## Operating Data

Miles of main line	467
Miles of branch line	54
Miles of yards and sidings	135
Total miles of track	656
Freight cars (owned & leased)	1,381
Passenger cars	51
Locomotives	57

## Operating Statistics (Jan. 1 - Dec. 31, 2008)

Passenger ridership	541,019 passengers
Freight tonnage	5.82 million tons

## Employees (as of January 2008)

Number of year-round employees	715
Average years of service	11.5
Average age	45
Male	585
Female	130

## Unions (as of January 2008)

Most ARRC employees are members in 1 of 5 unions:	
United Transportation Union	121
Transportation Communication Union	44
International Association of Machinists	63
American Federation of Govt. Employees	283
American Train Dispatchers Association	10

## Benefits

- Corporation provides a defined benefit pension plan
- Corporation provides health and life insurance
- Corporation provides retiree medical benefits



AlaskaRailroad.com

# Different from Other State Agencies

The Alaska Railroad Corporation Act of 1984 established an independent state-owned corporation that is governed by a seven-member board of directors appointed by the Governor. The President and CEO of the corporation reports to the board. Although ARRC is not covered under the State's Executive Budget Act, the state government ensures oversight of ARRC's operation and management practices through the following controls:

- The ARRC Board of Directors is responsible for initiating both a financial and a performance audit each year conducted by independent auditors and management companies. The annual performance audit is conducted by a recognized railroad management expert to ensure that ARRC is being managed and operated effectively and efficiently.
- The Legislative Budget and Audit Committee can review ARRC's operation, management and financial practices.
- ARRC must file an oversight report with the Legislature and Governor before it undertakes certain expansion, reduction, or diversification of services.
- Legislative approval is required for certain corporate actions, such as sale or transfer of the Railroad's entire interest in land, or leasing land for longer than 55 years.
- ARRC's procurement procedures are required to be substantially equivalent to state procurement requirements.
- ARRC employees and directors are subject to the Executive Branch Code of Ethics.
- ARRC's spill prevention and response plans are filed and regulated by the State and ARRC is required by state law to show sufficient financial responsibility to respond to spills.
- Bond authorizations must be approved by the Legislature.
- ARRC is required by law to submit an annual report with audited financial statements
- ARRC is required by law to adopt a long-range capital improvement plan each year and shall share that plan with the Governor and Legislature.
- ARRC is defined as an interstate commerce carrier by the Federal Alaska Railroad Transfer Act of 1982 (ARTA).



AlaskaRailroad.com

# Alaska's Railroad

- Contributes to health care, business services, and retail payrolls
- Principal transport for heavy and/or bulk commodities to tidewater
- Major mover of jet fuel to Anchorage International Airport.
- Viable passenger alternative to long-distance driving
- Supports the U.S. military with the transport of equipment to and from the "DOD Strategic Port" of Anchorage
- Potential to reduce pressure on State road system ... commuting
- Potential to significantly contribute to the Alaska Natural Gas Pipeline

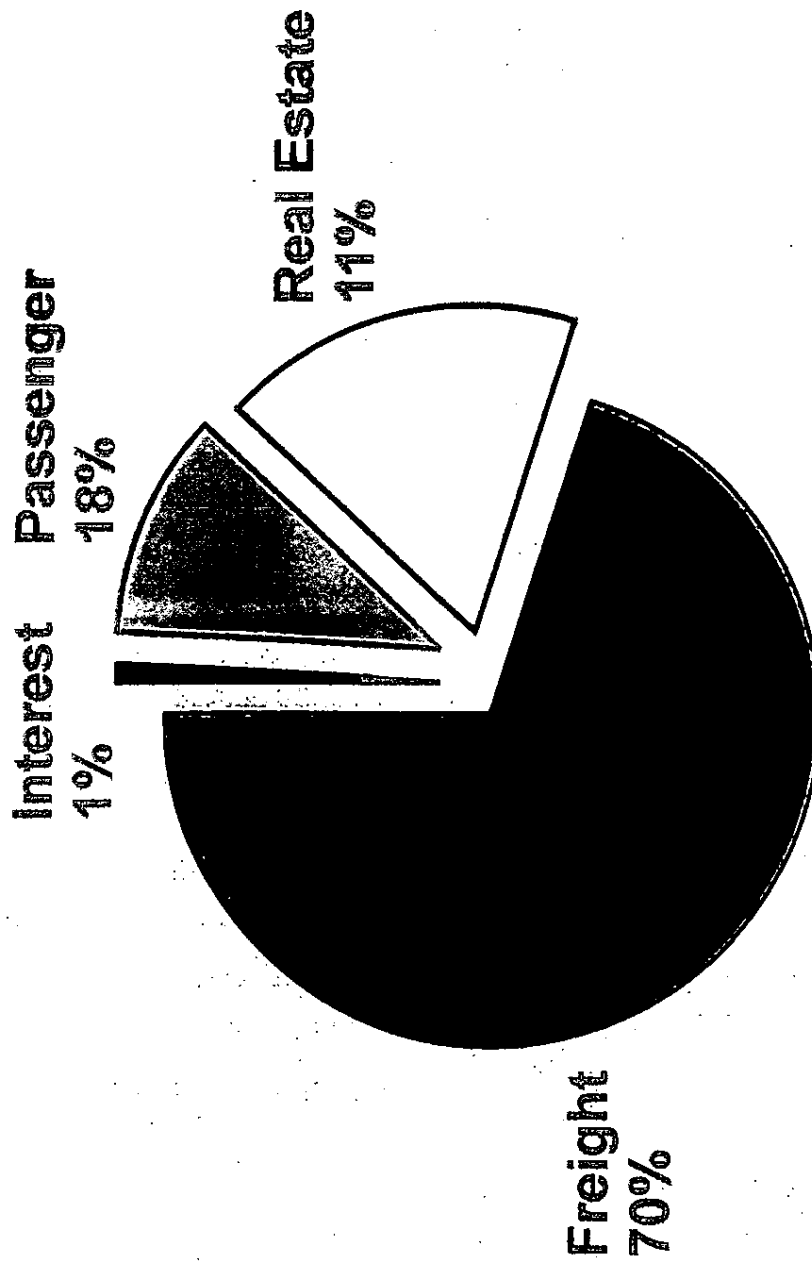
Creates 3,000 jobs and \$150 million in payroll across the State

Source: "Economic Significance of Alaska Railroad", December 2004, ISER report, University of Alaska



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# 2008 Sources of Revenue

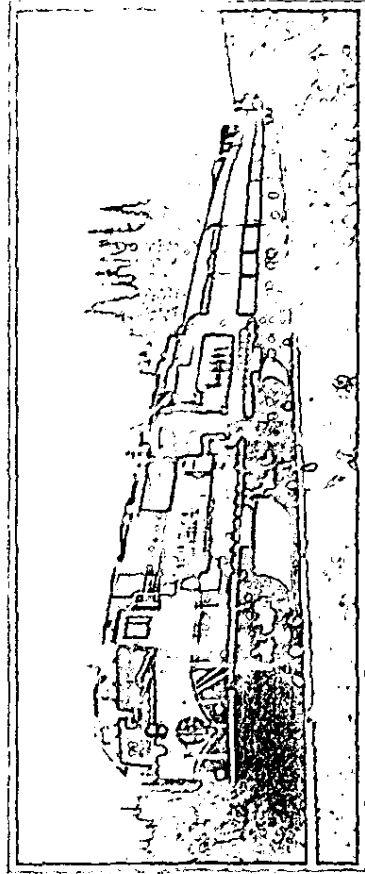
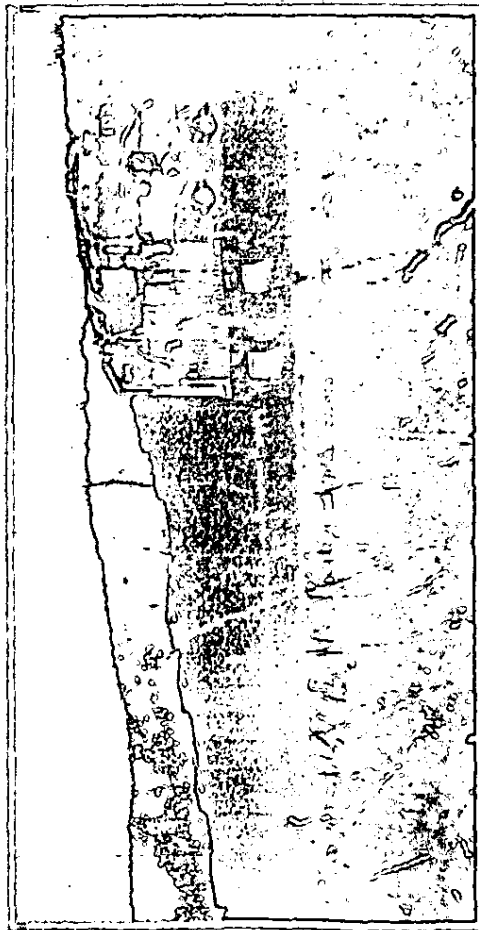


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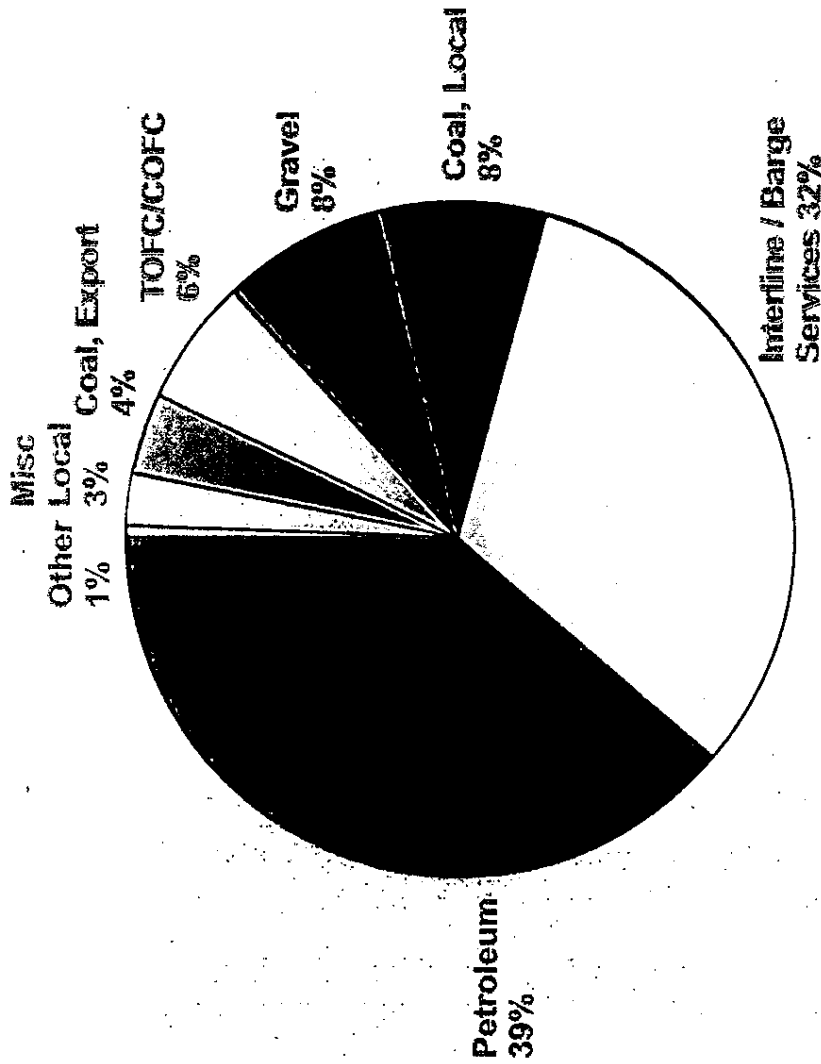
# Freight and Passenger Service

## Freight Service in 2008: Passenger Service in 2008:

- 5.82 million tons moved
- 541,019 passengers moved
- Award Winning Service
- Homegrown high school tour guide hosts and hostesses



# 2008 Freight Revenue Mix

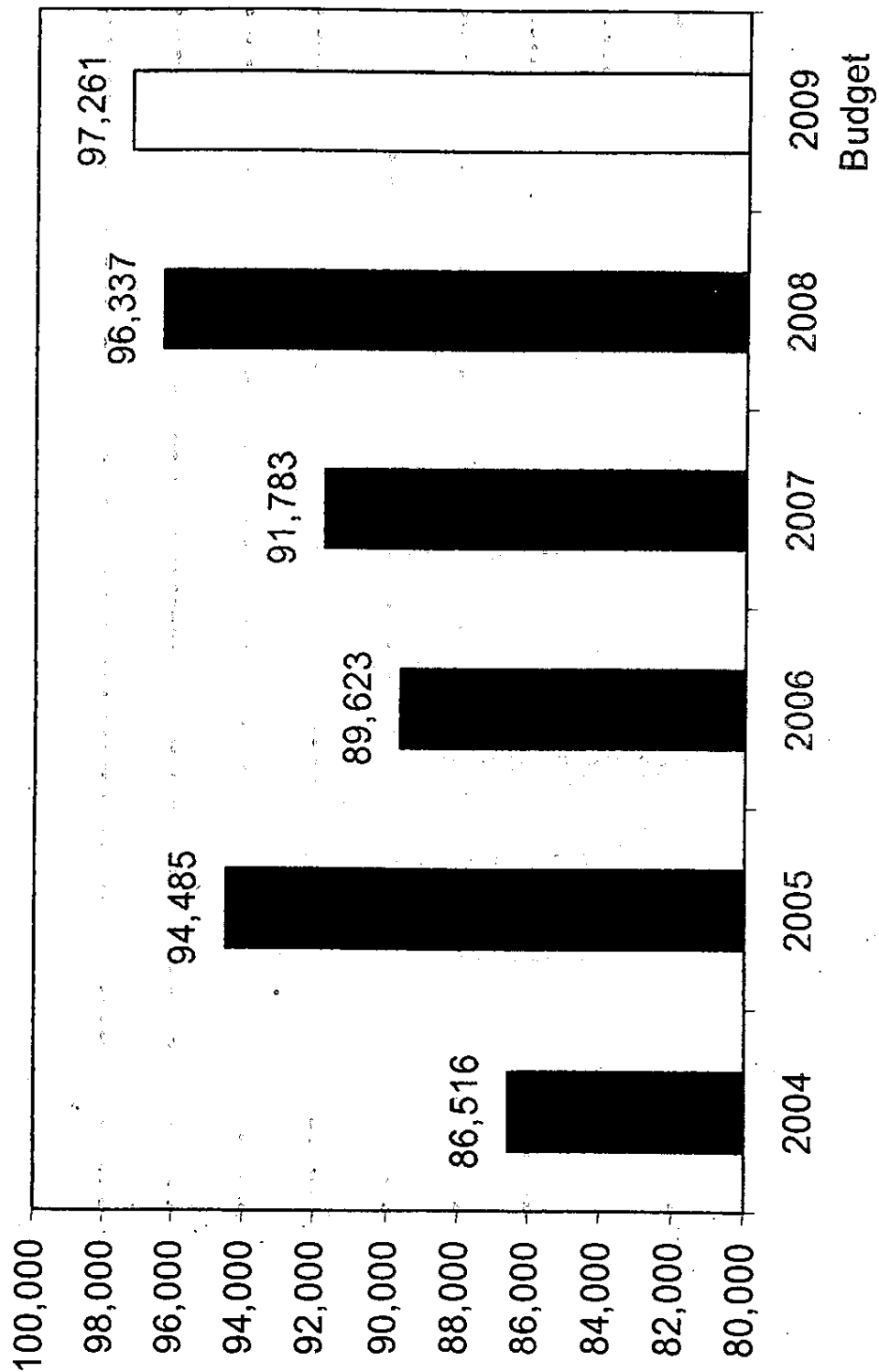


TOFC: Trailers on Flat Cars  
COFC: Containers on Flat Cars



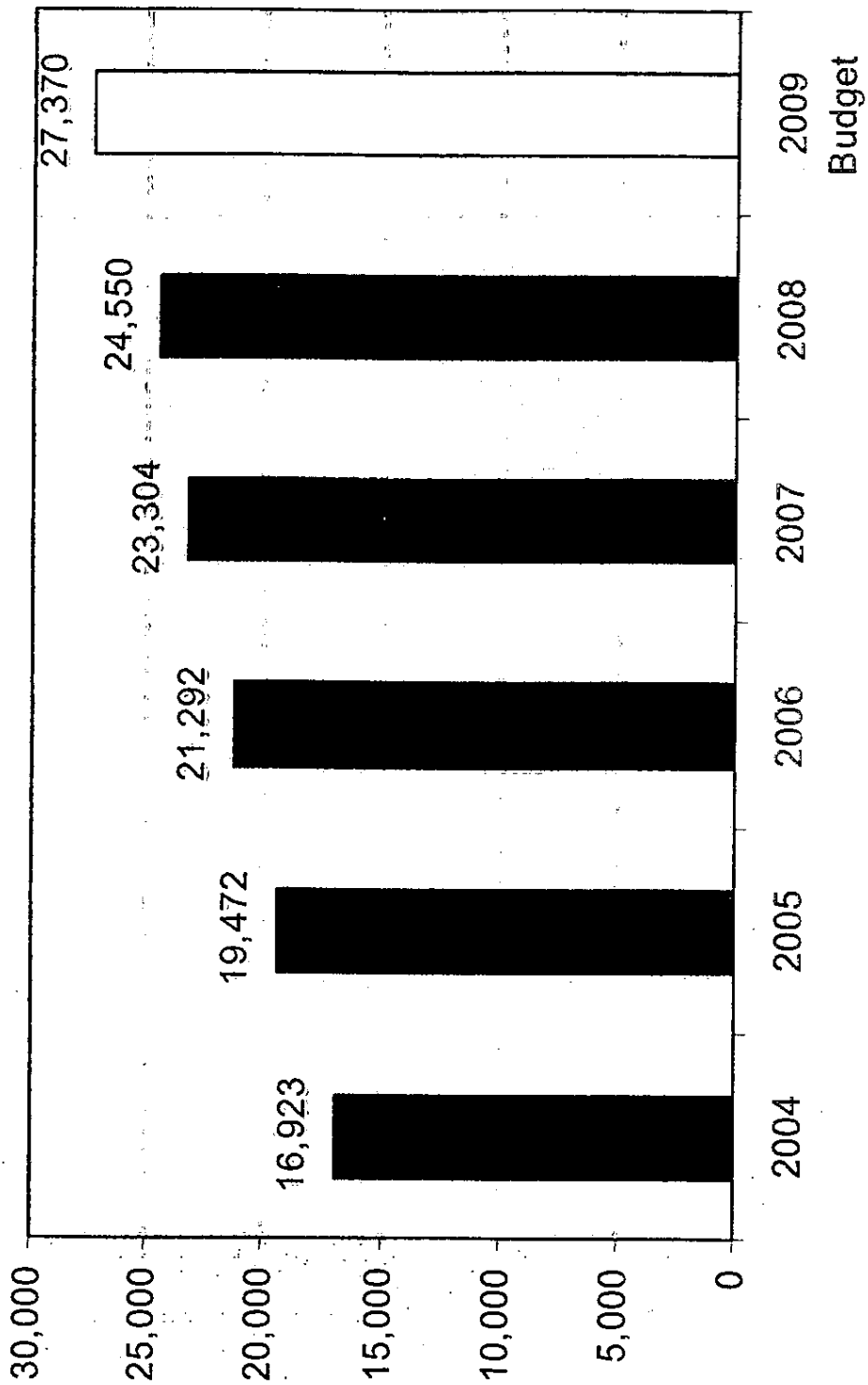
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# Freight Revenue



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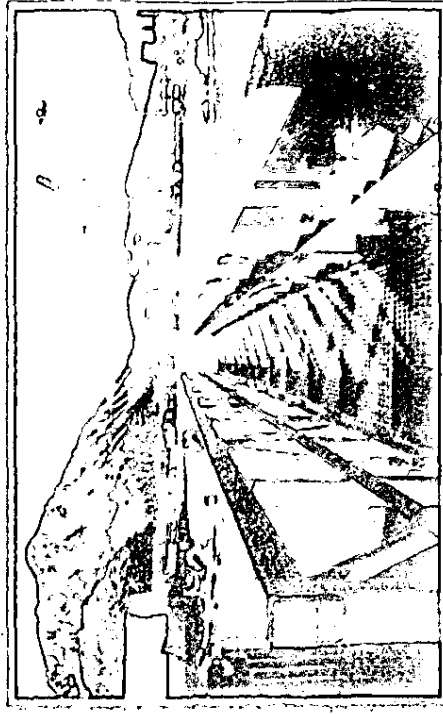
# Passenger Revenue



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# Real Estate

- Property Development
- Leases and Permits
- Dockage and Wharfage
- Facilities Maintenance and Management

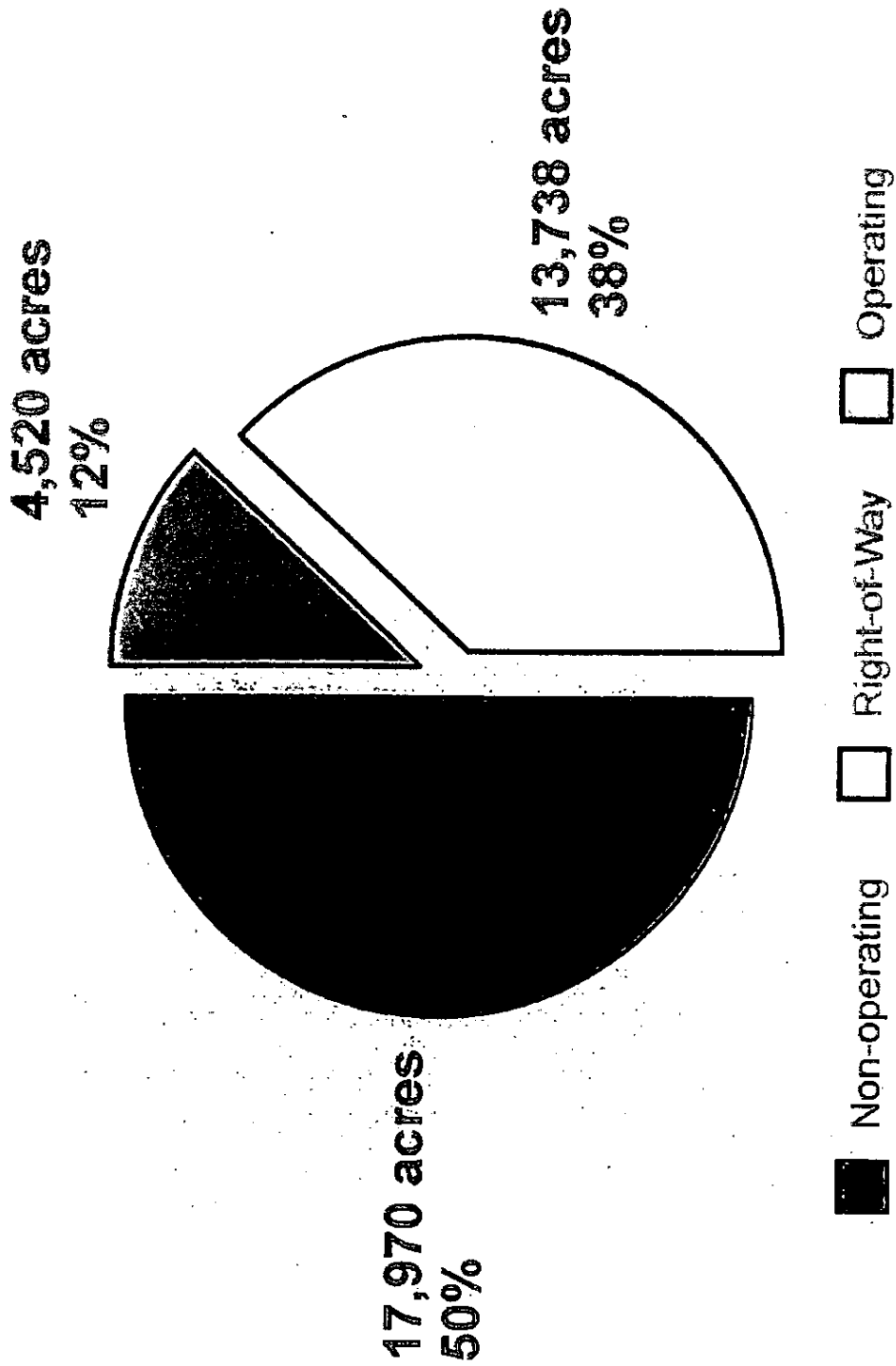


**Clockwise from bottom left: New depot in Fairbanks; Ship Creek basin includes highly valuable leasable land; upland from the Seward freight dock is being developed**



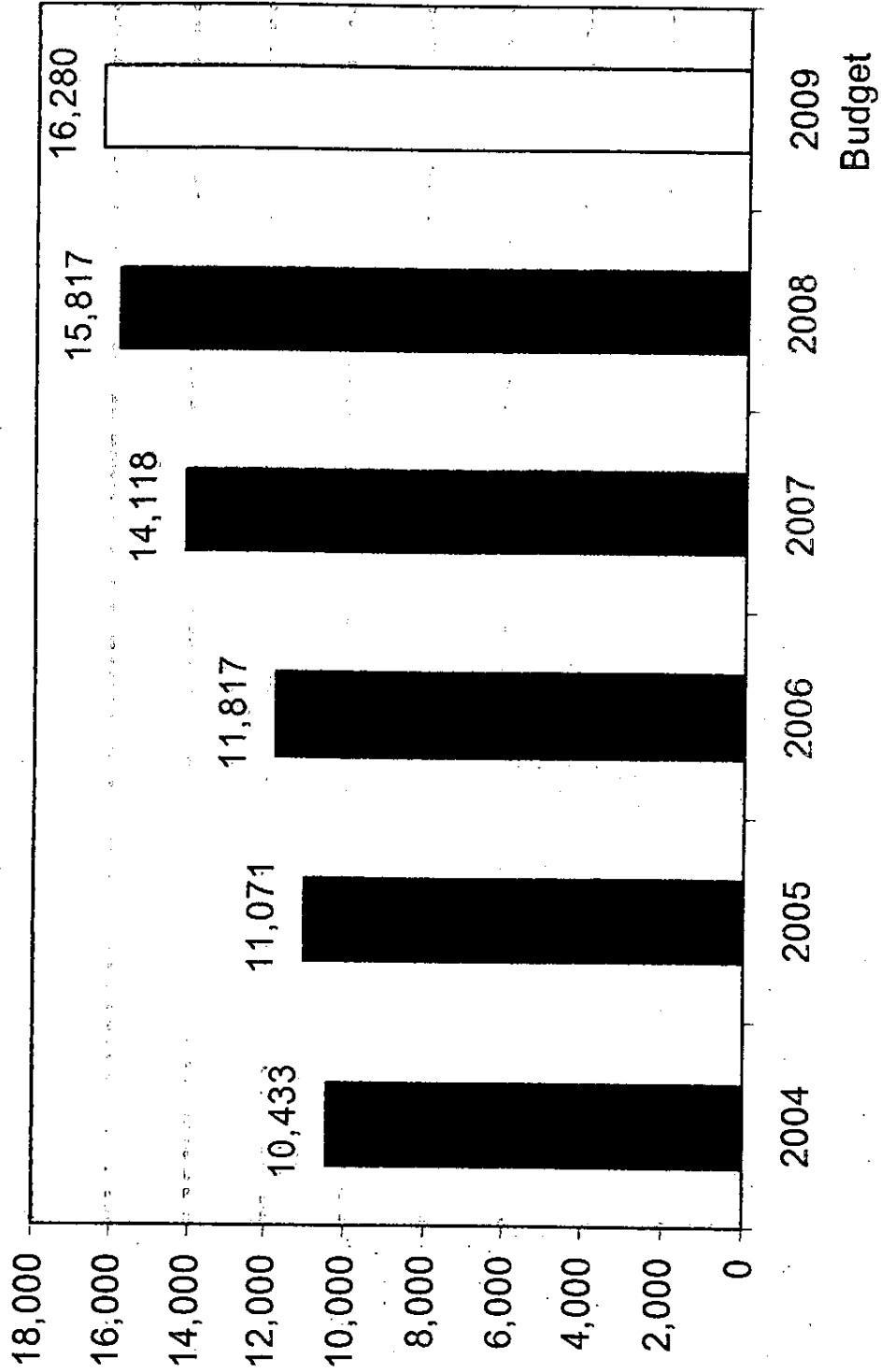
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# Distribution of Land By Category

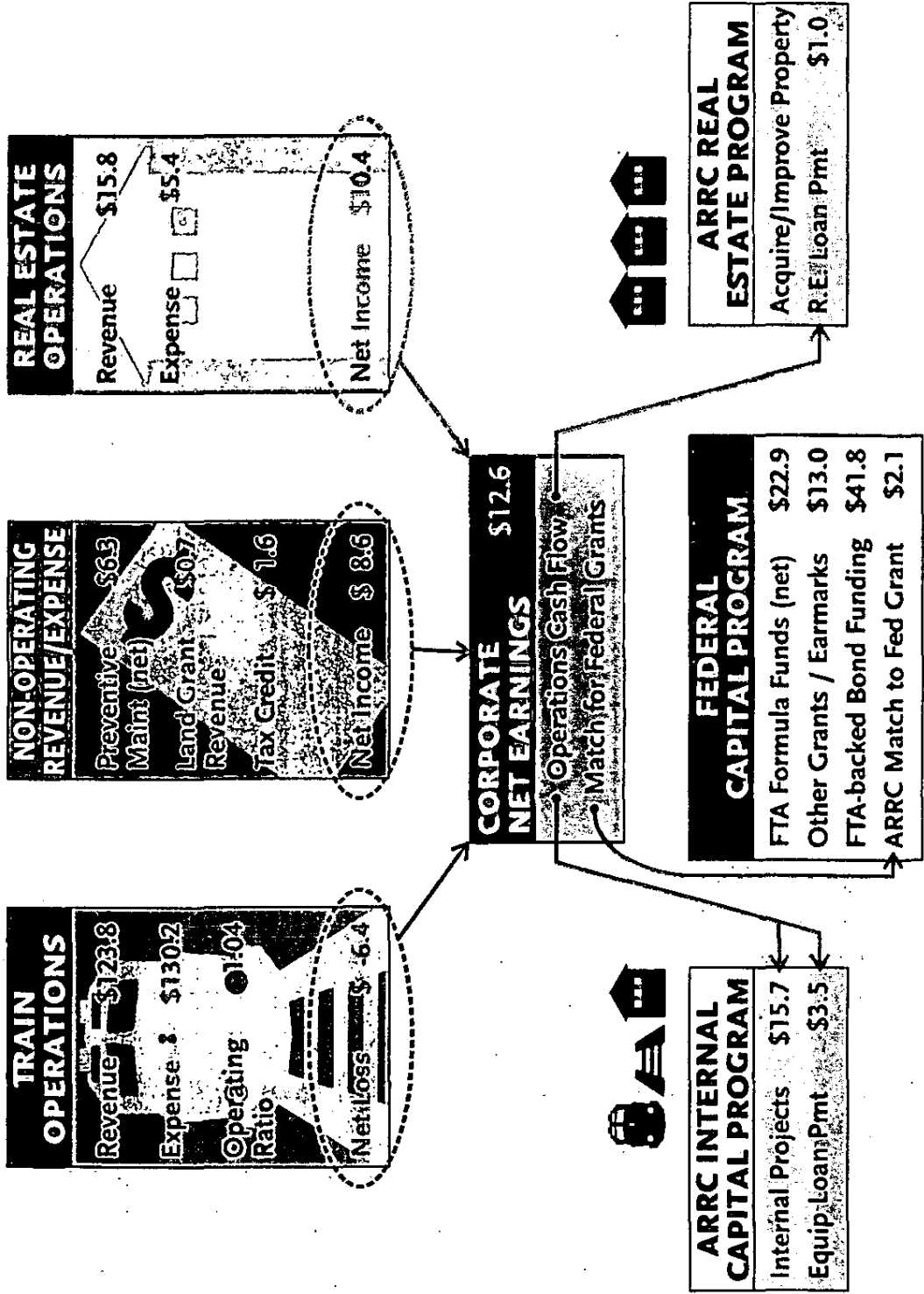


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# Real Estate Revenue



# ARRC Fund Flow Model: 2008 Data



# Overall Growth Pattern

	2001	2008	% difference
Total Assets	\$ 306.0 M	\$856 M	180%
Total Earnings	\$ 6.6 M	\$ 12.6 M	91%
Total Revenue	\$ 105.0 M	\$ 138 M	31%
Passenger Train Starts	771	839	9%
Freight Train Starts	3,386	2,524	-25%
Freight Cars and Intermodal Units Moved	96,453	92,190	-4%
Capital Investments	\$ 67 M	\$ 135 M	101%
Employees (FTE*)	788	897	14%

\* FTE: Full Time Equivalent. Accounts for seasonal and capital project jobs; includes overtime.

Passenger Bi-level Dome Cars (4 to 6) 50%



# Capital Projects

## 2009 Program Major Projects



# Capital Funding Sources

- ARRC Internal Funding
- DOT/Federal Railroad Administration
  - Alaska Railroad Track Rehabilitation funds
  - Department of Defense Allocations
- DOT/Federal Transit Administration
  - Formula Funds; Grants
  - 9-20% ARRC Match Required
- DOT/FHWA
- Federal funds allocated to ARRC do not routinely affect federal funding for other state transportation projects
- ARRC federal match is *not* from State of Alaska general fund or gas tax...match is solely from ARRC earnings.
- ARRC does not receive operating funds or reimbursements from the State Budget.



# 2009 Capital Budget

- \$785 million+ in federal grant money received since 1996, including \$109 million budgeted for 2009:
  - \$60 million Department of Defense (administered through FRA)
  - \$15 million Federal Transit Administration (FTA)
  - \$31 million from Bond sales (repaid by FTA formula funds)
  - \$1 million Federal Highway Administration
  - \$2 million Federal Emergency Management Administration
- ARRC has provided \$42 million in federal grant matching funds since 1996, including \$1.3 million budgeted for 2009.
- Additional \$214 million ARRC funds spent on non-federally-funded projects since 1996, including \$29 million budgeted for 2009.
- **Total capital budget for 2009 is \$138 million**
- **Stimulus likely to add \$26 million**



# Stimulus Package Funding

## American Recovery and Reinvestment Act of 2009 Final Bill (as of February 17, 2009) Estimated Funding for ARRC

Funding Pot	Program Amount	Alaska Railroad
Sec 5307 Urbanized Area Formula	\$ 5,399,200,000	\$ 25,825,000
Energy Program	\$ 100,000,000	TBD
Multimodal Discretionary Funds*	\$ 1,500,000,000	TBD
<b>Total estimated increased funding from the Economic Stimulus Package</b>		<b>\$ 25,825,000</b>

\* This program is very competitive, with many criteria. Grant minimum \$20 million to maximum \$300 million.



# Major Capital Categories

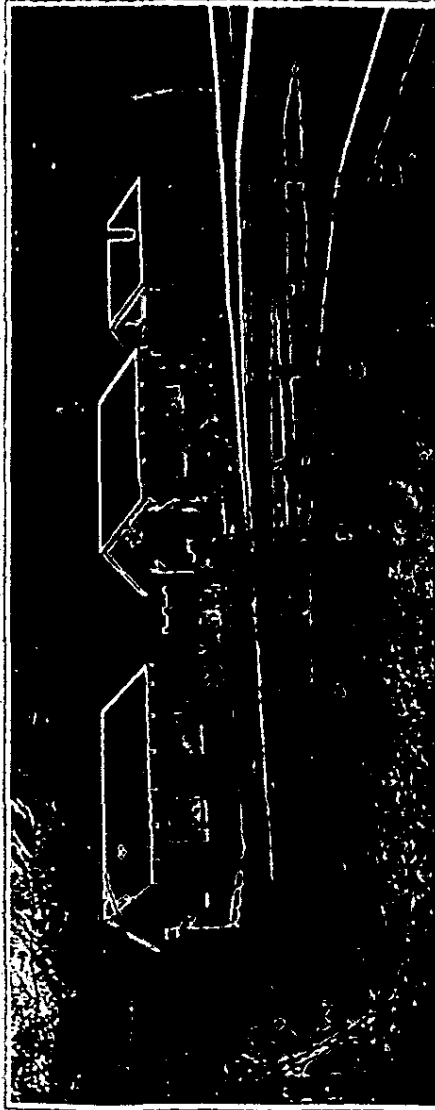
▪ Rail	\$ 18.7 M
▪ Ties	\$ 7.5 M
▪ Ballast/Surfacing/Widening	\$ 3.9 M
▪ Bridges / Docks	\$ 6.9 M
▪ Slope Stabilization	\$ 2.0 M
▪ Track Realignment/Extension	\$ 60.9 M
▪ Technology / Signal / Collision Avoidance System	\$ 10.8 M
▪ Equipment/Vehicle Purchase	\$ 2.7 M
▪ Rip Rap / Gravel	\$ 0.8 M
▪ Mechanical / Equip Maint.	\$ 3.1 M
▪ Facilities	\$ 4.4 M



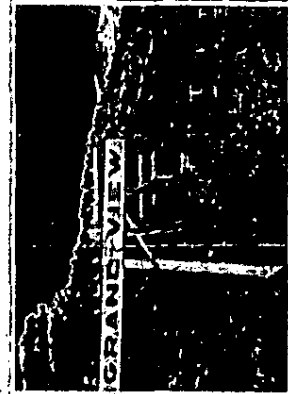
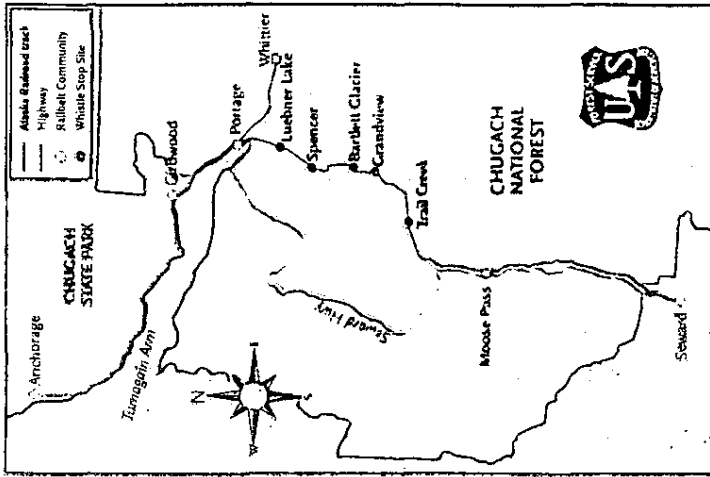


# Chugach Forest Whistle Stop

- Joint venture with Forest Service to develop camping and viewing facilities at 5 whistle stop sites, interconnected by a system of trails, along the track between Portage and Moose Pass.
- Spencer built 2007-08, with a water well to be installed in 2009. Grandview site is conceptual.
- Self-propelled railcar to be delivered early 2009.



Spencer construction in 2007



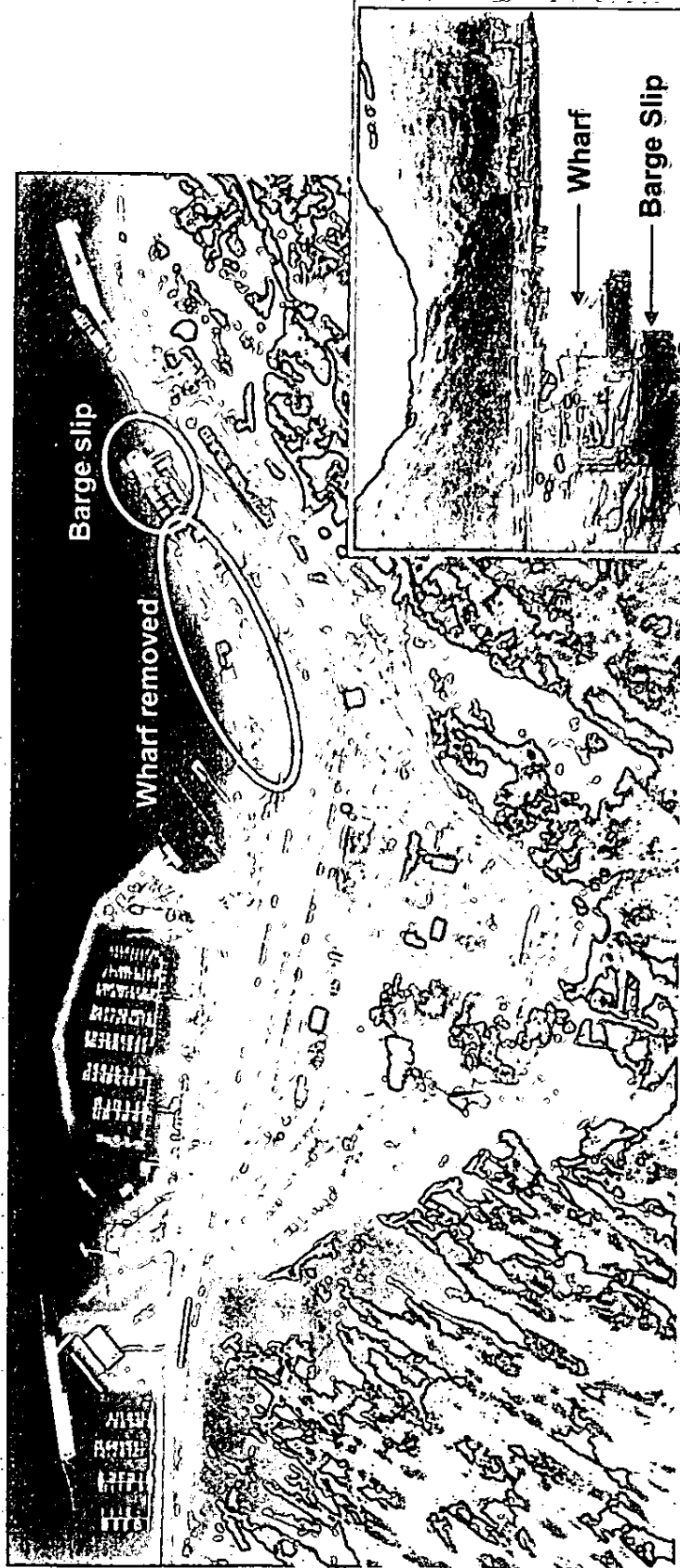
Grandview is next.



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# Whittier Infrastructure

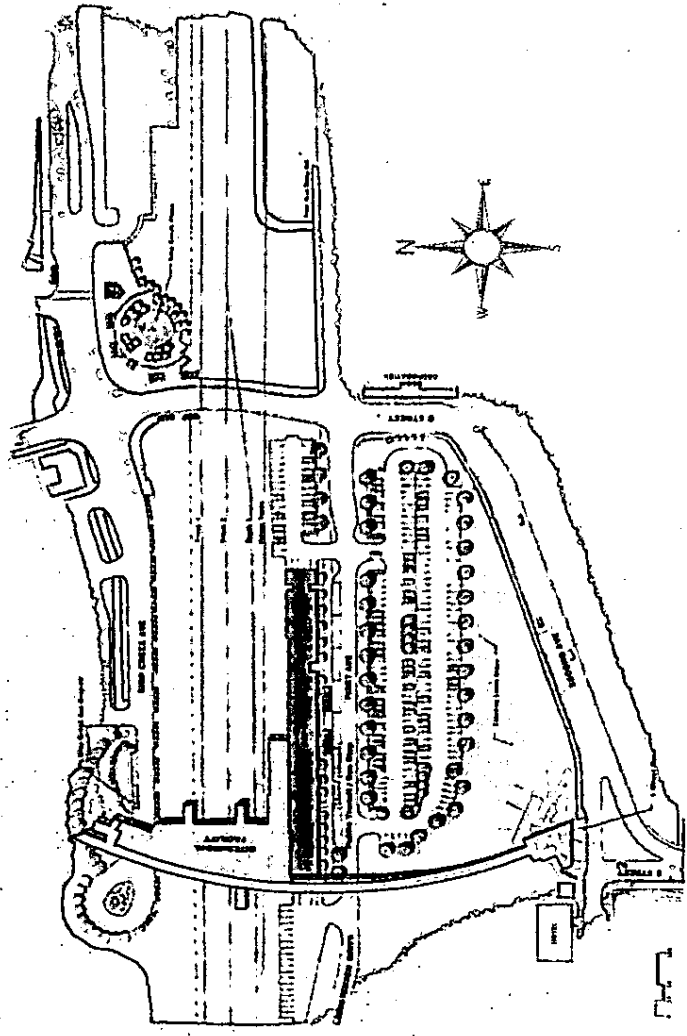
- ▣ Marginal Wharf demolished and new winch installed in 2008; Long-term plans for a passenger dock and intermodal facility.
- ▣ Freight Barge Slip repairs budgeted for 2009.



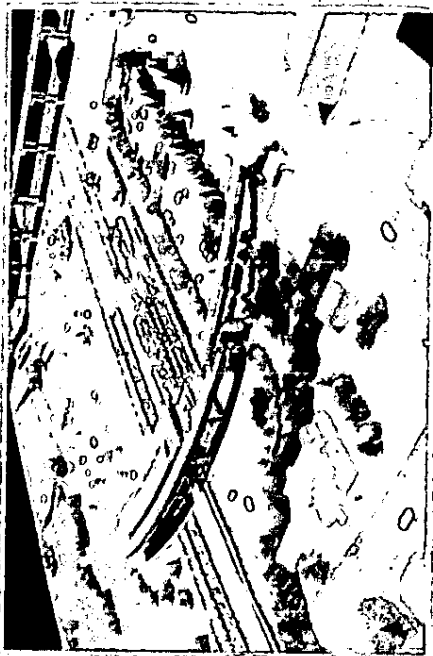
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# Ship Creek Intermodal Center

- Multi-phased project to build an intermodal hub that incorporates the Historic Depot.
- Phase 1 utility and track work 2007-09.



Utility and track construction

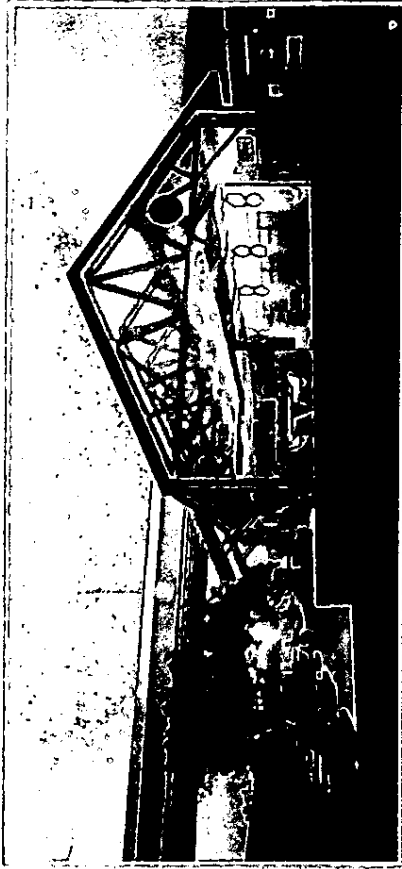


Design model

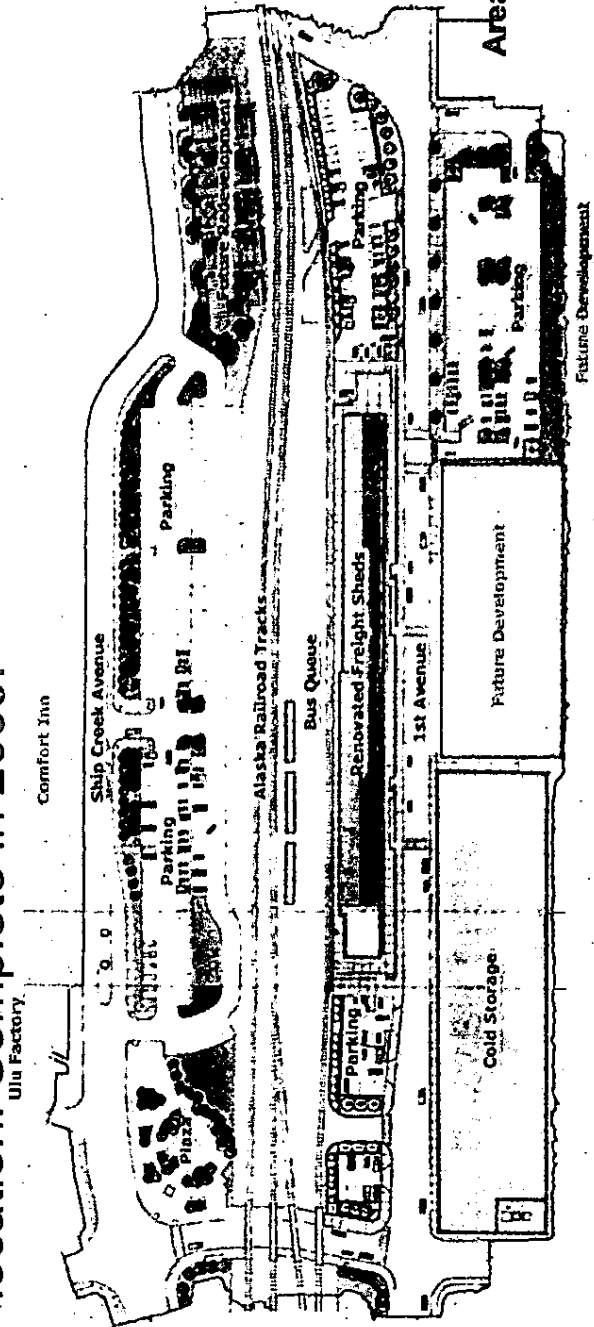


# Historic Freight Shed

- Renovate a 36,000 sf historic large timber freight shed into a LEED-certified office building.
- Green design, ample parking, raised sidewalk, downtown location. Complete in 2009.



Architect's rendition.



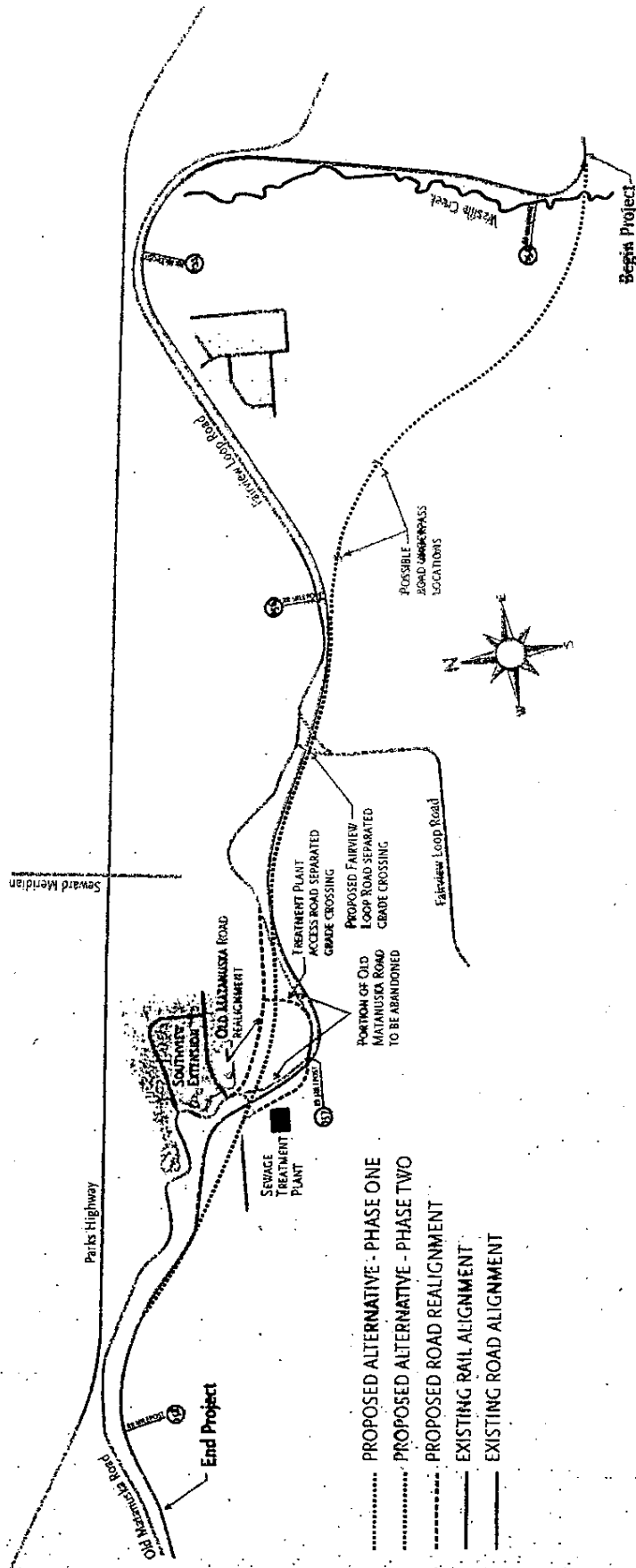
Area Site Plan



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# South Wasilla Rail Relocation

- Straighten curves along a 4-mile stretch in south Wasilla to eliminate at-grade crossings and increase track speed.
- EA complete, and new ROW land acquisition is underway. Construction cost of \$30 million is not yet funded.



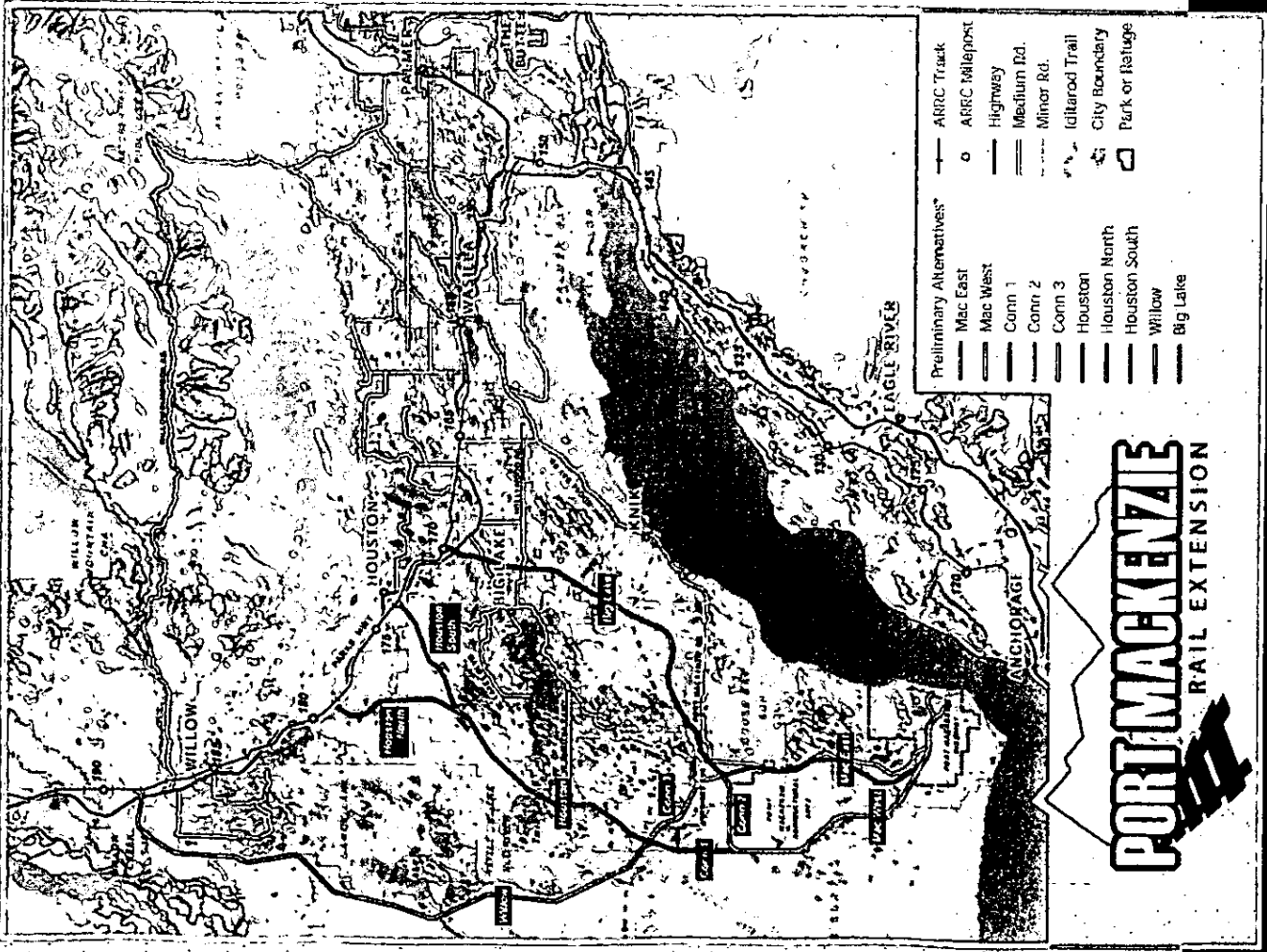
AlaskaRailroad.com

# Port Mackenzie Rail Extension

- Construct a 30- to 45-mile rail line to connect the port to the main line.
- Sponsored by the Mat-Su Borough, with \$27.5 funds allocated to date by the State Legislature to fund an EIS.
- Surface Transportation Board (STB) is overseeing EIS.



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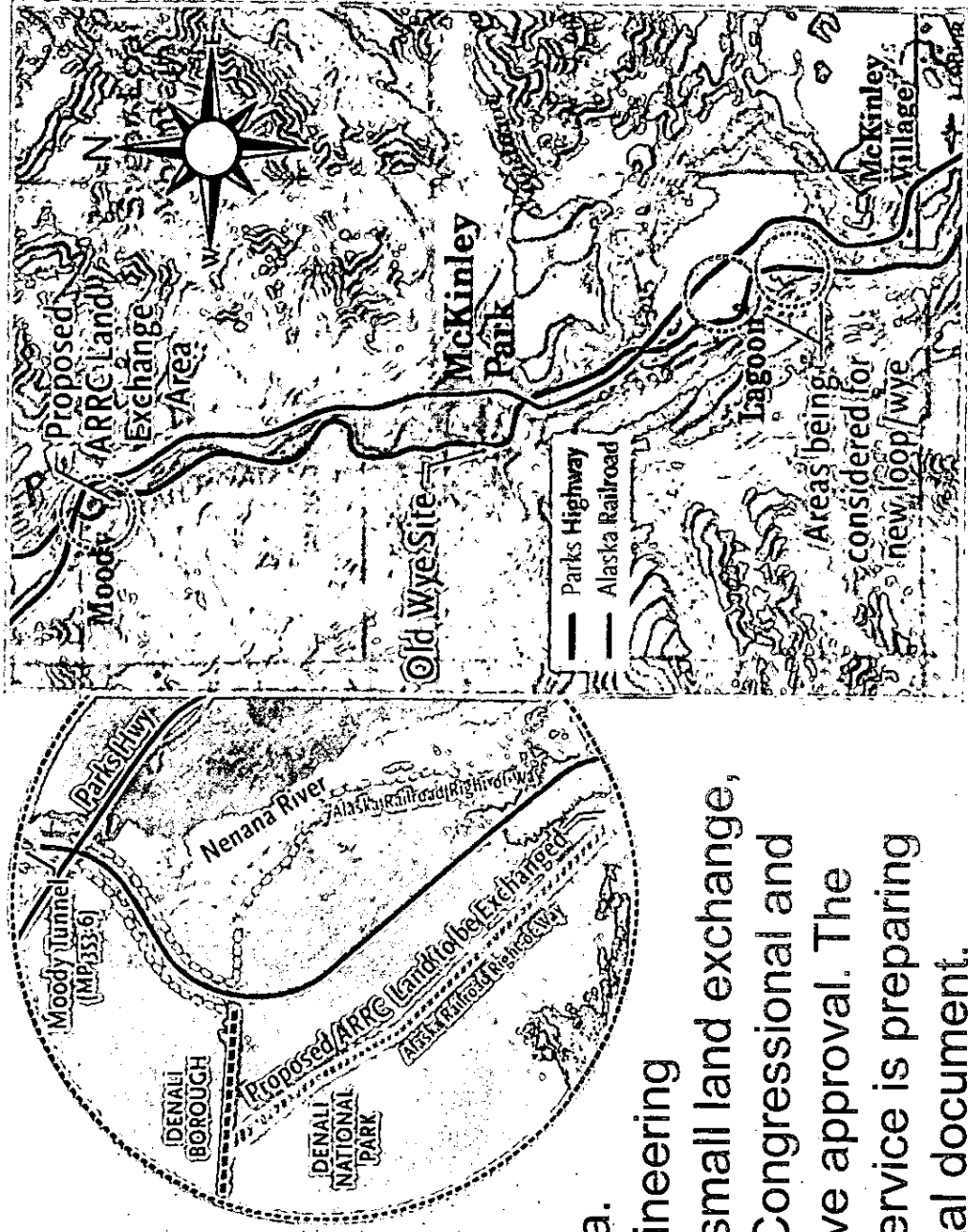


**PORT MACKENZIE**  
RAIL EXTENSION

# Denali Park Turnaround Track

Re-establish a loop or wye track to allow passenger trains to turn around in the Denali Park area.

Conceptual engineering recommends a small land exchange, which requires Congressional and Alaska Legislative approval. The National Park Service is preparing the environmental document.



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# Healy Canyon Stabilization

- Series of projects to stabilize track bed, control rock falls, reinforce tunnels and realign the track.
- 2009 Program: **\$900,000**. Moody Tunnel Phase 4

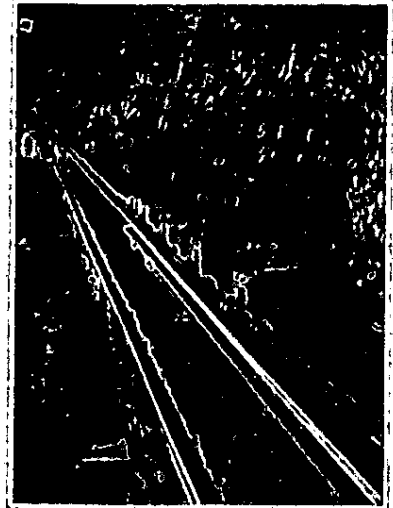


Moody Tunnel before and after a final blast to remove the top in April 2008.

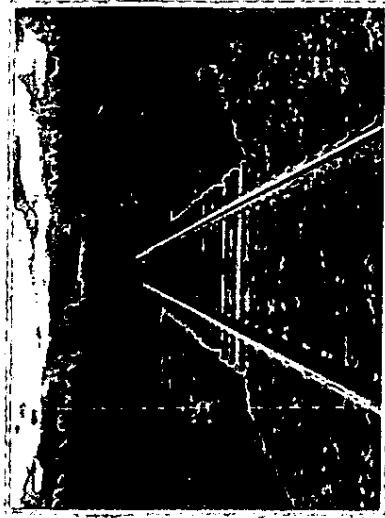


# FEMA: Track Flood Repair

In August 2008, three Alaska rivers overflowed, flooding several communities, such as Nenana, where road and rail were submerged.



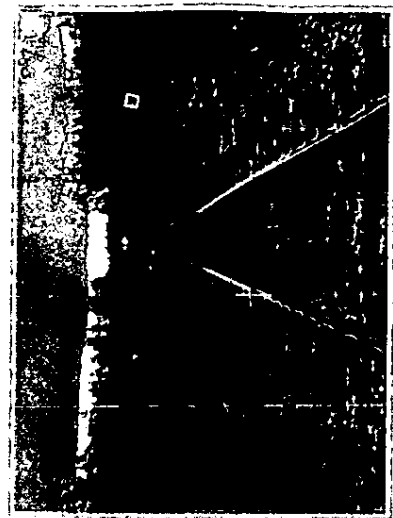
Flood waters flow over the track.



Track bed and ballast washed out.



Left: Aerial view show road and rail submerged near the bank of the Nenana River.  
Above: Submerged rail.



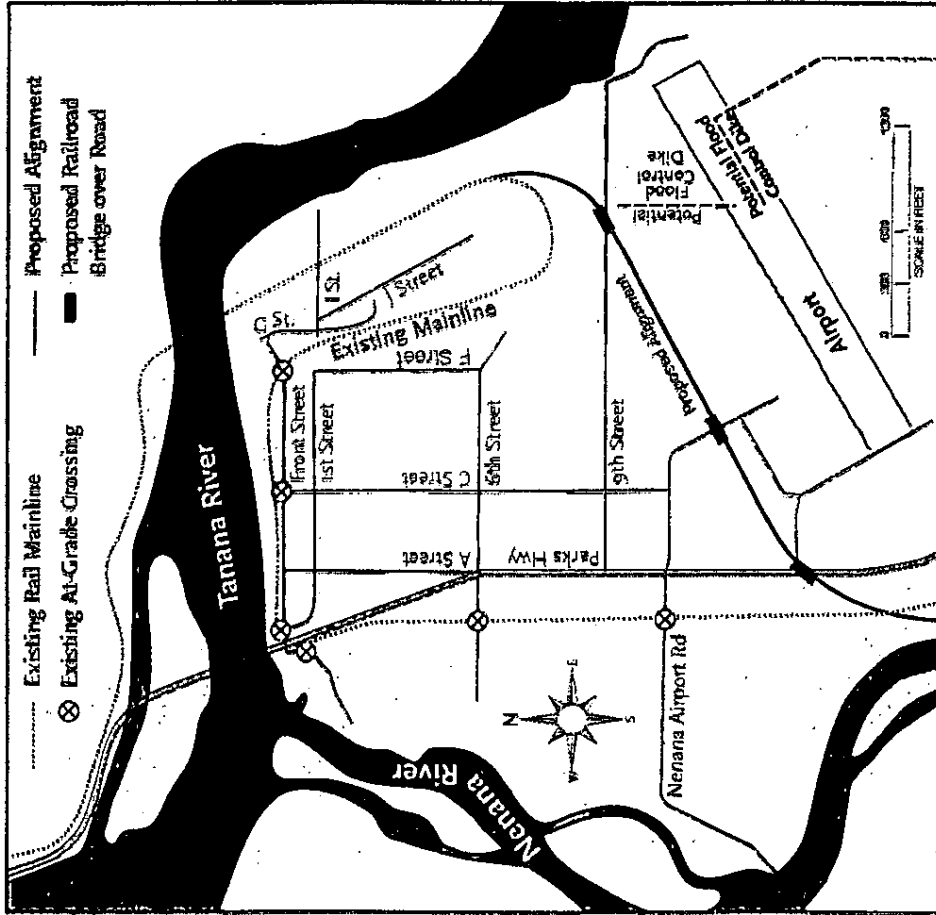
Work trains respond immediately to repair the washouts and other serious track damage.



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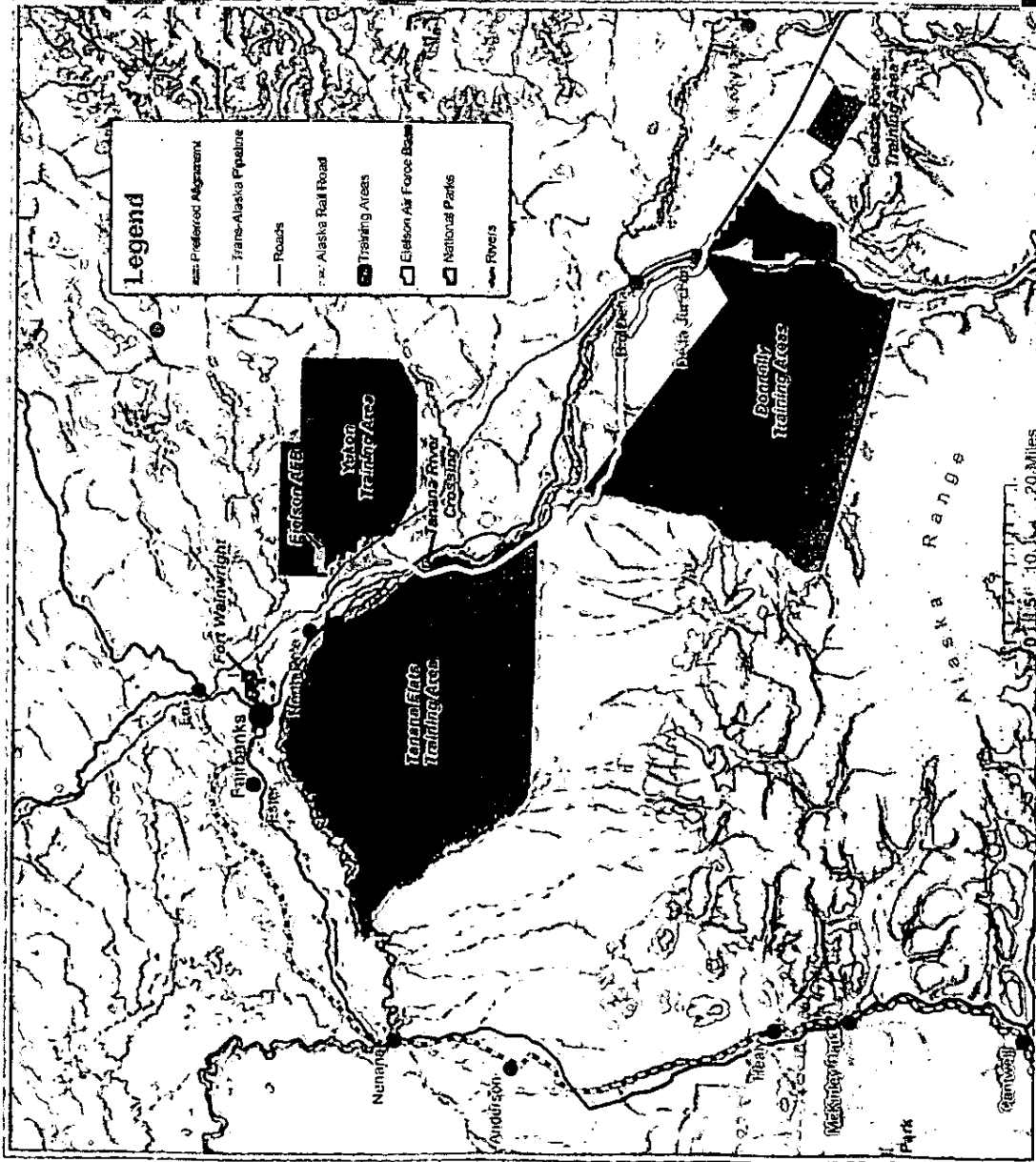
# Nenana Rail Realignment

Started in 2008 the project seeks to relocate the tracks around downtown Nenana. The EA was complete in 2004. Right-of-way land acquisition will be complete in 2009. Construction estimate of \$25M is not funded.



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# Northern Rail Extension



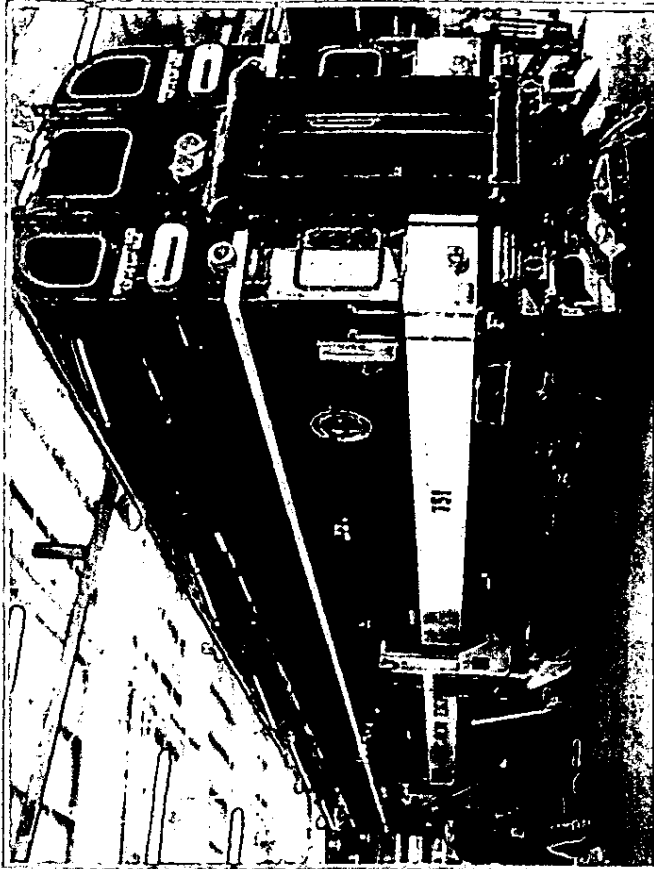
- Construct an 80-mile rail line between North Pole and Delta Junction
- Surface Transportation Board (STB) released draft EA for public comment in December 2008
- STB decision expected in 2009



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# Passenger Rolling Stock

- Colorado Rail Car built one self-propelled DMU and two bi-level railcars for 2009 service.
- Additional Passenger Equipment rehabilitation scheduled for 2009.



Delivery of the new DMU for service in 2009.



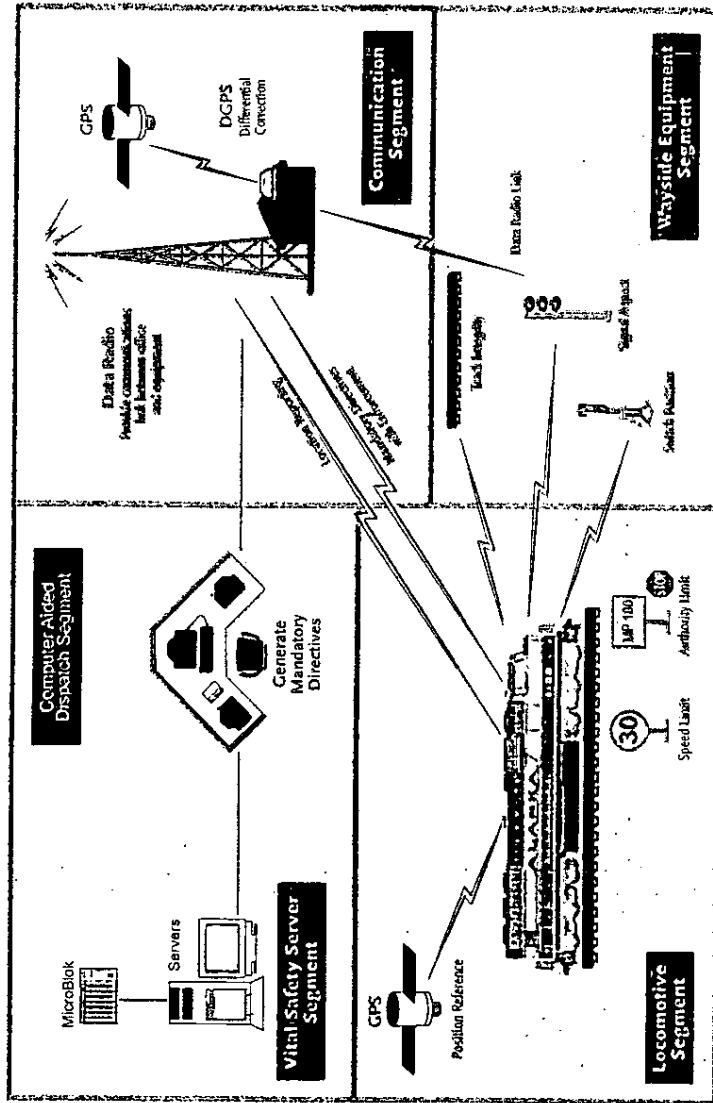
Two bi-level dome cars were delivered for GoldStar first-class service in 2009.



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# Collision Avoidance System

- Multi-phased project to develop and implement a train control system that greatly reduces the risk of human error.
- Integrates a computer aided dispatch system, locomotive on-board computer system, GPS locator, track-side detection devices and a dedicated communications network.



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# Historic Preservation

ARRC works with state and federal historic preservation agencies and organizations to preserve railroad history. Preservation efforts include educational and informational materials.

**Bridging the Gaps**

State engineers and President Franklin D. Roosevelt changed the Alaska Engineering Commission (AEC) into the Alaska Railroad Commission (ARC) in 1933. The ARC was responsible for the construction of the Alaska Railroad from 1933 to 1942. The ARC was also responsible for the construction of the Alaska Railroad's bridges and trestles.

**Ship Creek**

A railroad crossing the Ship Creek was established at Ship Creek, and then the ARC's first bridge was built at Ship Creek. The ARC's first bridge was built at Ship Creek in 1933. The ARC's first bridge was built at Ship Creek in 1933. The ARC's first bridge was built at Ship Creek in 1933.

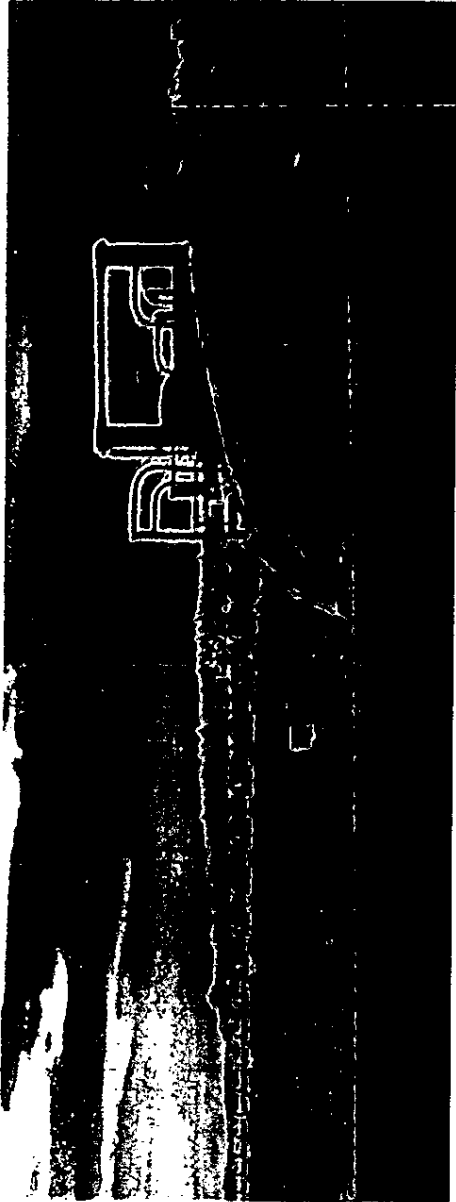
**Timber Trestle Bridges in Alaska Railroad History**

Timber trestle bridges were used extensively by the Alaska Railroad from 1933 to 1942. These bridges were built using local timber and were designed to be easily dismantled and moved to other locations. The Alaska Railroad's timber trestle bridges were a key feature of the railroad's infrastructure during its early years.



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# 1st Five Year Plan




2002 - 2006



# Here Is What Guides Us



## STRATEGIC PLAN



**MAY 2007**

<b>PRESIDENT'S OVERVIEW</b>	Setting the tone for this working document	<b>2</b>	
<b>FOUNDATION</b>	Energy, early vision & mutual cooperation	<b>5</b>	
<b>ARRC TODAY</b>	Assessing where we've been, who and what we are	<b>7</b>	
<b>MILESTONES</b>	Overriding, logical benchmarks and focus areas	<b>11</b>	
<b>LANDSCAPE</b>	Issues impacting the railroad environment	<b>15</b>	
<b>5-YEAR STRATEGIC PROGRAM</b>	Plan, communicate and implement initiatives	<b>20</b>	



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# The Methodology: Effects Based Thinking

- A way to help stay focused on the strategic level
- What is the high order effect we are trying to achieve?
- Formulate the desired outcome first, freeze it, then consider only the timely, affordable, relevant paths that can get you there



# Components of ARRC Planning

- **Strategic Level – “Forest”**
  - Describing the desired corporate outcome ... effects
- **Operational Level – “Trees”**
  - Major independent elements which jointly compromise the desired outcome.
- **Tactical Level – “Weeds”**
  - Bits and pieces that compromise each operational element.
  - ARRC project list goes here.



# Desired Strategic Effects

- Continue to improve safety
- Recruit, train, and retain quality employees
- Establish effective railroad security
- Improve financial soundness
- Improve productivity
- Build constructive community relationships
- Position for growth and sustainability



# Productivity

- **A product of:**
  - People x Stuff**
- Both need attention if you are trying to maximize the outcome
- Depends upon the concept of “balance” across the entire company, regardless of job
- The more employees “feel the love”, the more productivity you gain



# Productivity Comes From Satisfied Employees, But We Had ...

- No 401K match
- No retirement health care account
- Unhappiness over profit sharing
- Working conditions/quality of life needs repeatedly deferred ... failing to make the cut in the capital budget
- Extensive wage tiers creating resentment
- Guard/reserve considerations outdated
- Corporate training program lacking
- Sick leave abuse rampant

**Conclusion: We needed to do much more**



# **Tactical Activity: We Began Budgeting to Improve Productivity**

- Pay
- Benefits
- Workplace tool modernization
- Break/Rest Areas
- Workplace facility improvements
- Recruiting
- Schedules
- Rewards
- Training
- Mentoring



**First Five-Year  
Plan  
Achievements**

**2002 - 2006**



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# Safety

- Incident Command Center created
- Response plan, training, field exercises
- Employees create a user friendly Safety Manual
- National Safety Employee of the Year
- Harriman Award

Four record years out of last six

2006 Best Ever !!



# Safety (continued)

- 65% reduction in FRA reportable injuries
- 72% reduction in derailments
- ARRC FRA reportable train accidents 82% below US Railroad average
- Employee lost time down 60%

Wholesale Change in Safety Culture



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## External Affairs

63% → 85%

- ARRC public opinion poll approval:
- Six favorable bills passed in Juneau
- Employee Recognition Program started
- Corporate Branding Program started
- Moose Salvage Program started
- Rebuilt Corporate "Charitable" Giving program, ARRC external website, All Aboard, Community Ties newsletters
- Created Dispatch, Tenant Ties newsletter
- Community outreach visits increased to over 1,000/year
- Sea Train ... All Anchorage 5<sup>th</sup> graders to Sea Life Center
- Conducted 3 employee cultural surveys (2002, 2004, 2008)



# Corporate Recognition

## Corporate Awards

- 2004: Public Relation Society of America (PRSA):
  - Award of Excellence for 2004 Annual Report
- 2005: International Silver Davey Awards:
  - Consumer Magazine Advertisement – Industrial Strength
  - Print Collateral Annual Report – Alaska Railroad Annual Report
  - Print Collateral (safety advertisement) – Planes, Trains



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# Corporate Recognition

## Marketing Sales & Service Awards

- 2003: Seven awards given from *Onboard Services*. Overall best Railroad; 1st place in safety, Equipment, entertainment, uniforms, and food services; 2nd for onboard services.
- 2004: Rob Halpin receives Distinguished Service Award from National Defense Transportation Association



# Corporate Recognition

## Operations Awards

- 2005: Dwight West for Safety Person of the Year, American Short Line and Regional Railroad Association (ASLRRRA).
- 2004, 2005: “Jake” Award from the ASLRRRA for exceeding the industry safety average.
- 2006: Wasilla Chamber “Gold Award” for significant contributions to the visitor industry



# Real Estate

- New facilities brought on line
  - Airport, Denali and Fairbanks Depots
  - Anchorage Operation Center
  - Consolidated Projects and Signals Building
  - Facilities Maintenance Shop
  - Seward Intermodal Facility upgrades
  - Railroad Police / Security Building
  
- Ship Creek property development continues
  - The Bridge
  - C-Street Park
  - Paved parking lots, curbs, landscaping
  - Purchased Railroad HQ building
  - Trail improvements
  
- Fairbanks Terminal/Yard Heat Conversion Project completed...coal fired boiler plant shut down



# Real Estate

- Facilities department created
  - Cradle to grave comprehensive property management and maintenance
  - Owner-user concept applied
  - Standards developed for design, architecture, energy efficiency
  - \$11M account
- Real estate facilities acquisition strategy developed
  - “Bundling” for better market response, using debt



# Passenger Service

- 2008 sets another passenger revenue record
- GoldStar... first class upgraded service a big winner
- 2009: 2 New luxury bi-level coaches and a new self-propelled DMU to fit growing demand
- New charters:
  - 2007: Cruise Train and Princess “Straight to the Wilderness”
- New Services
  - 2008: U.S. Forest Service Whistle Stop – first site completed at Spencer



# Track Rehabilitation Program

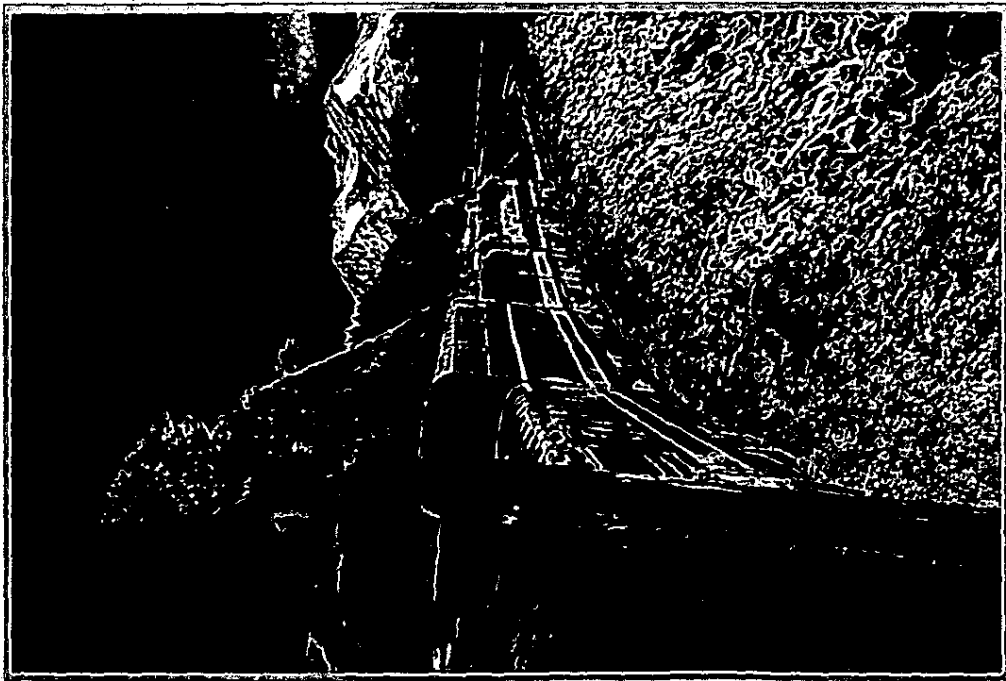
2006 - 2012

Project	2007 Actual	2001 Actual
Wooden Ties	61,052	30,600
Concrete ties	22,224	0
Welded Rail	45.72 miles	7.6 miles
Surfacing	319.38 miles	242 miles
Rail Grinding	500 miles	0
Rail Detection	2,000 miles	0
Bridge Replace/Rehab	10	6
Siding Upgrades	0	3

**Productivity!**



# What's in Our Future?



## Second Five Year Plan

2008 – 2012



# 2009 Budget: Challenges

- Core Business... train income from operations ... should be profitable
- Financial security ... betting the farm on Federal Entitlements is too risky
- Must reverse Operating Ratio trend line
- Railroad must create a culture of thrift throughout
- Railroad must improve ability to control costs despite a tough environment of seasonal demands



# Directions from the ARRC Board

- Improve Net Income from Operations and Operating Ratio in the 2009 Budget
- Look at ALL railroad areas for possible cost savings, including manpower



# Personnel Impacts, So Far

- 79 positions eliminated (attrition)
  - 39 Management (8 received layoff notices)
  - 26 Represented (attrition)
  - 14 Special Services
- 3 more management reclassified from expense to all capital
- 1 Assistant Vice President position downgraded
- 1 Assistant Vice President position eliminated
- 4 Director-level positions eliminated



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# 2009 Revenue Wild Cards

## Possible Gains

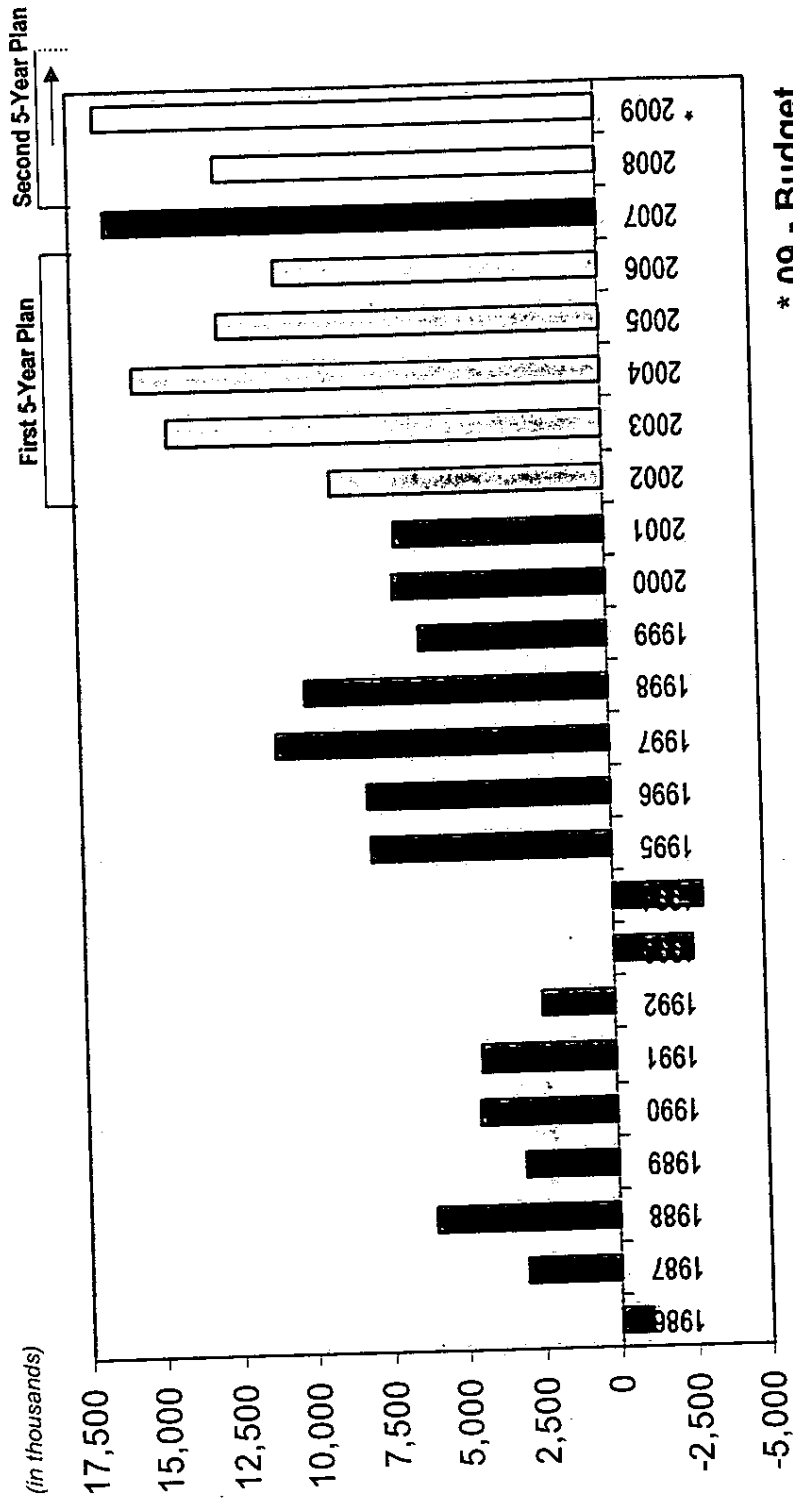
- Gravel
- Coal
- Pipe

## Probable Losses

- Petroleum



# Forecast Impact on ARRC Corporate Net Income



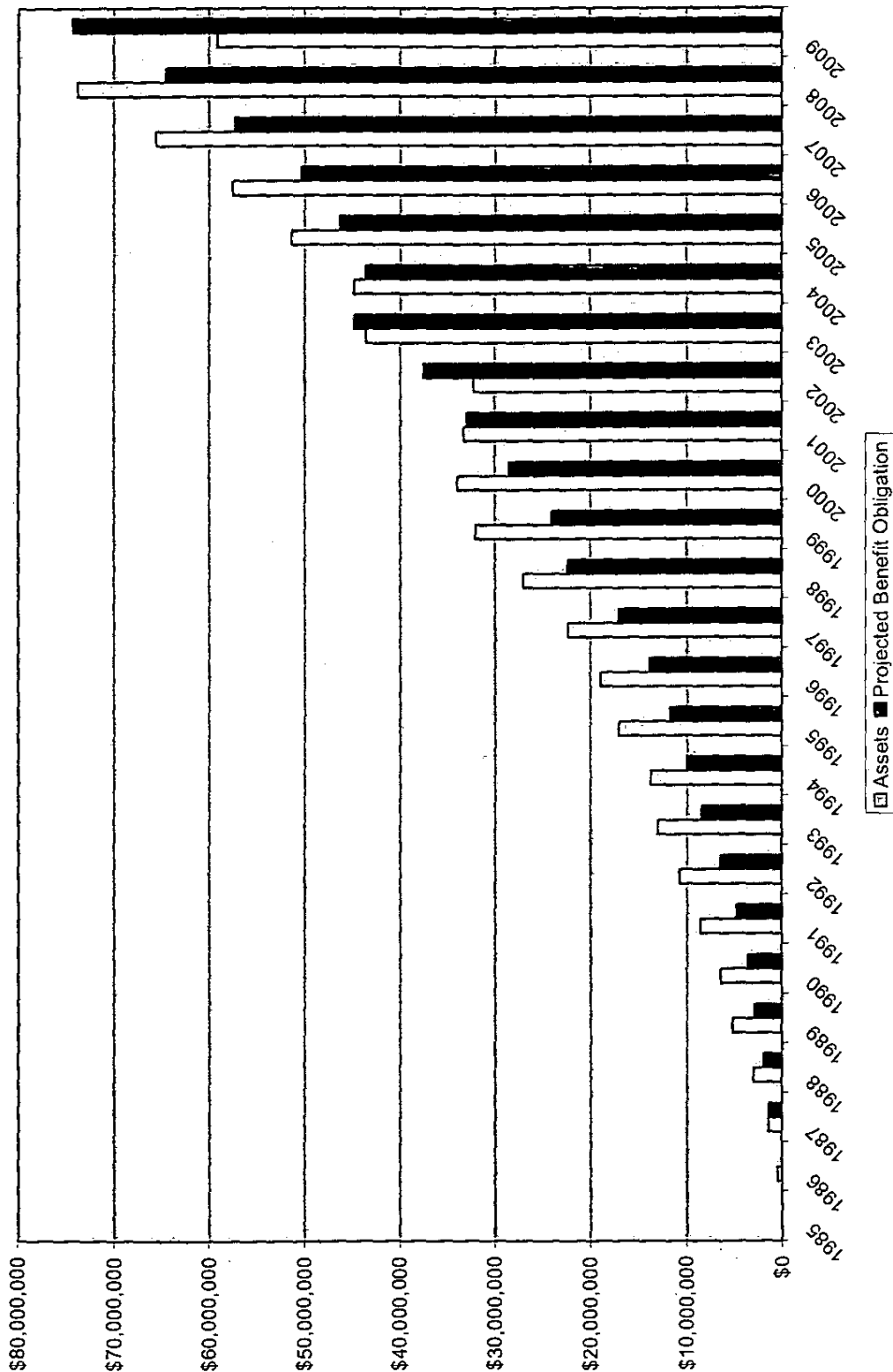
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# 2009 Status of Benefit Trust Funds

- Defined benefit pension trust fund totaled \$59.8 million
  - Down \$13.8.1 million from year end 2007
  - Liability exceeds funding by \$15.1 million (79.6% funding ratio)
- Retiree medical trust fund totaled \$19.0 million
  - Down \$2.6 million from year end 2007
- Considerable down-market impact



# Funded Status of the Pension Plan



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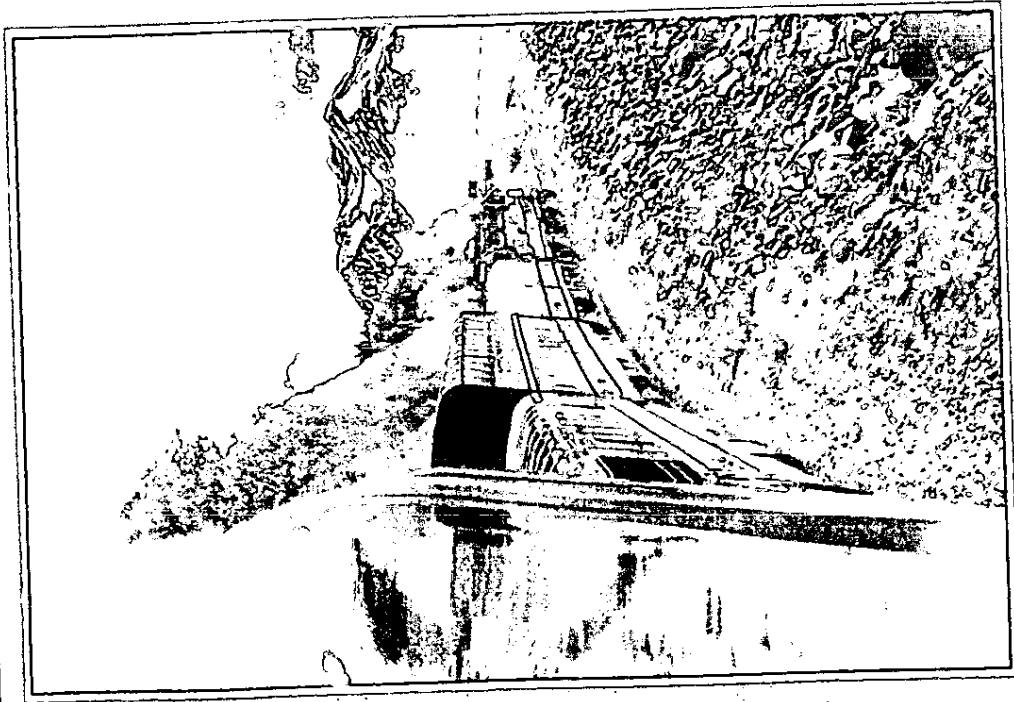
# **Pension Plan Administration**

- **ARRC Pension and Represented 401(k) Committee**
  - Two Union Members
  - Three Management Representatives
- **Retirement Specialist in Human Resources**



# How Does It Work?

## Alaska Railroad Post Retirement Medical Program



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# Post-Retirement Medical

- ARRC Labor Contracts (5 union contracts) provide that retirees can purchase ARRC medical insurance by paying 60% of the monthly premium.
- Non-represented employees are eligible for retiree medical coverage under ARRC policy
- Eligible retirees must be:
  - 62 or older under the ARRC Pension Plan (represented)
  - 58 or older under the ARRC Pension Plan (non-represented)
  - With the Civil Service Retirement System
  - On disability retirement

# Post-Retirement Medical

- Retirees who don't meet the criteria above can participate by paying 100% of the premium
- Certain surviving annuitants and family members can continue their participation following the death of the retiree on the same cost sharing basis
- Surviving dependent children of an ARRC pension plan participant are eligible to participate on the same cost sharing basis, without the requirement that there be a pension plan recipient



# Post Retirement Medical

- Deductible: \$500
- Co-insurance: \$80/20 up to \$1,500
- Includes prescription drug benefit
- Does not include audio, vision and dental coverage
- Medical Plan for retiree is identical to the plan for active ARRC employees

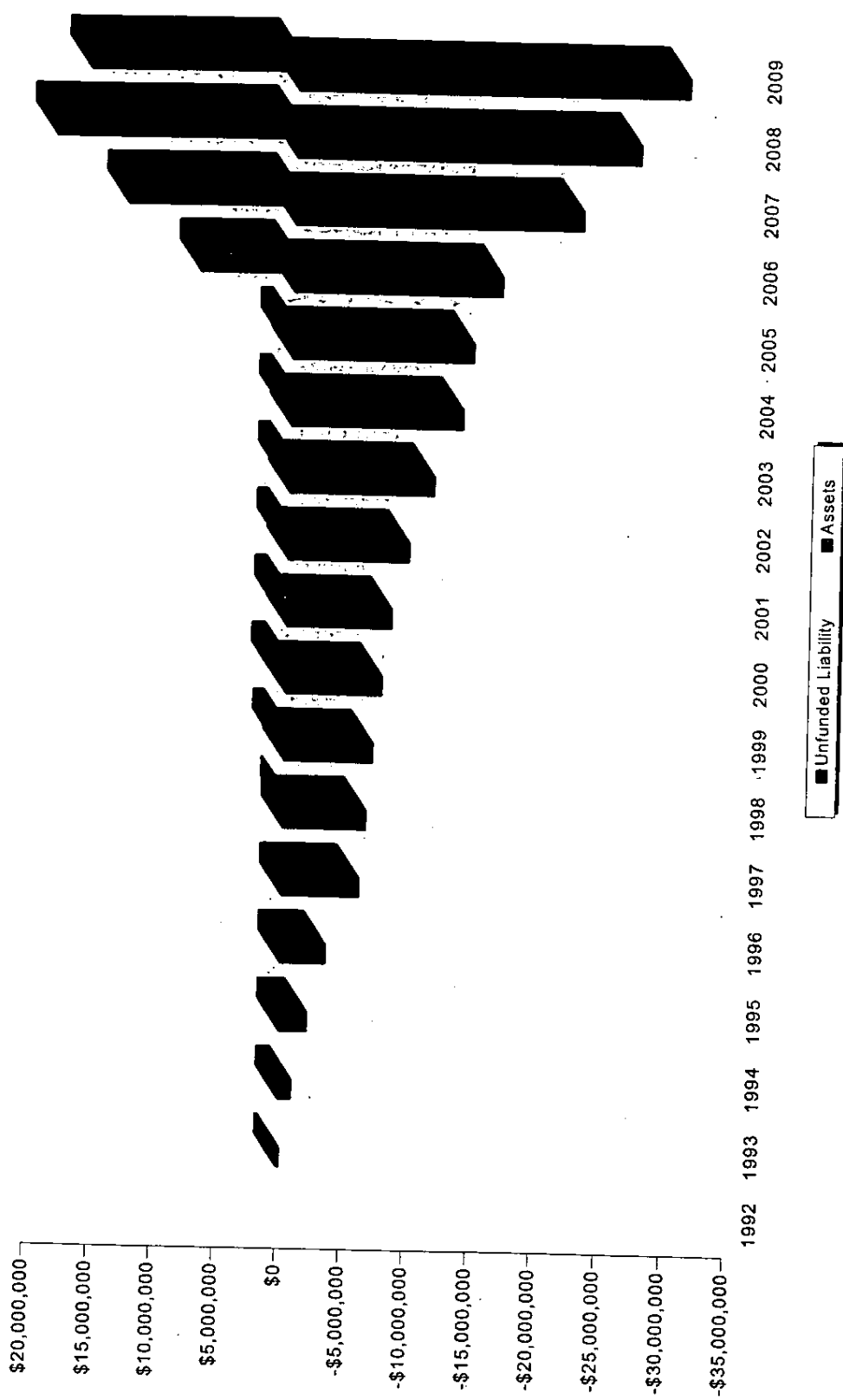


# ARRC Contributions

- In addition to the premium contributions, ARRC makes annual contributions to the Post Retirement Medical Trust based on the recommendations of the actuary. The 2008 contribution was \$2.8 million.



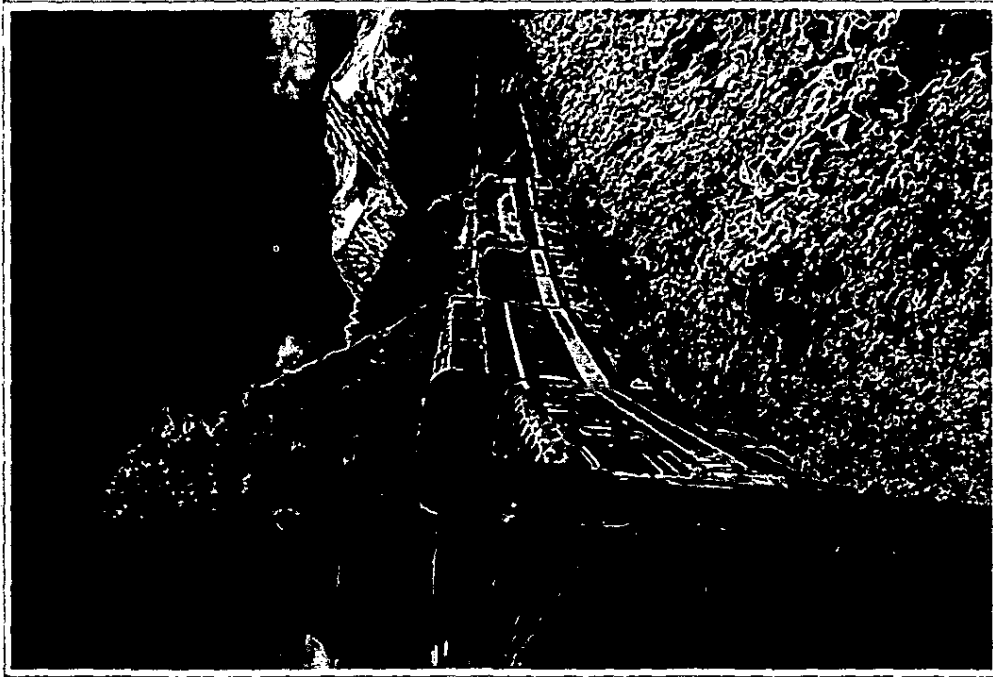
# Post Retirement Medical Expense/Accrued Liabilities/Assets



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# Hot Topics

## Issues impacting the rail belt

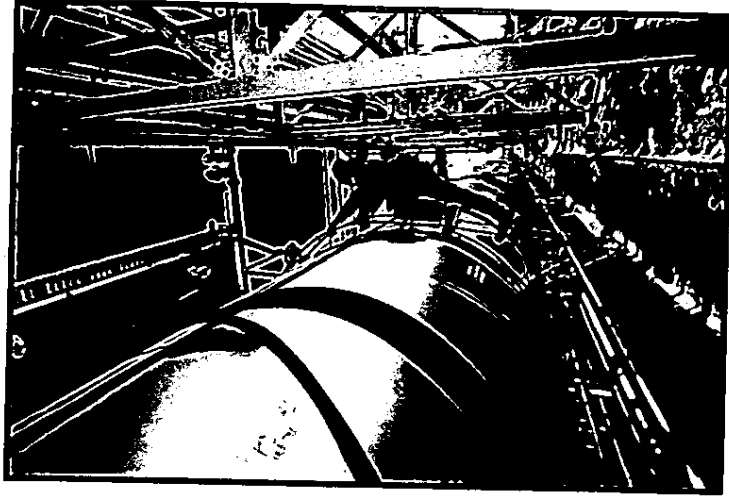


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# Importance of Flint Hills to ARRC

- **By far, ARRC's largest and most important customer**
  - 2007 Freight Revenue from Flint Hills Resources (FHR) - \$43.6M
    - 45% of total freight revenue
  - Year-round, high-margin business line buffers highly seasonal passenger/gravel revenue fluctuations
  - Land lease revenue >\$1.2 million/yr
  - ARRC contracts to maintain FHR leased fleet of ~400 tank cars at > \$1 million/yr



- **Partnership that heralded great potential when Flint Hills purchased the North Pole Refinery in 2004... but,**
  - While the petroleum compound annual growth rate (CAGR) between 1998 – 2003 = 11.5%...  
...the Flint Hills CAGR 2004 – 2008 = 1.2%
  - We have already experienced a 25% volume reduction (200 million gal/yr) between 2004-2008

# Flint Hills Resources at Crossroads

■ FHR had originally indicated it was considering 3 alternatives, with a decision to be made by end of 2008:

**1. Preferred Option:**

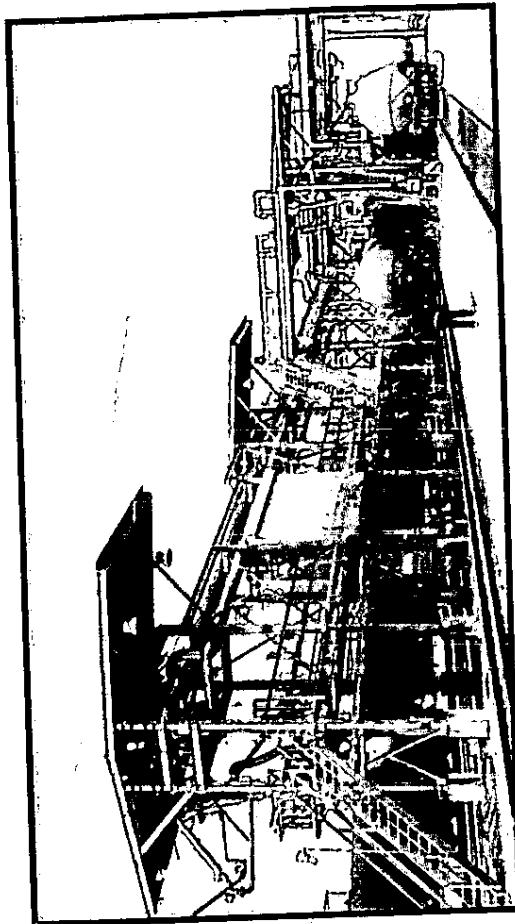
Major capital investment into North Pole Refinery, significantly increasing production capabilities to Alaska, Pacific Rim.

**2. Practical Option:**

Give up on Alaska... sell North Pole Refinery.

**3. Last Resort:**

Convert to "terminal operation." Minor amount of refined fuel is shipped north to Fairbanks and there distributed by truck. Refinery closed. Flint Hills jobs lost ~165.



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# Impact of Terminal Scenario

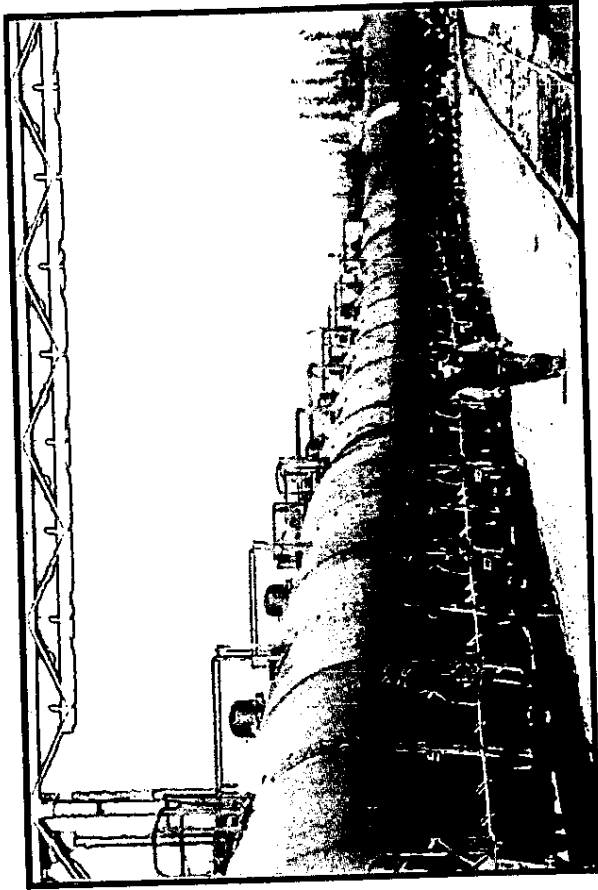
- **Option #3 would devastate ARRC's economic contribution to the State of Alaska**
- **To fulfill statutory mandate of self-sufficiency, massive restructuring of ARRC would be required**
  - Roughly \$25-30 million/yr in expense reductions would need to be offset
  - **200+ high-paying railroad position eliminations**, divestiture of locomotives/track equipment, draconian reductions in rail service and railbelt capital programs necessary
  - Precipitous drop in winter cash flow would necessitate a close look at the ability to provide year-round interior train service.



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# Railroad Bottom Line

Almost overnight, the Alaska Railroad would cease to be one of the State's most successful and well-recognized annual economic contributors.



# Impact of Terminal Scenario

## ■ Economic Impact to Alaskan communities significant

- ISER quantified impact of ARRC reductions on Alaskan communities
  - 250 non-ARRC jobs lost due to ARRC reductions
  - Another \$21 million/yr in non-ARRC payroll lost
- Many, many more Alaskan jobs at serious risk from economic shockwave
  - Fairbanks, North Pole, Municipality of Anchorage, Anchorage International Airport, Port of Anchorage
- Loss of annual capital expenditures in the tens of millions/yr.  
Significant annual railbelt work that typically uses Alaskan-owned businesses, labor and material purchases, dries up.
- Anchorage International Airport left with a single source of jet fuel.
- Alaska would need to import POL products and ship them north.

