RAILROAD WEEK IN REVIEW
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"The purpose of this proposal is to restore shippers' access to the Board's regulatory oversight and processes." STB on EP 704, Review of Commodity Exemptions, March 26, 2016

The STB Press release headline is innocuous enough. "STB Seeks Comment on Revocation of Commodity Exemptions." What they're leading up to is re-regulating terms of transportation for a number of low-rated commodities that represent the core franchise of many short lines. The Board maintains that when they made the rules exempting these commodities as part of the 1976 Railroad Revitalization and Regulatory Reform ("4 Rs") Act 29 years ago, "regulation was not needed to prevent abuses of market power."

Now, however, it appears there have been a significant number of customer "inquiries questioning the relevance or necessity of some of the existing commodity exemptions." Having reviewed the customer comments, the Board now proposes "to revoke the commodity exceptions" for crushed stone; coke made from coal; steel plates, pipes, rods, and scrap; and hydraulic cement. You can read the full description as EP 704 on the STB website.

I've read the customer comments and my overall impression is that trucks can't or won't compete in certain lanes, so the rails have priced to What the Traffic Will Bear. Rates have thus crept above the — to me, at least — magic and mysterious 180 percent Revenue/Variable Cost threshold. Ergo, shippers in these lanes must be allowed to complain to the STB when they feel abused. And to sanity-check my thesis, I asked around.

Long-time STB Practitioner Fritz Kahn tells me it's the goal of the Board to establish procedures whereby shippers "may request the revocation of the exemptions denying them the ability to complain to the STB about the poor service and high rates of the railroads serving them. If NITL, CURE and ARC were to alert their members to this extraordinary opportunity to get some relief from the railroads serving them, I think the exemptions will be greatly cut back."

The AAR's Ed Greenberg says they're taking a close look and while they do, we are reminded in a news item, "In 2011, the AAR expressed serious reservations with the Board over its review of certain commodity exemptions, indicating at the time there was no basis for it and through the Staggers Rail Act of 1980, the exemptions have led to enhanced competition, enhanced service offerings, and increased productivity and efficiency, which continue to benefit rail customers today." I can't argue with that.

An associate who's been in the business of wrangling rates for more than two decades writes, "EP 704 comes as a result of shippers having grown so frustrated with the STB's failure to exercise its role over the market power of the 7 Class Is that they're willing to revert back to regulation as a means of forcing the STB to do its job. Customers in these commodity lanes want some way to challenge the railroads, and you can't do that through the STB with deregulated rates. It doesn't mean contracts go away; it just gives shippers an option of forcing the rails to publish public tariff rates. Tariffs can be challenged: contracts and quotes can't."

My friend's wrap is the rails must embrace any new revenue opportunity to replace lost coal and the lost promise of crude. He echoes my earlier remarks here about the need for railroad senior managers to get out in the field and start managing. "It's about field management autonomy and aggressive marketing to put more traffic on the tracks - not less. This ain't rocket science. It's just railroading 101."

Kansas wheat: Watco's Doug Story writes, "From a wheat perspective, we could see an increase in price. Our wheat crop is further along than normal this time of year and we just had a freeze a week ago; everyone thought it didn't do a lot of damage, but then we had 2-3 inches of snow over the weekend in central and western Kansas. We will have to see how the market views these weather effects on the 2016 crop. Our old crop is moving very slowly, elevators are waiting for the producers to sell, and an increase in price could get things moving."

Doug continues in the May *Trains:* "It's simply market conditions — the value of our commodities relative to the rest of the world, and the strength of the dollar. The positive thing is we're coming off a good harvest so we're sitting on a tremendous supply for when the market is going to turn and allow the product to move."

The 2016 First Quarter Earnings Season kicks off with CSX reporting on April 12 after market close. TD Securities rail analyst Cherilyn Radbourne writes,

> The volume outlook has not changed much, in our view, but we believe that fears of recession have receded in favor of an expectation of sluggish growth. Management outlook commentary may be slightly more optimistic (excluding coal), but will likely remain cautious. We expect cost-control to be a focus in 2016, especially in H1/16, and believe that the rails may be able to surprise. UNP is our top pick, followed by CN; both are BUY-rated. CP, CSX, and NSC are HOLD-rated. Among the three HOLD-rated, we prefer CSX.

A dear shortline owner friend of many years' standing comments on my railroad transaction costs thread (WIR 3/25/2016). His railroad began as a classic mom-and-pop 14-mile short line that had been in the same family for nearly 90 years when he had bought it in 2006. Not being a "railroader" as such (when we met 20 years ago he was an investment banker doing railroad transactions), he brought new eyes to this old industry. He writes,

> I am reading the third page of the latest WIR. When I remark that we have quadrupled traffic in four years, people ask how. It is everything you and I discussed 10 years ago, getting to really know our customers, understanding their logistics, and going to bat for them on such potentially troublesome items as car supply, rates, etc.

> We were successful in getting the customers' confidence that we are going to be around for a while by cleaning up the right of way, refurbishing track, laying new sidings, and — since this is a small community —- getting out and being visible at community events. We really try to help our customers so hiring a truck is not a lot easier than rail service.
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> Customers already know about the challenges of rail service, but if they see their local short line fighting for them with the Class 1 railroads and assisting them with things like car tracing, they will build a loyalty to the short line. A recent example is our lumber customer. He had complained that our connecting Class I had priced one particular O-D pair so high it was cheaper to truck it. It did not sound right.
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> Turns out, part of the problem was that there had been deep cuts among market managers, and we had won a recent college grad trainee with no pull. We went to the senior guy on the desk and after taking a close look we got enough of an adjustment to keep the business on rail. It may have been just ten carloads per year, but the customer was so impressed with how hard we fought for his cause that he purchased the land next-door to double present capacity. Plans are to double next year's carloadings, after a record year for this customer.

Gartman on the Millennials, Uber, and car ownership: In Tuesday's Letter, Dennis cites a Federal Reserve Bank chart showing how, five years ago, annual miles driven started drifting below the long-term trend line heading up and to the right since 1975. Says he,

> We attribute this to any number of things, not the least of which is the rise of Uber and the Millennials' collective embrace of that 'high tech' ride-sharing business. To the Millennials, a car is a wasting asset, and they have embraced Uber, seeing a car as simply another mode of transport that can be summoned upon command but to which they've no allegiance… and never shall.

Gartman concludes that car buyers in urban areas are getting scarce, and as the younger crowd opts for more modest living spaces from which one can walk to everything from a bottle of Sauvignon Blanc to the opera, McMansions and Mommy Vans are found wanting. "If a car is needed, it will be summoned, and the auto makers will be the losers. Uber wins, Ford loses."

What's this got to do with short lines? GE Transport's RailConnect Index shows auto-related products comprise about three percent of Class II and II rail volumes. These are concentrated among short lines serving ports and automotive distribution centers, and, if Gartman is on track (as a car-free, Uber-using city dweller for many years, I take no umbrage), these carriers are at risk. The question thus becomes what are they going to do about it?