

Enterprise Denied: The Bankruptcy of Industrial Rail Services, Inc.

Extracted from

Revitalizing New Brunswick's Rail Sector



By

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1.0 Introduction

It might be asked why the receivership and bankruptcy of privately-owned Industrial Rail Services, Inc. (IRSI) should be a component of a report covering what seem to be public sector decisions concerning the future of New Brunswick's rail sector. In fact, this issue is very much the result of public policy decisions by the federal government and the consequent actions taken by publicly-owned VIA Rail Canada.

The collapse of IRSI is a graphic illustration of all that is wrong with Canadian rail passenger policy, funding, management and service delivery. It involves actions taken by a seemingly unaccountable management team that not only have had severe repercussions for IRSI, but for VIA itself. Behind this lurks the question of federal government rail passenger policy and funding, which are largely responsible for the decisions made by VIA management.

The whole matter came to a dramatic climax on March 16, 2012, when VIA Rail Canada terminated its contract with Moncton's IRSI for the remanufacturing of 98 Light, Rapid, Comfortable (LRC) coaches. This was one of three contracts signed with IRSI in 2009 and 2010 for the modernization and upgrading of up to 163 pieces of rolling stock of three types at an estimated total cost of \$117.3 million.

At the time, no one asked VIA why the corporation had even been rebuilding rolling stock that was largely obsolete and should have been scrapped, not remanufactured. It has been suggested by rail industry insiders that this decision was a direct result of inadequate funding to allow for the complete renewal, not re-manufacturing, of a large portion of VIA's fleet.

No questions have yet been asked publicly about VIA's desperate need for reliable rolling stock on a daily base to cover its operations. What effect has the termination of the IRSI projects – particularly the LRC contract – had on VIA's ability to cover its daily operating needs and respond to pressure from Ottawa to reduce its annual funding?

One must also wonder about the managerial decision-making process that led to the cancellation of these projects when the contractor was not only willing to make good on its obligations under its contracts with VIA, but had investment in additional facilities and equipment to ensure the work was done to a very high standard.

Furthermore, from a public policy point of view, there is the question of the effect of the cancellation of all three of these contracts on 240 skilled IRSI workers, the regional economy and the local industries on which IRSI had depended for many of its supplies.

While virtually nothing has been said publicly by VIA or the federal government about the IRSI bankruptcy and its impact on VIA, that wasn't the case when the contracts were signed on May 4, 2009, and March 29, 2010. Back then, VIA staged two media events at the IRSI Hump Yard Road plant, which were well promoted and attended. These events gave VIA executives and members of the federal government the opportunity to enthuse about IRSI's capabilities and its impact on the local economy.

At the first, when the contracts for the rebuilding of 98 LRCs and modification of up to 59 Renaissance cars were announced, VIA president Paul Côté said:

“I know the people of Industrial Rail Services will deliver equipment that will be world class. We’ve benefitted from their unique craftsmanship, which they applied to the rebuilding of our rail diesel cars in 2001. I congratulate Dick Carpenter and his highly-skilled team. You are not only maintaining Moncton’s role in the evolving saga of the iron horse, you are taking it to new heights. Your specialized work on the LRC and Renaissance cars will bolster that reputation.”

At the second ceremony, announcing the \$12.6 million contract for the modernization of six Budd rail diesel cars (RDCs), Côté’s successor, Marc Laliberté, said:

“The awarding of this contract for the rebuilding of our RDC fleet is yet another tribute to the unique skills and expertise the people of IRSI bring to every project. You are helping all of us at VIA prove that the road to the future is paved with steel wheels.”



FROM PRIDE TO PARIAH: When the company was on the upswing, politicians such as Moncton Crescent MLA John Betts (right) and New Brunswick Premier Bernard Lord (centre) flocked to the IRSI plant to participate in photo-op events with IRSI founder and owner, Dick Carpenter (left). They all vanished when VIA Rail Canada forced the firm into bankruptcy on highly questionable grounds that raise concerns about the management of what has become a highly-politicized Crown corporation. Photo courtesy of MLA John Betts

When this all imploded in early 2012, VIA managers gave the media a few negative comments about IRSI but little detail; the politicians said nothing. No statements were made by Richard “Dick” Carpenter, the Moncton heritage property developer who founded IRSI.

So, what happened? And what impact does it have not only on New Brunswick’s economy, but on the functioning of an undeniably troubled national passenger railway? What follows is an attempt to answer those questions and assess the solutions in light of IRSI’s owner’s stated intention to restart the business in the near future.

2.0 Consultant’s Disclosure

In the interests of full disclosure, it should be known that this consultant has had a working relationship with IRSI since 2009. This began with work on behalf of VIA’s Public Affairs Department, preparing the media materials for the two contract signing ceremonies in Moncton.

Increased contact with IRSI staff occurred between 2010 and 2012, when this consultant served as transportation policy adviser to Peterborough MP Dean Del Mastro on his plan to re-launch rail passenger service between his riding and Toronto. It was this consultant’s recommendation that remanufactured RDCs be purchased from IRSI for that service and operated on the line under VIA auspices.

Contact was maintained throughout the period of the IRSI receivership and bankruptcy, during which time this consultant served as the director of Transport Action’s National Dream Renewed campaign. IRSI shared a limited amount of information at that time.

Most importantly, it should be noted that Industrial Rail Realty, Inc. (IRRI) – part of Mr. Carpenter’s Heritage Group of companies and a creditor under the bankruptcy plan – later asked this consultant to review additional documentation and recommend a possible program to get the company’s side of the story told. That report was delivered to IRRI on December 6, 2012, although the company has taken no action short of a CBC Radio *Information Morning Moncton* interview with Mr. Carpenter on September 20, 2013, and an article in the Moncton *Times & Transcript* on October 3, 2013.

Despite this long and productive relationship with IRSI, this consultant has attempted to let the documentation provided by IRSI (including much correspondence from VIA) and the views of others intimately involved guide this recounting of the story of the three failed VIA contracts. VIA has said little about this situation, so not all the facts and opinions of the two parties are yet on the table.

Nonetheless, the end result of all of this still remains the collapse of what appeared to be a viable New Brunswick railway supply firm and an extreme delay in the seriously overdue renewal of VIA’s fleet.

3.0 IRSI's Track Record

IRSI was established in the former CN Moncton Diesel Shop at Gordon Yard in 1999. The facility became available as a result of the ongoing CN retrenchment in the Maritimes, which included the closure of the hump classification facilities at Gordon Yard and the reassignment of repair work to other CN shops. Although it was built as a running repair shop, it was readily convertible to a heavy overhaul facility.

IRSI also purchased a number of surplus pieces of equipment from VIA in 2000 and 2002. This equipment was made redundant largely by the sweeping 52 per cent VIA service reduction ordered by the Mulroney government in 1990. At a very low cost, IRSI bought 18 problem-plagued Bombardier LRC diesel-electric locomotives and 27 Budd RDCs of various configurations. It was thought the LRCs could be rebuilt for use on one of the high-speed rail passenger projects then being discussed in various parts of North America. Nothing came of that and the units were subsequently sold for scrap.

The RDCs were another matter. As has been established earlier in this report, all Budd stainless steel rolling stock was so well designed and built in the period from the early 1930s through to the closure of the company's rail division in the 1980s that it earned a reputation for being virtually indestructible. It is still applicable to contemporary operating conditions, if modernized.



A CENTRE OF EXCELLENCE: Modernized and well-equipped, IRSI's facility at Moncton's Gordon Yard earned a reputation for excellence prior to the recent VIA debacle. Owner Richard "Dick" Carpenter hopes to revive this unique business, which employed 240 skilled workers prior to the bankruptcy resulting from the cancellation of the VIA contracts. IRSI photo

IRSI management saw an opportunity in the RDCs. Remanufactured at the IRSI Moncton plant and equipped with 21st century sub-systems, these versatile cars are potentially desirable for everything from new-start commuter rail systems to lighter-density intercity runs by VIA, Amtrak or others. That logic is sound.

In 1998, the Dallas and Fort Worth transit systems launched the Trinity Rail Express (TRE), the area's first commuter rail service. The successful start-up operation made use of 13 ex-VIA RDCs remanufactured by Alstom at the former CN Pointe St. Charles Shops in Montreal. This was a low-cost means of launching a new commuter service with assured mechanical and operational reliability, a fact not lost on IRSI.

IRSI was so convinced of the marketability of this concept that, at its own expense, one of its 27 ex-VIA RDCs was completely remanufactured as demonstrator unit #6202.

When the rail service to link Toronto's Union Station with Pearson International Airport was still a private sector project initiated by federal Minister of Transport David Collenette, the builders selected IRSI's remanufactured RDCs as their equipment choice.

That project ran into funding problems and had to be taken over by the Government of Ontario's regional transit agency, Metrolinx, through its operating division, GO Transit. To be launched in 2015 as the Union Pearson Express, it will use foreign-built diesel multiple unit cars rather than RDCs. That equipment is costing Ontario taxpayers \$12.6 million per three-car trainset versus \$9 million per three-car trainset for the IRSI RDCs.



SOUND STRATEGY: Inspired by the successful use of refurbished ex-VIA Budd RDCs for the launch of the Dallas-Fort Worth region's first rail commuter service in 1996, IRSI purchased 27 surplus VIA units. The well-founded strategy was to re-manufacture and market them for similar low-cost start-up projects around North America, as well as the downtown-to-airport services proposed for Toronto and Montreal. Photo by Bill Hakkarinen

IRSI put forward a similar proposal to Aéroports de Montréal for that agency's proposed rail service linking downtown Montreal with Trudeau International Airport at Dorval. That plan is mired in controversy and nothing concrete has developed.

VIA, too, looked at expanding service with remanufactured RDCs from IRSI. In November 2009, just prior to the end of VIA president Paul Côté's term of office, this consultant was assigned by VIA to prepare all the public affairs materials for the announcement in Kitchener, Ontario, of VIA's plan for a large service improvement on the Toronto-Kitchener-London North Main Line.

In addition to major track, signal and station improvements, the plan would have used three-car RDC trainsets from IRSI to bump service up to six departures daily in both directions. The announcement was cancelled at the last minute and the plan vanished with Côté's departure from VIA.

In its first decade, IRSI secured small to medium-sized contracts for passenger and freight equipment rebuilding, modification and wreck damage repair work for clients ranging from CN to Rocky Mountain Vacations. In this, IRSI earned a reputation for fine craftsmanship. This was especially so of its partial overhaul of VIA's RDCs in 2001. The VIA management team of the time was impressed and this led to IRSI being considered as a preferred bidder when larger contracts became available.

4.0 The VIA Contracts

In 2008, with what eventually totalled \$923 million in publicly-funded capital, VIA began its infrastructure and equipment upgrading projects, which have been partially discussed previously in this report. A key component of this plan was fleet renewal.

VIA's fleet renewal plan was based not so much on its full needs as on the amount the Harper federal government was willing to provide. In other words, the project was going to be fit to the budget, not the other way around. This is a seriously flawed and inadequate approach to capital renewal; the outcome is partially due to this.

Sadly, this is the way successive federal governments have dealt with VIA's large and ongoing need for stable, adequate funding to correct the deficiencies in the rail passenger system that have existed from the time of VIA's creation as a Crown corporation in 1977.

Once again, the words of the Mulroney Conservative government's Rail Passenger Action Force need to be considered when exploring this situation:

“Treasury Board must somehow be convinced that modernization is the only way by which the deficits of a continuing, national VIA system can be brought under control.”

VIA was unable to convince the federal government to fund the complete renewal of its frontline Quebec-Windsor Corridor fleet. Instead, it settled for a plan to rebuild the 30-year-old, aluminum-bodied LRCs, as well as changes to its problematic Renaissance cars in order to conform to the accessibility orders brought against it by the Canadian Transportation Agency.

While refurbishing the LRCs would be less expensive than acquiring new equipment and could be done faster, the wisdom of this decision has been questioned by many in the rail passenger industry. Even renewed for another 15 to 20 years of grueling daily service, the LRCs are already beyond their commercially effective age, although they can be mechanically and structurally upgraded for continued operation.

The IRSI contracts under VIA's \$923 million renewal plan covered three equipment types and various degrees of retrofitting and remanufacturing. The contracts were for:

- Repair and modernization of 98 LRC cars, which form the backbone of VIA's Quebec City-Windsor Corridor fleet;
- Reconfiguration of up to 59 Renaissance cars for use on the *Ocean* and the central Canadian corridor, including accessibility upgrades for 12 cars; and
- Modernization of six RDCs, which are used on VIA's Sudbury-White River and Victoria-Courtenay routes.

The VIA executives involved seemed quite sincere in their belief that IRSI would do a world-class job and establish itself throughout North America as the continent's premier rebuilder of passenger rolling stock. Those VIA managers were also committed to assisting IRSI with what would be an admittedly steep learning curve.

The VIA rebuild program ran into trouble early and worsened as the two contracts grew to three. The LRC project was the most difficult for a variety of reasons. The most basic issue was the quality of the equipment itself. As could be said of the later Renaissance equipment, the LRC wound up being a noble Canadian intention gone wrong.

5.0 The LRC Factor

The LRC concept for a fast, lightweight passenger train was conceived in 1966 by an engineer at Alcan, which took it to CN and received a positive response. With CN's encouragement, a consortium of Alcan, Montreal Locomotive Works (MLW) and Dofasco was formed in 1967 to develop a design for a new train capable of operating on existing rights-of-way with diesel or electric traction at speeds of up to 125 mph.

At the time, CN was experiencing tremendous difficulties with its five non-conventional TurboTrains, which had been intended for service on the Toronto-Montreal route in time for the capacity crowds that would be generated by Montreal's Expo 67. The U.S. Department of Transportation also ordered two smaller, American-built versions under the *High-Speed Ground Transportation Act* of 1965.



GOOD INTENTIONS GONE WRONG: The Light, Rapid, Comfortable (LRC) passenger train concept was visionary, but early production and deployment problems plagued the trains, causing Amtrak to return its two leased sets and plaguing VIA and builder Bombardier with several years of expensive and embarrassing debugging. Photo by Robert Truett

The builders, MLW and United Aircraft, were nearly two years late in delivering CN's five low-slung, turbine-powered trains. The Turbos were pulled from service three times before they were sufficiently de-bugged to offer reliable service in 1973.

The LRC was designed to avoid the TurboTrain's non-conventional pitfalls. With a monocoque aluminum body design and a modified, conventional diesel-electric power plant, it would be built as a traditional set of separable locomotives and cars that could be easily expanded and reduced in length according to passenger demand fluctuations; the Turbo was an articulated, fixed-formation design that couldn't be easily varied.

Where the Turbo used a passive system to tilt the cars in and out of curves, providing for a faster and more comfortable ride at higher speeds, the LRC would use a new active tilt system, where sensors would read the degree of the curves and then employ hydraulic rams to actively tilt the cars. Like the Turbo, the objective was a 125 mph maximum operating speed on existing rail lines, albeit significantly upgraded.

With government assistance, a prototype LRC coach was built by the consortium in 1971 and a sleek, low-slung locomotive was completed in 1973. When Bombardier purchased MLW in 1975, it assumed the entire LRC project from the other two partners. The first production order didn't come until 1977, when the Government of Canada agreed to buy two LRC-1 locomotives and 10 coaches for a two-year lease to Amtrak.

Following the government's order for the Amtrak lease, the government ordered 22 LRC-2 locomotives (later reduced to 21) and 50 coaches as part of its intended creation of a new Crown corporation to take over the existing CN and CP passenger services. When VIA was subsequently formed, it became the de facto owner and operator of the LRCs favoured by Transport Canada and Industry, Trade and Commerce.

The Amtrak LRC-1s were delivered in 1980 for their two-year tour of duty. The trains malfunctioned on so many occasions that Amtrak removed them from service before the lease expired, returning them to the Government of Canada in 1982.

Even before the first LRC went into assigned service, and at the same time as he announced the discontinuance of 20 per cent of the VIA route network effective November 15, 1981, Transport Minister Jean-Luc Pepin announced a second order for another 10 LRC locomotives and 50 coaches. These LRC-3 trains incorporated mechanical changes resulting from the experience with the LRC-1 and -2 trainsets. While the LRC-2s and -3s were compatible and inter-operable, there were differences in their method and quality of construction.

While any new technology typically requires in-service debugging, the LRC's teething problems were extensive. As Bombardier's first intercity trains, the company was facing a steep learning curve. Numerous retrofits were required, yet still the LRCs couldn't be counted on for reliable service. The banking system was particularly troublesome, often failing en route and leaving the coaches in the tilted position. The LRCs also required different maintenance facilities than conventional passenger rolling stock because some of the equipment could only be serviced from below.

The Rail Passenger Action Force of 1984-1985 tried to help resolve the LRC problem and noted in March 1985 that modifications were required in three major areas. Also noted was that LRC availability was then worse than that of VIA's 30-year-old equipment.

Because the LRCs were the backbone of VIA's corridor fleet, replacing old equipment that was long past its economic service life expectancy, they had to be made to perform. After more than a decade and three complete fleet withdrawals, they were brought to a reasonable level of reliability. All the locomotives were withdrawn by the end of 2001 and the banking system on the coaches was eventually disconnected.

It is impossible to determine the current reliability and efficiency of the LRCs. Once again, this is due to the veil of secrecy cloaking many aspects of VIA, which is unwilling to provide data on reliability, miles per defect and per car-mile costs for its fleet.

When VIA required additional rolling stock for the Quebec-Windsor Corridor in the mid-1990s, it did not buy additional LRCs. Instead, VIA obtained 33 secondhand Budd coaches built between 1946 and 1953 for various U.S. railways. These were completely stripped down and rebuilt with electric head end power (HEP) systems and LRC-style interiors, emulating VIA's highly successful HEP 1 program for its Budd long-haul fleet.

Today, these 33 Budd HEP 2 cars, plus some of the HEP 1 long-haul coaches, are doing yeoman duty on the Quebec-Windsor Corridor.

Quite simply, the LRCs were highly problematic. As former VIA officials involved in the decision to rebuild them say, the project was only endorsed because the corporation couldn't obtain the necessary funds for all-new equipment from the government.

VIA's 2002 Quebec-Windsor Corridor study estimated it would cost \$720 million to fully re-equip the route with new, higher-speed trains, such as diesel-powered versions of the 150-mph Acela electrics that Bombardier built for Amtrak. Rebuilding the LRCs appeared to be a bargain by comparison. That decision is now open to serious doubt.

Even the LRC rebuilding project was subject to cost constraints that forced a reduction in the scope of the work. Given the budget available, VIA began cutting items from the remanufacturing plan, most notably the banking system, which was to be removed.

VIA also required IRSI to recycle certain components originally slated for replacement. This included 75 per cent of the windows and much of the plastic interior fittings, such as the overhead luggage bins, seat frames and fixtures, and the washroom modules.

Just as important, the specs agreed upon in the contract were not final and allowances were to be made for ongoing input from VIA's Marketing and Customer Experience departments. This would likely entail some additional costs, which VIA assured IRSI it would cover out of its federal funding package based on the changes requested.

6.0 Execution of the VIA Contracts

As soon as LRC prototype car #3451 arrived at IRSI, there were unforeseen problems. VIA engineered and rebuilt this coach at its Montreal Maintenance Centre to serve as a model to be copied by IRSI in re-manufacturing the cars on a production line basis. But both VIA and IRSI soon agreed the car was no prototype; it required multiple changes, some of them due to VIA changing its mind about what it wanted in the renewed fleet.

This required IRSI to engineer and rebuild another LRC coach, VIA #3315, as the true prototype, adding time and cost to the project with VIA management's approval. This was the first of many project change requests (PCRs). The contention of IRSI is:

1. 3451 was not the prototype LRC coach car for Contract C20090146.
2. IRSI spent unbudgeted time and money developing prototype car 3315.
3. Prototyping 3315 delayed production and ate up IRSI working capital.



THE FULL MONTY: Rebuilding the aluminum-bodied LRC coaches required IRSI to strip them down to the skin and remove every component. It was only during this process that it was discovered just how deteriorated these 30-year-old cars actually were. IRSI photo

Adding to the challenge of getting the LRC production line rolling to meet the December 2013 completion date was the Renaissance project. The shortcomings of this rolling stock have already been discussed in detail in Chapter 4 of this report. Hanging over this project was a Canadian Transportation Agency (CTA) order for accessibility upgrades that had to be met by June 2012, although IRSI maintains this deadline was not communicated to the company at the time it was awarded the contract.

When IRSI received the contract to rebuild the six RDCs, this brought another complication. The funding for that project came from the government's Economic Action Plan, which required completion of the project by March 31, 2012.

To assist in making this work, IRSI called on a number of highly-qualified advisers. The first was retired Amtrak president David Gunn, now living in Cape Breton. As the head of the U.S. passenger carrier, and previously as the chief of the Boston, Philadelphia, New York City, Washington and Toronto transit systems, Gunn had been responsible for billions of dollars in equipment upgrading and acquisition programs.

The second key adviser was chartered account Ken Evans, who gained transportation industry experience in his 10 years as Marine Atlantic's special auditor. Evans often served as a negotiator for IRSI in its dealing with VIA.

Rounding out this team of IRSI advisers after his retirement from VIA at the end of 2009 was Roger Hoather, who had been the railway's director of capital programs. Among his successful projects were rebuilding the Budd HEP 1 long-haul and HEP 2 corridor fleets. Hoather was instrumental in having the LRC, Renaissance and RDC contracts awarded to IRSI. With VIA's permission, he became a key IRSI adviser.

At the outset, Hoather points to a fundamental flaw with the LRCs that should be borne in mind in any assessment of the program: "The cars are old. No other passenger rail system runs cars that old unless they're stainless steel."

This view is shared by Gunn: "Those cars were not a great car. They're aluminum; they were not a strong car. They're not like the RDCs, for example, where you strip them and they look like they were just built. That's because they're stainless steel."

Hoather also points out that the lack of an acceptable prototype car and the varied input from the different departments within VIA added time and changes every step of the way, right from the beginning of the project.

As early as November 4, 2009, IRSI asked that the specs for the LRCs be frozen and the production schedule be extended by 92 days as a result of those changes accepted up to that date.

This proposal was rejected by VIA's senior project leader on November 9, 2009, who said it was excessive and it was the corporation's contractual right to request any and all changes it required.

Although the correspondence from both sides up to the end of 2009 appears to be firm and polite, one detects a rising air of tension. This situation was inflamed shortly afterward by a "changing of the guard" at VIA. Following the retirements of Paul Côté as president and Roger Hoather as director of capital programs, the emails and letters became much more acrimonious.

VIA submitted a total of 18 PCRs to IRSI, some of which might be described as fanciful and non-critical in terms of the overall project objectives. For example, the selection of the LRC seat fabrics became a major sticking point. The file on this aspect of the project is thick and it is difficult to follow all the twists and turns in what was a deteriorating client/supplier relationship. That a matter of this nature could become such a major bone of contention and a source of cost overruns is shocking.



IRON HORSES REFRESHED: By the time the first LRC coaches and club cars arrived at IRSI (above), they'd delivered millions of miles of service and were nearing the point of total exhaustion. Despite all the brickbats VIA used on IRSI over the execution of the contract, the one thing the Crown corporation never claimed was that the work was anything less than first class, as the final product (below) demonstrated. IRSI photos



Other issues that progressively derailed the LRC project and delayed the Renaissance and RDC contracts include:

- (1) A facility built as a running maintenance shop, not a rebuild shop, which required substantial modifications to make it suitable for the LRC production line plan and which IRSI was willing to undertake at its own expense;
- (2) The deteriorated, brittle condition of the interior plastic fittings and the window frames, which made it difficult (if not impossible) to recycle them;
- (3) VIA-initiated changes in the selection of the electrical gear on the rebuilt cars;
- (4) Changes in the configuration of the club or business class cars, replacing the original 2+2 seating with a new 2+1 arrangement;
- (5) The additional requirement to create 26 combination cars containing business class 2+1 seating in the forward end and standard 2+2 coach seating in the rear, instead of just business class cars and coaches, as originally proposed;
- (6) An ongoing inability of VIA to provide enough cars to IRSI to launch a true production line, which was the only way the company could realize any economies of scale and make a profit on the project;
- (7) VIA's higher-than-budgeted costs for the CN Kingston Subdivision Project between Toronto and Montreal, eating up funds from the limited amount contained in the \$923 million capital renewal envelope provided by the government (see Attachment A); and
- (8) Unexpected structural issues with the cars, particularly the ply-metal floors in the LRC-2 cars.

In June 2011, with the concurrence of IRSI, VIA appointed two rail car manufacturing consultants to visit the IRSI facility and meet with its management. They also met with VIA management. In their July 2011 report, the consultants concluded:

- (1) In its bids, IRSI had underestimated the work to be performed;
- (2) IRSI did not have a capable and experienced management team; and
- (3) The work would be late and IRSI would run out of funds before completion.

This third-party assessment was accepted by both IRSI and VIA, and it is included in full as Attachment B. The report was quite fair and impartial, looking for solutions, not more finger pointing.

While it determined there were obvious problems in IRSI's execution of the VIA contracts, it concluded:

“[T]here is no insurmountable element with IRSI being able to complete the contractual obligations that they have with VIA, as long as both parties recognize the existing situation and are willing to work together.”

The consultants' key finding bears highlighting, namely the issue of the acrimonious relationship that had developed between IRSI and VIA. Said the consultants:

“The one key, if not pivotal, area that could have a determining factor on the outcome and longevity of this contract is the relationship between the VIA on-site team and the key members of the IRSI executive and work team. Whether the over two years of frustration, missed dates and promises, slow growth and progress is a key contributor, or whether there is a firm (perhaps not factual) belief by both supplier and customer that they have conceded, given, accepted and bent over backwards in support of the other over this period, the end result is that the communication is poor and the relationship is seriously strained.

“Perhaps this has been recognized and thus the creation of the Steering Committee, although we see no evidence the Steering Committee's existence has improved the working relationship. As we all know, it takes two to tango and we offer no opinion as to cause, rather that this must be addressed for the project to have any hope of an on-time delivery going forward.”

This was never resolved and the relationship deteriorated further, with targets missed. By this point, it was also apparent IRSI would not bring the number of worker-hours per LRC to the point where it could generate a profit. Nonetheless, IRSI owner Carpenter told VIA he would honour his commitments, take the loss and demonstrate to the industry it was a reliable remanufacturer of first class rail passenger equipment.

A key flaw in the whole project was apparent from the beginning. Chronically tight on equipment to meet its daily operating needs, VIA would only agree to provide 10 LRC cars at a time for the production line, which eventually rose to 12. This was insufficient. When rebuilt cars were “red tagged” by VIA inspectors for minor flaws, such as paint finishes, they had to go back into the shop, disrupting the production line.

This contrasts with the bid from Bombardier, a builder which long ago overcame the problems it had with the original LRC contract and had become a respected manufacturer of rail passenger and transit equipment, and the largest. Bombardier stated at the outset it required 20 cars at a time to maintain a production line that would enable it to profit and deliver the cars within the allowable time frame set by VIA.

IRSI adviser and former VIA director of capital programs Hoather says this was one of the reasons Bombardier was not awarded the contract to rebuild the LRCs. As it turned out, even providing 12 cars at a time strained VIA's ability to provide enough equipment to meet its daily operating needs, particularly during peak travel periods.



FROM DOWDY TO DAZZLING: It took months of extra work and costs that IRSI ultimately absorbed itself to accommodate VIA's constantly-changing specifications for fabrics and fittings to replace the dowdy interiors on the LRCs (above). But when it was done, the cars looked like they had just rolled off the builder's assembly line (below). IRSI photos



One must ask why VIA took such a high-risk approach to the project. While IRSI had proved itself more than competent in dealing with small contracts, the company had never had to contend with such a large, production-style project. Compounding this were the add-on Renaissance and RDC contracts, which overloaded a company trying to come to grips with the intricacies of its first large contract.

Where was VIA's high-level oversight through all this? As far as can be determined, senior VIA executives were only in Moncton twice during the whole tumultuous period when work on the three contracts was underway and encountering problems. The direct involvement of senior VIA managers – not just production line inspectors – might have had a positive effect on the relationship and the output.

VIA had problems with virtually all of its capital projects previously, stretching back to the construction of its maintenance centres in the 1980s and its Budd HEP 1 in the 1990s. In these cases, VIA worked co-operatively with its contractors to complete the projects and even went back to the government for additional funding.

One might also ask about the apparent lack of federal government oversight. VIA reports to the minister of transport, Transport Canada, Finance and Treasury Board, so it would be assumed they were monitoring the situation. They weren't. Transport Canada was relying solely on information from VIA.

When the government's senior rail policy analyst asked to be allowed to meet with IRSI staff and see the work under way in Moncton, his request was denied on the basis of tight restrictions on government travel.

Apparently with Transport Canada's approval, VIA cancelled part of the 59-car Renaissance contract on September 11, 2011. The 12 cars requiring time-sensitive accessibility modifications were taken to VIA's Montreal Maintenance Centre for completion. This left 47 of the cars still scheduled for lesser upgrading by IRSI.

After IRSI completed six of the remaining 47 cars, VIA then cancelled the entire contract.

The final snapping point came when IRSI reported to VIA that it had encountered severe deterioration and rot in the LRCs' ply-metal car floors, particularly the LRC-2s. Among other implications, this systematic rot and the variable nature of some of the original construction techniques employed by Bombardier made it difficult for IRSI to secure the seat tracks, which hold and lock the individual seat modules in place.

Gunn, in particular, was concerned about this situation, feeling it raised safety and liability issues that could come back to haunt IRSI in the event of an accident wherein the seats on the rebuild cars came loose from the floor. IRSI decided to submit one car to static load tests conducted by an independent structural engineer. When the results of those tests were conveyed to VIA, the timing couldn't have been worse.

On February 26, 2012, VIA train N° 92, en route from Niagara Falls to Toronto, derailed at high speed near Aldershot, Ontario. The two locomotive engineers and a trainee were killed, and there were multiple passenger injuries. The lead LRC coach was damaged beyond repair.

The day following the accident, IRSI notified VIA's chief operating officer, John Marginson, of the results of its structural testing. In response, the heated relationship between the two companies blew up, with VIA sending a letter via email on February 29, 2012, in which IRSI's actions were described as "strictly a negotiating tactic of poor taste and dubious merit." IRSI's raising of the safety issue was called "highly contemptible, morally reprehensible and a total lack of respect for those who lost their lives on Sunday and for those who mourn their passing, including the undersigned. I trust that the record will show that this despicable act is nothing more than IRSI's desperate attempt to shift blame for its own failures."

The end result of this complete fracture of the relationship was that the contract for the LRCs and the RDCs was cancelled. The Government of New Brunswick was notified and the provincially-guaranteed lines of credit to IRSI on behalf of VIA were called in. These funds – totalling \$20.5 million – were paid to VIA by the province. IRSI's own investment of \$10.2 million was lost and Ernst & Young was appointed as receiver.

When the IRSI rebuild program collapsed, the company had completed 10 LRCs, two RDCs and six Renaissance cars. VIA then applied to the receiver for permission to retrieve its equipment and complete a portion of the outstanding work at IRSI's plant. With the approval of the receiver and the creditors (which included IRSI owner and president Carpenter), VIA arranged for CAD Railway Industries (CAD) – one of the unsuccessful bidders on these contracts – to complete six more LRCs and the four remaining RDCs.

CAD has done this work on a cost-plus agreement with VIA and was scheduled to vacate the IRSI plant on October 31, 2013. It is believed the last of the CAD-rebuilt cars from Moncton were shipped to Montreal on the tail end of VIA's *Ocean* on October 29, 2013, although the number of cars completed is still unknown.

To date, VIA has not publicly stated how much this additional and un-budgeted work by CAD has cost. In fact, VIA has said nothing of substance about the whole affair. The views of the railway should be considered before assigning degrees of responsibility for this unfortunate, painful and costly outcome. But questions do need to be asked by parties with the power to compel answers.

7.0 The Experience of Other VIA Suppliers

In the pre-VIA, CN and CP handled most of their passenger equipment repair and refurbishment work in their own main back shops, including the CN Moncton Shops. Under the original agreements with the freight railways and the relevant unions, VIA continued this practice for several years after it took over of the passenger service.

This became a bone of contention because of the high costs. The railways were paid for work on a cost-plus-profit basis that had no incentive for shop and labour productivity improvements. This problem was highlighted by the Rail Passenger Action Force of 1984-1985, which found the freight railways were often charging 200-225 per cent of the real cost of performing this work in old and inefficient facilities.

A partial solution was the construction of five VIA maintenance centres in Halifax, Montreal, Toronto, Winnipeg and Vancouver, beginning with the Toronto Maintenance Centre, which opened in 1986. Though not main back shops, they resulted in the transfer to VIA of all maintenance up to a certain level of complexity.

However, VIA was still not equipped for major refurbishment, so outside contractors were required. This contrasts with Amtrak, which took on this work by purchasing the former New York Central Railroad Beech Grove Shops in Indianapolis, Indiana, in 1975. In 1983, an Amtrak executive told a CBC Television documentary crew that Beech Grove was “a house of miracles and the corporation couldn’t exist today without it.”

Lacking this type of facility, VIA contracted with CN for the HEP 1 rebuilding of its Budd long-haul fleet in 1989-1993. The work was well done, but CN soon complained it was more extensive than it anticipated and demanded an additional \$60 million. VIA denied this claim, but later negotiated a smaller settlement with CN.



AN UNCERTAIN FUTURE AWAITS: IRSI’s fleet of 27 Budd RDCs, which the firm acquired from VIA at its own expense, sits derelict outside its plant at CN’s Gordon Yard. If a positive solution to IRSI’s forced bankruptcy is not soon crafted, the RDCs may go for scrap rather than being rebuilt by IRSI’s highly-skilled work force for many more years of cost-effective service at VIA or other North American rail passenger operators. Photo by Michael Taylor

When the HEP 1 project was expanded to include additional secondhand Budd coaches, this contract went to an inexperienced Quebec company, SEPTA Rail, which underestimated the work and declared bankruptcy. VIA retrieved its coaches and contracted with CN's AMF subsidiary to complete the coaches on a cost-plus basis.

In December 2007, VIA contracted with CAD Railway Industries (CAD) of Lachine, Quebec, to rebuild its fleet of 54 General Motors F40 locomotives, at a cost of \$100 million. Not unusual for a project of this nature, it ran into unforeseen difficulties and the first 30 units were delivered late. However, VIA and CAD worked together to resolve the problems and the project was completed on schedule in December 2012.

As well, in October 2009, VIA contracted with Avalon Rail of Milwaukee, Wisconsin, for the deluxe upgrading of 12 Budd HEP 1 cars for the Toronto-Vancouver *Canadian* at a cost of \$19.5 million. Very little has been said about this project, which VIA aborted, bringing the cars back to Canada for a cost-plus rebuilding by a small remanufacturing firm in Charny, Quebec.

Originally scheduled for completion in 2011, none of the reconfigured cars has yet been put into service to date, although a 2014 launch date for the Prestige Class deluxe western transcontinental service has been mentioned.

In short, none of VIA's individual fleet renewal projects has ever gone exactly according to plan and many ran over-budget and/or over-schedule. Yet, VIA is publicly stating its current fleet renewal program is on target and virtually complete. But a close look at the sketchy information provided reveals this claim is based on a reduced number of cars, not the full number originally proposed. The fleet renewal program is far from complete, leaving VIA with a fleet that is not delivering its maximum utility and is getting older and more worn every day.

Many questions still need to be answered for the public, which is ultimately the owner of VIA and the source of the funding that has gone into these incomplete and questionable capital renewal projects.

8.0 Reviving IRSI

The collapse of IRSI is a sad chapter in the equally sad saga of rail passenger service under VIA. Yet, there is some hope for a correction of this situation. Despite IRSI's collapse as a result of the cancellation of the VIA contracts, owner Carpenter says he will restart IRSI, chastened by his experience with the VIA contracts.

Carpenter, as advised by Gunn, believes there is still a large volume of work for a firm such as IRSI in locomotive and freight car repair and rebuilding. There is also the untapped market for IRSI's 27 ex-VIA Budd RDCs.

Speculating on what work may be available to IRSI is difficult without a full and proper assessment of the market, which is beyond the scope of this report. But there are several positive factors to be considered.



RETROFITTING ON THE RISE: The Lac-Mégantic tragedy and several other high-profile rail accidents have focused attention on the need for improvements to the inadequate DOT-111 tank cars that make up the bulk of the North American fleet. With car builders backlogged with orders for new tank cars, plus the continuing increase in demand for the movement of crude oil by rail, these sub-standard cars will require modification if they are to remain in service. This bodes well for a revived IRSI. Photo by Andy Cassidy

First, the Class I railways of North America are continuing their process of shedding assets they feel are not as productive and cost-effective as necessary in their quest for increased shareholder dividends. CP has closed all of its heavy overhaul shops and now contracts out this work, and there is no major CN heavy maintenance facility east of its Transcona Shops in Winnipeg.

As well, the numerous short line railways in eastern North America are unable to maintain facilities such as these for their own purposes; they contract out this work.

Tragically, one potential market for a company such as IRSI is a result of the July 6, 2013, derailment and explosion of the crude oil train at Lac-Mégantic, Quebec. A suspected factor in this tragedy was the use of tank cars built to the standard known as DOT-111. These cars, which constitute nearly 70 per cent of the U.S. tank car fleet and nearly 80 per cent of the Canadian fleet, are the subject of much study and debate right now by the regulatory authorities.

The general feeling within the railway industry is these tank cars are not well suited to the handling of commodities such as North Dakota Bakken crude oil, which is more volatile than certain other types of crude.

While the ideal fix would be the replacement of these DOT-111 cars with those built to higher safety standards, such a solution is going to be an expensive long-term one. The demand for the movement of crude by rail is growing and so is the need for rolling stock to handle it. At the same time, rolling stock manufacturers are straining to keep up with the demand for additional tank cars and other pieces of freight equipment.

The result is that it may be necessary to retrofit a large portion of the North American DOT-111 tank car fleet. If so, this will create an opportunity for a revived IRSI and other equipment remanufacturers.

These and other opportunities are being investigated by Carpenter's Heritage Properties Group, which is working to re-establish the IRSI Moncton facility as a major rebuild centre catering to a broad range of customers. The company was unable to pursue opportunities such as these during the execution of the three VIA contracts because they completely consumed its time, physical and staff resources, and working capital.

A revival of IRSI would also benefit the Canadian railway industry, in general. While there are a handful of small companies capable of doing a limited amount of locomotive and rolling stock maintenance and overhaul, the only company with the broad capabilities that IRSI had developed is CAD, leaving the market sole sourced for now. Having a second reliable, full-service remanufacturer can only aid the rail industry by maintaining a competitive supply industry.

While the bankruptcy and eventual revival of IRSI is a private sector matter, it does have public sector implications. Not only did the company have a direct impact on the economy of Greater Moncton, its efforts affected other municipalities through its use of many New Brunswick suppliers. As the U.S. Department of Commerce and other credible economic agencies have established, investment in rail projects produces a multiplier effect that ripples out through local and regional economies, generally at a rate of \$3.00-4.00 of economic spinoff for every \$1.00 invested.

The effect of the \$117.3 million VIA equipment renewal program at IRSI, therefore, can be assumed to have stimulated the economies of Greater Moncton and New Brunswick by \$350-470 million had it run to completion. At the contract award ceremonies, it was said the LRC and Renaissance projects would create 135 new jobs and 613,000 person-hours of employment. The RDC project would support 31-40 jobs and create 22.5 person-years of employment. In total, IRSI would be employing 240 skilled workers on all three contracts. The impact of the projects on the economy of Atlantic Canada was significant, but it was all lost in the cancellation of the projects.

If the new IRSI wants to establish itself as a high-quality supplier to the North American rail industry and spur the regional economy, the company needs to clear its name. It has not done so to date and this allows questions to linger in the minds of many within the rail industry. IRSI's reputation for excellent craftsmanship has been badly damaged.

However, the failure of these projects has been no credit to VIA, which has never been called upon to publicly explain its actions. The bankruptcy of IRSI has been detrimental to the ongoing operation of Canada's national rail passenger service, which has been in a precarious position for most of its 36-year life. To use a popular phrase, VIA seems to have shot itself in the foot.



REPAIRING THE DAMAGE: At a time when VIA's fleet is crumbling and the railway is finding it difficult to field enough equipment to meet its daily needs, it makes little sense for Industrial Rail's well-equipped Moncton shop and the 240 skilled workers it employed to be sitting idle. This is not in the best interests of VIA, its passengers, the economy of New Brunswick or the taxpayers of Canada.

The IRSI contract cancellation has extended the appalling delay created by the problems encountered in executing the three projects and resulted in VIA still not getting all the equipment rebuilt for further and, hopefully, more cost-effective service. Completing the job is going to require yet more time and funding, but VIA has not explained how it will do this or if the additional funds will even be made available by the government.

What is required is an open and unbiased analysis of this situation by an authority with access to all the documentation and the people involved. That should be the Auditor General of Canada, Michael Ferguson.

As previously mentioned Chapter 3.3 of this report, there is a way to clear the air on this and other matters concerning VIA's future in Atlantic Canada and throughout the country: a thorough investigation by the Office of the Auditor General (OAG). Every Crown corporation and major government program goes through a five-year cycle of in-depth investigation by the OAG. VIA will be under the microscope this year.

The OAG should be encouraged to probe the collapse of VIA's fleet renewal program and the IRSI's forced bankruptcy. As also discussed in Chapter 3.3 of this report, Transport Action has already alerted the OAG to the serious flaws it perceives in VIA's delivery of the CN Kingston Subdivision Project in the Quebec-Windsor Corridor. Encouraging the OAG to conduct similar in-depth investigations of the *Ocean's* reduced frequency and IRSI's bankruptcy would be worthwhile for the affected New Brunswick municipalities.

It will be recalled that it was just such an audit of Marine Atlantic by the OAG that transformed that Crown corporation into a public service that is today considered both highly efficient and effective. There is no reason to believe such an outcome wouldn't result from a similar investigation of VIA by the independent OAG.

This consultant can see no other way these issues will ever be fully and publicly explored on behalf of those who ultimately own VIA, namely the taxpayers of Canada.

9.0 Conclusions and Recommendations

Hope remains that IRSI can be successfully revived as a competitive and long-term player in the equipment remanufacturing sector of the North American railway industry. Tempered by its experience with VIA and with a clearer view of the challenges of surviving in a very unpredictable niche market with slim profit margins, the new IRSI could play a specialized and welcome role in New Brunswick's economy.

But questions still need to be answered about how the company could have collapsed and what needs to be done to get it rolling again. Although some may regard this as purely a private sector matter, it is not. It involves the conduct of a seemingly unaccountable Crown corporation, the effect its actions are having on our passenger railway's future, and the dubious expenditure of a large amount of public funding.

As the major funder of VIA's annual operating costs, Transport Canada should have a long-term stake in the operation of IRSI. The company is one of only a few firms capable of providing heavy repair work for VIA as it struggles to maintain or upgrade its fleet, under the effects of deferred maintenance and with no new equipment currently being considered.



PROFESSIONAL RAILROADER ON BOARD: Despite his high-level advisory role, even former Amtrak president David Gunn (seen here on the right in 2005 with North Dakota Governor John Hoeven celebrating the 75th anniversary of Amtrak's Chicago-Seattle/ Portland *Empire Builder*) couldn't overcome the meddling and politically-motivated interference that led to the forcing of IRSI's bankruptcy by publicly-owned and –funded VIA Rail Canada. Photo by Richard Elgenson

Therefore, it is recommended that the municipalities:

- Request that the minister of transport initiate a process to bring IRSI and VIA back to the table for a full and frank discussion of the situation that led to the company's collapse with a view to reconstructing the fractured business relationship and resuming the remanufacturing of rolling stock in Moncton; and
- Contact the Office of the Auditor General to request a full investigation of the IRSI situation – as well as the serious reduction in the service level of VIA's *Ocean* referenced in Chapter 6.2 of this report – as part of its periodic audit of VIA's activities and finances.

The clock is ticking on all three of these vital aspects of New Brunswick's rail sector. The time for action by all levels of government is now. By taking the actions recommended above, the municipalities that have funded this report – and others – can play an important role in making that happen.

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