# RAILROAD WEEK IN REVIEW
## JUNE 2, 2006

*"Those who can adapt to the changing global marketplace will likely do well; those who try to hold on to the past may not." – STB Chairman Buttry, National Press Club, 5/12/2006*

**Paper barriers just won't go away.** Yet reading between the lines of the STB decisions over the past few months one begins to wonder how long they will last in their present form. In his May 12 National Press Club remarks, Chairman Buttry notes that "the Board must be receptive to change. What was good precedent in the past may not make good sense today."

In a sense, he was echoing what Vice Chairman Francis Mulvey wrote in his dissent to the decision on the PAL acquisition if the Evansville Western, FD 34738, November 18, 2005: "The agreement includes a fundamentally anti-competitive provision—the erection of what is essentially a "paper barrier"—that would operate as a restraint of trade in rail transportation in the region."

Granted, PAL is the "recipient of an economic benefit reflected in the reduction in the sale/lease price of the infrastructure and right-of-way…However, over time the benefits received by CSXT should ultimately compensate it for the lower sale/lease price so that there is no need for the restriction to continue in perpetuity. Because paper barriers are not infinitely valuable, they should not have infinite lives, and *I do not believe* that the Board should continue to condone their inclusion as long as they are not time limited." (emphasis added).

There are two questions here: whether to overturn existing paper barriers or take steps to insure that future branch line transfers are not unreasonably encumbered in perpetuity. In my opinion, what's been done is done and ought to stay done unless the parties decide mutually to amend the agreement. Present and future deals have to be worked out so the intents are clear and are between business entities and not individuals -- successors and assigns is how the lawyers put it, I think.

I agree with Mulvey and Buttry that the paper barrier system has its flaws and must be addressed. Buttry told the Press Club "If you ask me whether future decisions will follow and affirm every precedent, the answer is, probably not." Seems to me he's talking *future* deals. Mulvey wrote in his EWRR dissent, "Because paper barriers are not infinitely valuable, they should not have infinite lives, and I do not believe that the Board should *continue to condone* their inclusion as long as they are not time limited." (emphasis added). Continue to condone, i.e., STB has condoned in the past but will be disinclined to allow them in the future.

In its 2/1/2006 decision re EP 575 the STB wrote, "We are especially interested in comments that: (a) discuss our statutory authority to address pre-existing paper barriers; (b) identify and describe existing paper barriers so that we can determine the extent of the problem alleged by WCTL; (c) identify and quantify any problems experienced by shippers as a result of paper barriers; (d) address the short and long term economic impacts of paper barriers; (e) address the effectiveness of the existing AAR/ASLRRA agreement on paper barriers; and (f) include information about the RIA, including the most recent version, amendment history, interpretations, proceedings, handbooks, etc."

And again it might well be the STB is more toward not continuing to condone, looking forward rather than seeking to fix old complaints. Buttry again: "Last summer, in the only small rate case ever to be filed, the Board's non-binding mediation process resulted in a private settlement in about three days. Some were disappointed because the case did not reach a regulatory conclusion, but I must say that I was pleased." In other words, Buttry, like Nober and Morgan before him, would rather see solutions agreed to without his interference.

Elsewhere, he talks about “reasonableness.” Overturning past agreements that reasonable people signed with their eyes open does not seem to fit that test. See the Wayne Michele VS in Reading Blue Mountain & Northern's EP 575 filing on 3/28/2006. Note too that Eric Hockey's cover letter does not ask the STB to undo what was done but rather to “develop standards for ending the paper barriers once the carrier has received an adequate return.”

The question remains, though, that if you propose to eliminate paper barriers through economic valuation methods, then how do you propose to reasonably value the paper barrier? The Class Is seem to want to price the paper barriers as if they are infinite. Their rationale centers on the inability to value something with so many unknown variables into the future. Yet pricing paper barriers too high may well eliminate any additional transfers from the Class I network to the short lines and regional railroads.

One solution might be to set the value of the paper barrier at the 5-year net present value of the business that’s on the line right now less the cost of maintaining or upgrading the track structure. The assumption is the incumbent Class I can’t or won’t add to the present traffic base and they’re transferring the line to keep the status quo. It’s a given that 10% of the customer base of any business will go away every year. Half the original business base will be gone in five years, all of it in ten (or less as service deteriorates). The only variables are how fast the Class I would run off the present business and how fast the shortline can bring on new businesses to replace the organic losses.

Now it may well be the new business the shortline finds wants to go out the other way. If the incumbent had kept the RR and not transferred it to the SL there would have been little likelihood that the new business would have located there, so it wasn’t the incumbent’s to have in the first place. Unless the Class I specifically pays the SL to build a business. But that’s another transaction entirely.

The other question to be answered when discussing paper barriers is that if the Class I were to keep that section of track would the customers receive the same type of benefits as being proposed by the elimination of paper barrier. In my mind they wouldn’t because the Class Is have a duty to maximize the value of their franchise for their shareholders, which quite often means pricing or routing certain business differently than the customer may prefer.

So the STB and rail customers should realize that continued use of paper barriers by the Class Is will allow additional parts of their networks to be transferred to the short line and regional railroads, which in itself is very positive. If Class Is are allowed to continue the use of paper barriers they will continue to divest parts of their networks and the customers will continue to receive a service and growth model from the short lines and regionals that is more attuned to their needs. But again I think the paper barrier terms must be laid out clearly and specify what is new business and what is not, and whether siphoning off carload traffic into intermodal boxes opens the other interchange for carload.

There are more pressing needs in the railroad industry than the elimination of paper barriers. We should focus on improving capacity through the investment tax credit proposal and the improvement of velocity across the rail network. The elimination of paper barriers will have little, if any effect, on these key initiatives. As Tom Murray notes in *Trains* for July 2006, “Shipper complaints have a similar tone: The only consistency about railroads is that they are consistently unreliable.” And until we fix *that* perception paper barriers won’t matter much.

On Thursday the STB issued an EP 575 Decision stating that The Board will hold a hearing on Thursday, July 27, 2006, beginning at 10:00 a.m., in the Board’s Hearing Room (Room 760), at 1925

K Street, N.W., Washington, D.C. Parties seeking to appear should file with the Board a written notice of intent to do so, with a requested time allotment and the full name and title of the speaker, as soon as possible but no later than July 6, 2006. Each speaker should also file with the Board a written summary of his/her presentation by July 13, 2006. This should be interesting.

**CSX Redux.** This comes from someone outside the industry, but a regular WIR reader whose name you'd probably recognize: "I bought the stock in March @ $56.66 and am a happy camper. Here's why, and it is purely anecdotal. For like two years CSX struggles with the One Plan. I make 3-4 trips a year up and down the A Line to Jacksonville and see that the manifest trains are all way out of their time slots - business as usual.

"Meanwhile, Ingram is firing people right and left. One day I think three division supers and a general manager were shown the door. Then this year I notice two things: One is that those Q400-series doggy manifest trains are all in their time slots - miracle of miracles. And they are all lonnnnnnnnng. That got me to thinking.

"CSX had seen a new face at the top of operations every year for a decade, in seemed. Why listen or pay attention to whoever it is, because there will be a new face with new priorities next year. But Tony *didn't* leave. Instead, a lot of other people did, a few of whom I knew and thought well of. I guess those who were left decided they had better begin paying attention and just run the goddamn plan. So I bought my 60 shares." And now that it's the Tony & Dave Show the message *will* get out. I'm still in on the dips.

**Anacostia & Pacific,** the Chicago-based shortline holding company (www.anacostia.com) , has stepped up to the plate with some significant equipment investments. The Pacific Harbor Line, serving the Ports of Los Angeles and Long Beach, will buy 16 "clean diesel" units from Wabco for delivery in 2007. These remanufactured locomotives will be equipped with new 2,000 h.p. diesel engines from Detroit Diesel that exceed U.S. Environmental Protection Agency "Tier 2" standards to reduce air pollutants.

One-half the cost will be paid by PHL with the balance shared among the Port of Los Angeles, Port of Long Beach, and the South Coast Air Quality Management District. "Pacific Harbor Line is investing $10 million to do its part to help reduce air emissions in the busiest port area in America," says PHL President Andrew Fox. MotivePower's Boise, Idaho facility will remanufacture 14 six-axle and two four-axle locomotives, which will be equipped with state-of-the-art electronic control equipment provided by Q-Tron, another Wabtec subsidiary.

Further east, the Chicago South Shore & South Bend Railroad (CSS) has ordered 100 new coiled-steel gondola cars equipped with insulated one-piece covers TRN got the order and began delivery last month. (I knew about it in April but had to wait for the press release.) Total cost of the new cars is north of $8 mm. The 112-ton capacity, 42-ft. long cars are equipped with end-of-car cushioning and feature a continuous trough with moveable crossbars to accommodate steel coils ranging from 30 to 84 inches in diameter.

"These new cars are part of South Shore's commitment to improve freight service for our steel customers," said South Shore President Henry Lampe. The railroad's service area accounts for about one-fifth of America's total steel production. Major steel customers located on CSS include U.S. Steel, Mittal Steel (formerly Bethlehem), and Roll Coater, Inc. Lampe expects his road to spend nearly $10 million on capital improvements in 2006, including the new equipment. Since beginning operations 16 years ago, CSS has leased or purchased 190 freight cars primarily for the steel industry.

**Providence and Worcester confirmed** Thursday that it has "entered into a confidentiality agreement with RailAmerica with respect to exploring possible business opportunities. PWX stressed that there is no agreement between the parties relating to any such business opportunities."

Indeed. There *are*, you know, physical connections between PWX and RRA's Connecticut Southern east of Hartford and with the NEC at Willimantic. It just might be that with Orville's passing PWX is rethinking its future. And just maybe RRA is looking for a way to connect CSO and NEC directly since CSX won't give them rights between Palmer and Springfield. PWX stock jumped 4% to $17 on the news; RRA hardly budged.

**Union Pacific won** the honors of hauling off Peabody's *billionth* ton of coal out of the North Antelope Rochelle mine in the PRB. This tidbit will give you and idea of the scale at which these guys operate. This particular mine shovels out 9 and a half million tons a year to AEC generating stations alone and last year churned out 83 mm tons, roughly 7% of total US coal production. The North Antelope Mine began operating in 1983, with the Rochelle mine beginning production in late 1985. The two mines were combined in 1999. Two concentric loop tracks connect with the Burlington Northern Santa Fe and Union Pacific railroads joint trackage. (I own shares in BTU.)

**The DME extension** into the PRB continues to generate thoughtful comment. For one thing, the greatly expanded RRIF loan package may not have gotten as big as it did without the DME project as a center-piece. But then, $250 mm to the DME might have been better spent in 50 packages of $5mm each to shortlines in areas of the country that could lose rail service without infrastructure help.

It can be argued the taxpayers are putting the DME into competition with UP and BNSF, but every dollar siphoned off the Class I revenue stream cannot make its way to the capex line for further capacity expansion and congestion reduction. It was one thing for the USRA to rescue Conrail and put Amtrak in business; it's something else to have the Feds funding a whole new railroad across the two cents plain. I'm also concerned about where the private lenders are. If it's such a good deal, why aren't the leading lenders buying in? And if the coal-burning utilities are encouraging it, are they doing so with dollars? I haven't heard of any.

**Buying on the dips.** In a volatile market like this one is well-served buy building a position over time rather than buying the whole thing at once. So when TRN stumbled below $60 on Thursday I picked up another 100 toward my full position thus shaving two smackers off my cost basis and pushing the potential gain at the $72.50 target price to a respectable 17%.