

# THE RAILROAD WEEK IN REVIEW

September 5, 2014

*“Service metrics were depressed year-over-year in Week 35: industry average dwell times increased 25 percent and train speeds dropped eight percent.” — Wolfe Research, Sep 3*

**Pennsylvania’s Reading Blue Mountain & Northern** (locally called the Reading & Northern or R&N) has secured a \$10 million Penn DOT grant to fund most of the cost of a new bridge across the Lehigh River just north of Jim Thorpe. It’s a \$14 million project, with the R&N putting in \$4 million of private funding. State funds are to be distributed in \$5 mm increments in the 2014 and 2015 fiscal years, with completion scheduled for 2016.

The new bridge, a 500-foot, steel and concrete, three-span construction, will make possible progressive moves to and from the north for customers along the R&N’s former CNJ Nesquehoning Valley branch, which, among other things, lies along the eastern edge of the Marcellus shale formation — a major nat-gas source opened up by horizontal drilling and shale fracturing. A little history is in order.

Back in the day, the area north of Reading and west of the Lehigh River was a significant source of anthracite coal. A major anthracite market was for residential heating in northern NJ and even NYC, and the CNJ, Reading and Lehigh Valley railroads all vied for this business. The Reading came straight north from, well, Reading, while the CNJ and the LV built lines on opposite sides of the Lehigh River between Allentown and Wilkes Barre, with feeder branches into the coal fields to the west of the river.

One such branch was the afore mentioned CNJ Nesquehoning Valley branch. Since the market was east, it made sense to build into the area with a northward (timetable westward) turnout to allow progressive moves between eastern markets and the Tamaqua/Hazleton anthracite fields. The CNJ main was at this point already on the west side of the river but, because of terrain, crossed over to the east side just above Jim Thorpe, at Nesquehoning, where it continued north on the east bank of the river on its own right of way, parallel to the LV’s.

It was here (cutting diagonally across the bottom left corner of the photo) the CNJ built the connection to the coal fields with a left-hand turnout from timetable east (out of the picture below). The north-facing bridge is still in service for north-south moves. (Conrail absorbed the CNJ, LV and RDG, eliminated much of the duplicate trackage, and ultimately transferred a majority of the Lehigh River trackage north of Lehigh to the R&N.)

Fast forward to 2014. The east-coast anthracite market is long gone. However, with the coming of the Marcellus nat-gas mining activity, frack sand and pipe flowing in from the north need a progressive move toward Tamaqua to avoid a time-consuming (and car-cycle time killing)

reverse move at Coalport (timetable west of Lehighton) to get across the river and access the Nesquehoning Valley line. The new bridge (drawn on photo below) will do precisely that.



Reading & Northern is to be congratulated for having the insight and forward-vision to design and partially fund what will be a critical connection for the eastern Marcellus shale drill sites. The state of Pennsylvania obviously agrees and the \$10 mm grant is proof of that particular pudding.

**The late keep getting later.** Wednesday's note from Wolfe Research in NYC posts AAR performance measures for the seven NA Class I railroads and the results are not encouraging. Average train speeds for Week 35 (August 29) were off eight percent year-over-year, for third quarter to date and second quarter as reported. Norfolk Southern is losing ground the fastest, down 18 percent for the week vs. down nine percent in Q2. At the other end of the scale, BNSF is gaining on speeds: down six percent in Week 35 vs. 12 percent in Q2. UP is slipping slightly, down 10 percent in Week 35 vs. down seven percent in Q2. CN and KCS are both averaging speeds in excess of 26 mph, best of breed, and holding steady with minuscule weekly deltas.

Yard dwell times are going up, which stands to reason. If trains are taking more time to get over the road they're missing their core yard arrival times and therefore connections. So where you only have one merchandise train a day between OD pairs, a missed connection means a dwell of 24 hours plus the number of hours by which the intended connection was missed.

North American Week 35 dwells increased 16 percent year-over-year to an average 22.5 hours. CP and CN have cut dwell times most drastically to eight and 16 hours respectively; everybody

else seems mired in the mid-20s. CP uses the same dwell time definitions as everybody else: “the average time a car resides within terminal boundaries expressed in hours.” Time starts with arrivals and ends with departure. CP does say on its website that it “updated the definitions” of dwell and train speed effective September 1, 2013, but doesn’t say how inasmuch as the above fits the AAR definition [WIR 8/22/2014].

Be that as it may, short lines and feeder roads may get their ISAs to work so interchange/on-off intervals are respectable, but they have no control over what happens beyond. Single-carload freight is most at risk as it must pass through several yard en route. A trip plan calling for eight days can easily become a trip taking twice as long as connection windows are missed at intermediate yards. The only defense is to get the trip plan in writing before the car release and then watch trip-plan compliance like a hawk.

**The STB decreed on Tuesday** that three of the five US class I railroads are “revenue adequate” based on 2013 data submitted in the companies’ R-1 reports. Canadian National’s US entities, lumped together under the “Grand Trunk” heading, are revenue adequate as well. Missing the mark are CSX, KCS and CP’s “Soo Line,” analogous to the Grand Trunk for US operations.

To be revenue adequate, a railroad has to earn “a rate of return equal to or greater than the Board’s calculation of the average cost of capital to the freight rail industry.” For 2013 that number is 11.32 percent and is determined by a process initially set down in 1981. Essentially, that process determines a cost of capital by examining railroad balance sheets and then comparing that number to assets and earnings from the annual R-1 reports. For the gory 2013 details, see EP-522 on the STB website.

The STB’s Revenue Adequacy announcement has long been a “who cares” event. But now, with UP having beaten the number four years running and with NS and BNSF beating it for three consecutive years, somebody may begin to care. The usual suspects -- chemicals, coal and now possibly grain -- may well come back to the STB saying, “Hey, these guys are revenue adequate; how dare they raise my rates?”

Writing in *Railway Age*, veteran columnist and Washington-watcher Frank Wilner observes, “As the railroads see it, a determination that one or more of them met the revenue adequacy test in a single year is no more indicative of revenue adequacy than a poor family being declared cured of poverty based on their winning a single year’s worth of zero-price rent and groceries.”

Should the STB decide to clamp down on successful Class I rails, the short lines most at risk are the handling lines. Consider this scenario. The Class I in the route wants an increase and the STB pushes back. The handling line fee comes out of revenue, so one way to raise revenue is to de-market the short line station and shift that revenue stream over to a station local to the Class I that is doing business with the same station doing business with the short line on the other end of the move.

Wilner again: “Geographic and product competition are not abstracts, meaning if a revenue adequate railroad’s rates are capped, a revenue inadequate railroad likely will be forced voluntarily to cap its own rates if its shippers find they cannot otherwise compete with shippers situated on the revenue adequate railroad whose rates have been capped by regulators. Such a result would be at odds with objectives of the Staggers Act and inimical to a goal of assuring a financially healthy national interconnected railroad network fit, willing and able to meet shipper demand.” So to be sure there exist risks to non-Class I rails as well as those subject to the revenue adequacy test.

But there's no need to sell all your railroad shares and head for the hills just yet. In a note on the subject, Wolfe Research opines, “Earlier this year, the STB announced that it will host a hearing in the future to formally begin the discussion on revenue adequacy. Our legal contacts believe this proceeding will take 3-4 years and it will likely take another 4-5 years after an STB decision before a rate case could be adjudicated. So we remain concerned about revenue adequacy longer term, but don’t believe it’s an issue investors need to worry about for five years or so.”

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