AMENDMENT 3474 – To ensure that Amtrak no longer consistently loses money on food and beverage services

AMENDMENT DESCRIPTION

Although the underlying bill requires Amtrak to prepare a "performance improvement plan" regarding Amtrak's poor financial results, the bill does not require any substantive steps to reverse Amtrak's significant income losses related to food and beverage services. Also excluded from the underlying bill are any punitive measures for poor performance or financial losses. While such losses would generally provide enough of an incentive for a regular firm to thoroughly examine its business practices, the large taxpayer subsidy provided to Amtrak allows it to subsist in the absence of needed reforms.

This amendment requires Amtrak to do the following:

1) Calculate and report quarterly to the Department of Transportation and Congress the quarterly profit or loss, by route or rail line, of food and beverage services;
2) Restructure food and beverage service contracts for any individual rail line that loses money on food and beverage services in any one fiscal year; and
3) Eliminate food and beverage services for any individual rail line that loses money on food and beverage services for two consecutive fiscal years.

The amendment allows Amtrak to reinstate food and beverage services on individual rail lines after at least one year following prohibition and after Amtrak submits a profitability plan to the Department of Transportation that will result in food and beverage service profitability in each of the next five fiscal years.

Amtrak has a long history of losing money on food and beverage services

In an exhaustive 2005 audit of the financial performance of Amtrak's food and beverage services, the Government Accountability Office (GAO) found that between fiscal years 2002 and 2004, Amtrak lost $244 million from its food and beverage operations. According to the GAO report, "This means that Amtrak spends about $2 to earn $1 in food and beverage revenue."[1] In the absence of a large federal subsidy, these types of losses would be unsustainable. However, billions of dollars in taxpayer funding for Amtrak have allowed it to continue money-losing services without implementing significant, firm-wide reforms.

As the Congressional Research Service (CRS) wrote in a report just issued a few days ago, "[Amtrak] runs a deficit each year, and requires federal assistance to cover operating losses and capital investment. Without a yearly federal grant to cover operating losses, Amtrak would not

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[1] "Improved Management and Controls Over Food and Beverage Service Needed", Government Accountability Office, August 2005

survive as presently configured."[2] The same CRS report also stated that "there are inadequate incentives for Amtrak to provide cost-effective service[.]"

GAO succinctly summed up the effect of Amtrak's inability to get food and beverage costs under control. "Amtrak's food and beverage service may represent a relatively small part of the company's operating budget, but it speaks volumes about Amtrak's need to get its operations in better order."

A letter from William L. Crosbie, Senior Vice President for Operations at Amtrak, to GAO, contains an even more damning conclusion about the viability of Amtrak's food and beverage operations:

> [E]ven if we were able to achieve 100 percent certainty that the amount we are charged is accurate and that the handling of food and beverage from the commissary to the train, its sale to the passenger or its return to the commissary were letter perfect, Amtrak would still lose a significant amount of money on food and beverage service. The principal reason for this is due to the high cost of labor to provide this service.[3]

Amtrak has had such a long history of mismanaging its food and beverage operations that legislation as far back as 1979 attempted to address the problem. The 1979 law required Amtrak to submit to Congress a plan for an "operational improvement program," which included the requirement that Amtrak implement an "[a]djustment of purchasing and pricing of food and beverages to achieve […] a continuing reduction in losses associated with food and beverage services with a goal of ultimate profitability."[4]

That law and the fact that current law prohibits Amtrak from losing money on food and beverage services prove that the current system has not sufficiently fixed the problem.

<u>According to GAO, Amtrak paid a wholesale price of $3.93 per bottle of beer</u>

One of the main findings of the GAO report was that Amtrak "is not fully exercising prudent management techniques to control its food and beverage costs[.]" For example, GAO found that Amtrak was paying as little as $0.43 or as much as $3.93 per bottle of Heineken beer. Although Amtrak claimed that the $3.93 data point was a data entry error, no documentary evidence was provided to support the claim. According to GAO, "[I]n fiscal years 2002 and 2003, payments of over $400,000 for 12-ounce Heineken beer varied from $0.43 to $3.93 per bottle."

According to one Amtrak menu available online, Heineken beer is sold for $4.50 bottle, which means that in some instances, Amtrak may have made a profit of as little as $0.57 per bottle before even taking into account the costs of distribution, storage, or labor.[5] Another Amtrak

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[2] "Amtrak: Budget and Reauthorization", Congressional Research Service, October 25, 2007
[3] Letter from William L. Crosbie to JayEtta Z. Hecker, August 2, 2005
[4] "The Past and Future of U.S. Passenger Rail Service", Congressional Budget Office, September 2003
[5] "Dining Car Menu", undated Amtrak menu

menu suggests that Heineken is sold for $5.25 per unit.[6] Either way, such small profit margins are one example of why Amtrak struggles to make a profit selling food and drinks.

"Amtrak product pricing excludes labor costs"

GAO identified the problem embodied by high labor costs when it noted that "Amtrak's product price to the customer does not take into account over half of Amtrak's total food and beverage costs." To make matters worse, GAO auditors found Amtrak's product pricing "excludes labor costs." Quite simply, it is impossible to make money selling a product if you pay more for it than you receive when you sell it. Sadly, Amtrak does not appear to have internalized this simple mathematical principle.

Amtrak's "target profit margins do not take into account Amtrak's on-board labor costs, which [GAO's] work has determined is estimated at over half of Amtrak's food and beverage total expenditures."

"Amtrak's food and beverage product pricing seems to ensure that its food and beverage service will not be profitable," the report stated.

Between fiscal years 2002 and 2004, 52.6 percent of Amtrak's expenditures on food and beverage services were attributable to Amtrak's labor costs. In a world of vending machines, food stands, and prepackaged foods, these costs are simply unsustainable if Amtrak ever wishes to make a profit by selling food and drinks.

Amtrak VP testifies that food service is not supposed to make money

In 2005 testimony before a House Transportation and Infrastructure subcommittee, Amtrak vice president William Crosbie stated, "Food service in the travel industry is not meant to make a profit."[7]

"Instead," Crosbie testified, "it was intended to maximize ticket revenues." By now, it should be obvious that this strategy has failed Amtrak and has failed the American taxpayer. According to an article in the New York Post from less than a week ago, "A record 25.8 million passengers took Amtrak in the last fiscal year, an increase of 1.5 million over 2006[.]"[8] It is readily apparent that Amtrak is maximizing ticket revenues.

However, the company is still hemorrhaging money. In 2006, Amtrak's net loss totaled more than $1 billion.[9] With 2006 revenues of $2 billion and expenses of over $3 billion, Amtrak's

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[6] "Amtrak California Zephyr Lounge Car Menu", 2006
[7] Testimony before the House Transportation and Infrastructure Subcommittee on Railroads, William L. Crosbie, June 9, 2005
[8] "Amtrak Ridership Hits A Record", New York Post, October 24, 2007
[9] "National Railroad Passenger Corporation and Subsidiaries (Amtrak), Consolidated Financial Statements For the Years Ended September 30, 2006 and 2005", March 7, 2007

expenses are still a sky-high 50 percent above revenues. In August of this year, Amtrak reported in its monthly submission to Congress a projected fiscal year 2007 income loss of $1.035 billion.[10] Amtrak's strategy of losing money to make money is simply not working.

Major airlines, which have been aware of cost issues associated with food service, recognized the problems years ago and took quick action. A January 2006 article in the Los Angeles Times noted that several airlines took drastic measures to cut costs:

> Saddled with huge losses and desperate to reduce spending, the airlines have eliminated the Salisbury steaks, lasagna and fish fillets that coach passengers on domestic flights once took for granted.
>
> Except in first class and on long international flights, where meal service is still the rule, airborne dining has been reduced to snack boxes, sandwich wraps and salads costing $3 to $5 — and only if the flight is at least two or three hours long.[11]

The same article also quoted one American Airlines official who said, "[B]y eliminating complimentary food we were able to save $30 million in our food and beverage budget each year[.]"

"Amtrak pays about 3.5 times the amount paid by comparable U.S. restaurants for labor"

According to GAO, in fiscal years 2002, 2003, and 2004, Amtrak's food and beverage service labor costs were higher than the total revenues from food and beverage service. Between 2002 and 2004, Amtrak's total labor costs for food and beverage service were nearly $14 million more than total revenues. Total expenses exceeded total revenues by $244.5 million dollars. The net loss for food and beverage service even exceeded total revenues.

Table 1: Amtrak's Estimated Food and Beverage Revenue and Expenses (by Major Category), Fiscal Years 2002 to 2004

	2002	2003	2004[c]	Total	Percent of Total Expense (%)
Total food and beverage revenues[a]	**$ 84,100,000**	**$ 78,400,000**	**$ 80,400,000**	**$ 242,900,000**	
Expense Category					
Amtrak Labor Costs	$ 83,768,416	$ 83,257,574	$ 89,162,529	**$ 256,188,519**	52.6
Payments to Gate Gourmet	$ 63,754,973	$ 59,769,085	$ 61,893,852	**$ 182,422,910**	38.0
All Other Amtrak Food and Beverage Expenses[b]	$ 16,961,343	$ 15,775,092	$ 13,123,348	**$ 45,859,910**	9.4
Total Food and Beverage Expenses	**$ 164,489,732**	**$ 158,801,751**	**$ 164,179,729**	**$ 487,471,212**	**100.0**
Profit or (Loss)	**$ (80,389,732)**	**$ (80,401,751)**	**$ (83,779,729)**	**$ (244,571,212)**	

Source: GAO analysis of Amtrak data.

Notes

[a]Revenues include a portion of first class ticket revenue dedicated toward food and beverage revenues.

[b]"All Other" expenses include such items as utilities, office supplies, crew meals, and reusable support items such as crockery and glassware.

[c]All 2004 figures are unaudited.

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[10] "Monthly Performance Report for August 2007", Amtrak, October 19, 2007
[11] "Airline cuts give caterers bumpy ride", Los Angeles Times, January 17, 2006

In congressional testimony in 2005 regarding Amtrak's unusually high labor costs, Amtrak Inspector General Fred E. Weiderhold, Jr. noted that "Amtrak pays about 3.5 times the amount paid by comparable U.S. restaurants for labor[.]"[12] The New York Times reported in 2005 in an article entitled "Beyond Brakes, Amtrak's Woes Hit the Cafe Car" that "Amtrak's work force is unionized and receives health benefits, which is not the norm in restaurants."[13]

According to the inspector general's testimony, "Amtrak food service workers are compensated more than $54,000, while comparably skilled food service workers are compensated $14,450 to $15,835." To be fair, unlike their counterparts in more traditional food service jobs, Amtrak food service employees are typically away from home for days at a time. However, there is no good reason why Amtrak labor costs should be more than three times higher than those of traditional restaurants.

His testimony also provided additional figures to illustrate Amtrak's out-of-whack labor costs:

> Depending upon the type of food service offered, it costs Amtrak anywhere from 2 to 4.5 times the amount paid in labor by the U.S. restaurant industry to generate each $1.00 in sales. It costs comparable U.S. restaurants approximately $0.33 in labor to generate $1.00 in food and beverage sales while it costs Amtrak anywhere from $0.64 to $1.51 in labor to generate each $1.00 in food and beverage sales.

Reforms of the food and beverage services at Amtrak can result in significant cost savings to both Amtrak and American taxpayers, who have given the company over $6 billion worth of federal subsidies since 2003.[14] The inspector general testified that tens of millions of dollars could be saved if Amtrak adjusted its costs to better match those of the restaurant industry in the U.S.:

> The total financial benefit that Amtrak would accrue if it could operate its existing food and beverage operation at the U.S. Restaurant Industry expense to sales ratios is almost $100 million annually.

<u>The reforms required in the amendment are proven to be effective</u>

According to a January 18, 2007 letter from the inspector general for the Department of Transportation, food and beverage service contract negotiations have been effective at reducing costs. The letter noted that contract renegotiations with Gate Gourmet, an Amtrak food service contractor, saved $937,500, and renegotiated contracts with other suppliers and realized savings of $5.2 million.[15] The same letter also disclosed that Amtrak saved $2.4 million by eliminating food service on the Empire Corridor train route.

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[12] Testimony before the House Transportation and Infrastructure Subcommittee on Railroads, Fred E. Weiderhold, Jr., June 9, 2005

[13] "Beyond Brakes, Amtrak's Woes Hit the Cafe Car", New York Times, June 10, 2005

[14] "Fiscal Year 2008 Congressional Budget Submission", Federal Railroad Administration

[15] Letter from Calvin L. Scovel, III to Sen. Patty Murray, Sen. Kit Bond, Rep. John Olver, and Rep. Joe Knollenberg, January 18, 2007

However, while these recent actions are encouraging, Amtrak must address its financial problems across the entire company. By requiring Amtrak to calculate food and beverage service profitability per route or rail line, this amendment will result in a complete financial picture, which will in turn allow Amtrak to make better decisions about the allocation of its resources. And, if a certain route is unable to create a profit on food and beverage service, then Amtrak will be required to eliminate the food services until it can demonstrate to the Department of Transportation that it will attain profitability on food and beverage services in each of the next five fiscal years.

Some may argue that profit losses in food service are necessary in order to lure customers and maximize revenue. However, Amtrak's continued losses from food and beverage service operations have not even come close to helping the company improve its bottom line. In both 2005 and 2006, Amtrak lost more than $1 billion. It is clear that Amtrak's taxpayer-subsidized strategy of losing money to make money is ineffective.

This amendment provides incentives to Amtrak to address both procurement and labor costs and gives the company the flexibility to use a broad set of tools to address cost overruns.