THE RAILROAD WEEK IN REVIEW
JANUARY 18, 2008

"The best-performing companies plan in advance" – Michael Mankins, Bain & Co.

The Midwest Association of Rail Shippers (MWARS) held its annual winter meeting this week in St Charles, IL, a western suburb of Chicago. This august group represents both sides of the transportation equation, with transportation buyers and users hobnobbing with their supply-side peers representing railroads, leasing companies and a myriad of service companies that help this complex industry work as well as it does. The theme of this year's session was the economy in general and the regulatory and legislative environment in particular.

There was a definite air of conflict. On the one hand was the need of more rail capacity while on the other was the threat of investment-limiting legislative and regulatory actions largely driven by special interests. No place was this more evident than in the Day One point-counterpoint discussion between Bob Szabo of CURE and rail industry observer and columnist Larry Kaufman. CURE opened with a series of motherhood and apple pie charts lamenting rail rate increases bordering on extortion, thousands of miles of track abandoned, yet more miles cascaded down to short lines, the unfairness of paper barriers and especially the plight of captive shippers. And throughout it all how a passive STB stood by and let all these awful things happen.

Szabo would have us believe that the sole objective of CURE is to assure compliance with laws already on the books. But it seems to me he is rather selective as to which laws CURE wants to push. Take differential pricing. Some of us got the impression that differential pricing and pricing to the market is OK except where CURE's sponsors (ACC, investor-owned utilities) are affected.

Szabo cited the example of a utility that saw rates increase by a significant multiple when the contract came up for renewal. But what he failed to mention -- as the STB's Buttry pointed out over lunch -- is that it was a 20-year contract where the effective rate had actually decreased to a third of the original price and renewal price reset the rate to the original rate plus two dollars a ton.

On paper barriers, Szabo said he "has never heard of" a satisfactory resolution of a short line paper barrier complaint. To the uninformed this would be quite shocking whereas in reality the success rate has been impressive according to my sources at the Class Is, the Railway Industry Working Group and the ASLRRA. As for "never hearing of," these are private negotiations between parties to confidential contracts between themselves so one can hardly expect the results of these discussions to be made public. But as I have found, ask and ye shall learn.

As for branch-line spin-offs to short lines, CURE would rather see the lines put up for abandonment and let interested parties step forward and negotiate a price for the property. However, this misses two important points. First, any hint of abandonment drives off business and thus the likelihood that *anybody* will step forward to buy. Second, a transaction that protects the seller's franchise at lower cost costs less for the buyer than it would if there were a risk that business could be lost to a second Class I connection on the line under consideration. The higher the price the higher the leverage to the buyer and thus the lower the odds of a successful transaction.

Kaufman's rebuttal contained no PowerPoint slides, no hyperventilation, and no hyperbole. He simply skewered every CURE argument and showed how the latter's position boils down to the protecting the commercial interests of its contributors. Then over lunch STB Vice Chairman Buttry said in so many words that he is against re-regulation and he continues to prefer that rail transportation disputes be ironed out without reliance on the regulatory process. Asked specifically about the Michigan JV between NS and Watco, Buttry said the STB “did not have enough information” to write a “for” decision that would stand up in court, adding that the STB “has never lost a case.” [The decision concludes, “We are denying the petition because the transaction would not come within the scope of section 10901,” seeming to infer that a new petition that *does* come under the scope of section 10901 might be more favorably received.]

On the morning of the second day I ran a panel on the economic outlook. The format was designed more to answer questions from the audience than to do a lot of speechifying from the platform. Sam Kyei, Chief Economist-Marketing for BNSF led off and set the scene. We had brief introductory comments from RailAmerica’s VP Marketing Charlie Patterson, barge-operator American Commercial Lines VP Brad Hall and Bulkmatic VP Larry Smith and it was off to the races.

The selection of panelists (which I had little to do with, BTW) was propitious because all but Kyei represented companies that are extensions of Class I line haul services. The questions came fast and furious and as soon as one was answered we were on to the next. My takeaway is that the MWARS crowd is very much aware of the myriad ways the economy can affect their companies and of the need to be ahead of the curve. The Dismal Science seemed not so dismal to this engaged group.

Time and space to not allow a full recounting of every panel and speaker, however I have to say this is one of the most engaged and involved audiences I have ever seen. I have reason to believe that in time the session’s presentations will be posted to the MWARS page at www.railshippers.com . A visit will be very much worth your while.

While in Chicago-land this week I called on Henry Lampe, President of the venerable Chicago South Shore & South Bend Railroad, an Anacostia & Pacific short line. Lampe is quick to point out that freight is the reason the South Shore has survived. Originally an Insull intermodal line (wooden catenary poles and street-running in Michigan City bear testament to this heritage), passenger business by 1976 had fallen to such a low ebb that then-owner C&O petitioned the ICC to abandon the line. The ICC said no, and in 1977 the Indiana General Assembly created the Northern Indiana Commuter Transportation District (NICTD or “Nick-D”).

Freight operations went to a new shortline operator in 1984. They went broke in 1987 and it was Anacostia to the rescue in 1989. Lampe says they are now running 60,000 annual carloads over the line, 45% of which is met and steam coal with the balance a nice mix of merch loads, all of which is interchanged for/from beyond. After riding NICTD and then driving the line with VP-Ops Jim Thompson I came away highly impressed and promise further observations on this line.

Providence & Worcester and GATX redux. Sharp eyes among the readership were quick to point out an arithmetic error in my per-share earnings impact of the PWX share count dilution as a result of the GATX purchase. The 3Q07 per share loss goes down, not up, with more shares, though the change is minuscule, to ($0.13) from ($0.14). The more important development is that GATX has acquired “a portion of” P&W’s existing rail car fleet, meaning that those cars leave the balance sheet lowering depreciation expense and increasing rent expense. We will have to see how this plays out given P&W’s unusually high operating ratio.

Knowing a Class I’s culture is a continuing theme in WIR. We have shown how the BNSF focus on velocity is shaping everything they do from capacity expansion to contracts. Aligning one’s shortlines with Hunter Harrison’s *Five Guiding Principles* has proven beneficial in case after case. Now come CSX’ *Core Va*lues as posted under the Employees tab at csx.com.

There are five tenets: It Starts with the Customer, People Make the Difference, Safety is a Way of Life, Fact-Based, and Right Results in the Right Way. Bullet points are supplied for each and the serious student is well advised to take a look. Since the TCI challenge emerged, I have been tracking CSX performance against these values as well as the elements of the TCI challenge. What I have concluded – and recent discussions with senior managers in Jacksonville bear me out – is that today's CSX is a vastly changed animal from what it was not that long ago.

Short lines can make a difference when all their dealings with CSX are fact-based and when they achieve their goals in such a way as to enhance the relationship with CSX. My sense is – knowing both Tony Ingram and David Brown from their NS days – which CSX is straightening out local ops by giving people the tools they need to do the job and then measuring performance against specific metrics. The process has to be working because on-time originations and departures have improved dramatically, terminal dwell is greatly reduced, and safety performance is at record levels.

As for short line-CSX service related issues, there are processes in place to address and resolve tactical problems. About a month ago, I spoke with Len Kellermann, Director of Regional and Short Line Development, about some specific interchange miscues. He suggests that short lines use this three-step process. First, call Customer Service Problem Resolution at 1-877-shipCSX (1-877-744-7279), prompts 5 and 6. Second, get a 10-digit personal identification number (PIN) to aid in the Customer Service problem resolution process. And third, sign up for the ISA performance measurement process These are procedures combined with data that should enable both parties to identify real problems and begin the improvement process.

There is one caveat, though. There has to be a dialog with CSX to make sure the problem is actually resolved. That is not to say that everybody has to be happy with the outcome, except insofar as the problem resolution process drills down to root causes and takes steps to prevent recurrence. For an example of how the system can help, consider this car delayed en route to a short line in the northeast. The short line initiated the dialog with CSX asking that the car be moved to it interchange for delivery beyond. CSX responded with an e-mail saying exactly when the car would be delivered and by what train, providing hard-copy documentation of what was promised.

In the final analysis it all starts with the customer and so must key elements of the short line-CSX relationship. Facts work; anecdotes and generalities do not. Processes are in place to encourage the former. ISAs are there to support a network of interconnecting pieces, and CSX is committed to establishing ISAs or modifying them if necessary. Cutting deals with the local trainmaster to fudge the interchange dates and times is not necessarily right results, right way. And getting wide of the safety mark can get you killed, literally.

The *Core Values* are there for a reason. I measure all my CSX short line clients against them and results are improving. Follow the Core Values and use Len's three-step problem-resolution process and yours will too.

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