RAILROAD WEEK IN REVIEW
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“The Commission may determine that the public convenience and necessity require or permit the sale of a railroad line if the Commission determines that … the transportation over such line is inadequate for the majority of shippers who transport traffic over such line. —Staggers Act, Public Law 96-448, October, 1980

“Micro-managing margin yields in the face of declining market share might not be in the interest of the railroad’s survival. Realizing where railroad managers sit in the competitive food chain should trigger a survival instinct that brings the parties together.” — Freightwaves.com

“Every industry’s conferences are exactly the same. Why? Because saying we’re going to do something in front of a group of people is how we give ourselves the moral license not to do anything.” — epsilontheory.com

Frank Lonegro, CSX Chief Financial Officer, is leaving the company after 19 years’ service. I’ve known Frank for a good many of those years and have always appreciated his candor and directness. He became CFO in September, 2015. Prior to that he was VP Service Design, so he knows how all the pieces fit. I met him when he was heading up the initial phases of the PTC initiative for CSX. Frank has always had a reputation as a go-along guy and I think added some stability when Hunter came to town.

His successor has not been named. CSX has initiated a search for a successor and has tapped Kevin Boone as interim CFO. He’s been with CSX for just 20 months, starting as VP Corporate Affairs and Investor Relations. Two months ago Boone was tapped VP Marketing and Strategy, a new position created to research and identify high-priority growth strategies.

It’s entirely possible this latest shuffle could also mark the beginning of any CP merger efforts. Perhaps with Trump they see a narrow window to do this. However, as we know from the recent past, such Big Railroad mergers are super-political. Moving the ball forward requires a certain degree of political savvy and a well-honed ability to pay the DC game, and I’m not convinced CSX is there just yet.

I’ve been close to the shortline scene for some thirty years, since just after the 1980 Staggers Act, a federal law that greatly deregulated the American railroad industry. It followed on the heels of the Railroad Revitalization and Regulatory Reform Act (4Rs Act), which sought to loosen regulatory restrictions on railroads in order to allow them greater independence in setting rates for contracts and services, and greater freedom to enter or exit various rail markets.

It was the latter that got the shortline spinoff ball rolling (see quote above). Those of us who had studied the USRA's Final System Plan of 1975 knew that any branch lines so divested would fall into one of three categories: long-term viable; might last a while until an old customer moved on; or near-term candidates for the bone-yard.

Many of the shortlines were formed/acquired on the basis that the track laid by the former Class I owner was being employed at a lesser rate that suggested an extended (but not infinite!) life. Yes, some (maybe a third) have kept up, but there are many others for whom the piper must be paid. The debt schedules and the depreciation schedules may not match, and refinancing becomes not an option.

Moreover, the changing marketplace has mandated the need for heavier cars. To escape the noose of losing the business because of lack of capital, the short lines have engaged in a poor-me campaign for a special interest tax break from Congress. And now, with the Class Is generating profits that end up in stock buybacks and PSR driving even higher expectations, the shortline industry has achieved the status of becoming a plutocrat on the dole. I'm doubtful that can stand in today's political climate.

That said, results can certainly be skewed by the talents -- and mistakes -- of the owners of various properties. I recall one line — one of today's strong survivors — where management devised and pursued a strategy of finding and courting industrial customers that might be seeking plant locations for new products. Moreover they had to be intent on finding new customers, realizing full well that the shelf life of existing customers could limited.

Unfortunately, some operators were so far removed from their customers that they never knew what hit them. I can recall more than one short line that was convinced that because a certain wood chip customer was still in business everything was OK. Yet, on a customer call for the short line the wood chip buyer said they were assessing the comparative values of different wood chip suppliers because the receiving plant's numbers were not good. The plant closed in months.

History repeats, and as I look over the 500 or so short lines in my database, I see the same pattern that existed 30 years ago: a third would go away absent 45Gs and grants; a third will hang on until the last customer turns off the lights; and a third will continue to add considerable value to their customers' supply chain process.

The times they are a-changing. The market for the individual merchandise freight car shipment is shrinking. Bulk chemicals, agricultural products (both grains and mill products), aggregates are about all that's left. Manufacturers are trending toward smaller inventories of materials, smaller inbound shipments, and want finished goods out the door ASAP. (I concede the paper companies are big boxcar users, but paper is low-margin business that is not geographically wide-spread.)

And so it is that I am gradually reaching the conclusion that buying and selling short lines has been a financial game and the game is now up. The prices for properties have escalated again and again and again, and have outrun the market demand and their cash flow support. It has become a version of the old broker dodge: Sell to whom? Unfortunately, a lot of debt was undertaken to support the higher values, and the assets, even if still "profitable," cannot support that debt.

"Railroads risk market share by charging shippers excessive fees," headlines the *freightwaves.com* piece on last week's STB hearings on demurrage fees and accessorial charges. The article notes — correctly I think — that PSR railroads "seem focused on changing customer behavior through aggressive penalties."

Shortline operators and customers tell me small-block shipments become big blocks as trains are held at class yards to meet PSR-set train lengths. Others say the bunching that occurs a result causes cars to be CP'd at destination, starting the demurrage clock. On the other hand, customers hurt themselves by not releasing cars as made empty or loaded for outbound. Lumber forwarders are guilty by waiting for customers to unload inbounds, rather than grounding the material and releasing the car back to the railroad.

That may be true for the mom-and-pops, but the ADMs of the world may have a case.

> Archer Daniels Midland supplies about 28,000 of it own railcar assets and argued that there is a need for reciprocal standards when the shipper is providing the railcars. ADM made the point that the purpose of demurrage should be to improve the utilization of all equipment, including customers' private tank or hopper railcars. Yet the ADM representative told the STB that railroads will not guarantee their service, and under existing railroad demurrage programs, there is no incentive for railroads to improve their service.

The railroads miss the point entirely. The faster the railroad turns the cars, the smaller the fleet needed for a given annual volume. More turns equals more revenue units and less congestion. Less congestion means fewer locomotives, crews, passing tracks, and class yards. And so on.

The *freightwaves* story cited above concludes that trucking already commands about 92 percent of general cargo freight revenue to the railroads' six percent. "Most shippers and receivers will have the long-term option of continuing to convert more of their supply chain movements to transportation by truck, which clearly sets the benchmark for precision delivery, with tight delivery and pick-up schedules." When will the railroads learn?