RAILROAD WEEK IN REVIEW
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"The new Michigan Central will preserve and enhance freight rail service in southern Michigan." – Dave Eyermann, Watco Companies

In a neat twist of fate, a major chunk of the old New York Central's Michigan Central route between Chicago and Detroit will become the Michigan Central Railway operated by Rick Webb's Watco Companies out of Pittsburg, Kansas. Back in 1999 the MC went to NS as part of the Conrail split and NS, like Conrail, found that with the auto parts business supporting the Big Three auto makers drying up, there was less and less there there to support all this real estate.

Recall NS Auto and Intermodal VP Mike McClellan's auto presentation in NY last month wherein he showed how the auto parts biz was way down (WIR 6/8/2007). Waybill samples for first quarter 2005-2007 show a 21% decline in revenue units and there was at the same time a major shift to Triple Crown and conventional intermodal, further decimating the carload business.

On the other hand, The MC lines support a growing cadre of potential, albeit smaller, carload customers not related to the auto business. NS realized early on that its centralized sales force with its focus on large accounts was not really equipped to provide the personal touch needed to turn these small customer opportunities into operating cash flow. Watco's EVP and Chief Commercial Officer Ed McKechnie tells me they have identified some 250 such customers and it is this core that will let the new MC "grow its way to prosperity," to use his phrase.

Beginning in 1Q08 Watco will take on 384 route-miles including the east-west core between Ypsilanti and Porter on the MI-IN border plus Jackson to Lansing and Grand Rapids south trough Kalamazoo to Elkhart. And since Kalamazoo to Porter is now owned by Amtrak, Watco will assume NS trackage rights west of Kalamazoo. The new MC will be headquartered in Kalamazoo with Dave Eyermann as interim president. Dave is an ideal pick for this assignment given the job he did building the Dallas cluster for RailAmerica.

The way I see it, this a new twist on the short line model: a joint venture in which NS retains some degree of equity and operating ownership -- a significant consideration in the present case given the interests of Michigan in preserving the corridor and of Amtrak which operates eight trains a day over it. Freight and other revenue streams flow into the JV which in turn pays Watco and NS for freight services.

Infrastructure maintenance and capex come from JV coffers as well, which is just was well given the track maintenance requirements for Amtrak – well north of the typical $5000 per mile per year estimate we use for maintaining FRA class 2 track on your typical shortline. I suspect there will be other JVs in the future and we can expect this to be the new short line model for NS.

Says Eyermann, "The new Michigan Central will preserve and enhance freight rail service in southern Michigan. We will employ approximately 118 people and in the first year alone we plan to invest more than $6 mm to improve track and equipment in Year One to capitalize on the rail-served economic development opportunities we envision for the region. Over the next thee years we expect infrastructure investments of another $20 mm." The transaction is subject to regulatory approval by the Surface Transportation Board (STB) in Washington , D.C. Norfolk Southern and Watco will make the required filings with the STB later this month.

Anacostia's Pacific Harbor Line (PHL) formally accepted the first four of 16 remanufactured locos (14 MP20C-3 six-axle and two MP20B-3 four-axle) it has ordered from MotivePower, Inc., a Wabtec subsidiary. All are equipped with 2,000-hp MUT Detroit Diesel engines, which are said to reduce particulate emissions by 70% and smog-forming nitrogen oxides by 40%, while burning 30% less fuel.

MotivePower is also equipping the locomotives with state-of-the-art electronic control equipment provided by Q-Tron, another Wabtec subsidiary. These are the first units built in the U.S. using MTU-Detroit prime movers. The cities of LA and Long Beach are contributing $5 mm each toward the $23 mm project, with PHL paying $10 mm and the remainder coming from a California clean air program. Delivery will be completed by year-end.

PHL opened for business in 1988, dispatches all BNSF and Union Pacific trains within the ports, maintains 60 miles of track owned by the ports, serves seven on-dock intermodal terminals and has some 140 employees, according to Andrew Fox, PHL president. The port railroad moves nearly two million containers annually directly from and to the docks. Fox noted that the railroads move about one-half of the international container freight in the Los Angeles region yet contribute only six percent of the particulate emissions and are three times more fuel efficient than trucks, thus reducing greenhouse gases. PHL has been using low-sulfur diesel fuel since 2004 and is the first small railroad to join the EPA's Smartway Transport Partnership to promote fuel efficiency and reduce greenhouse gases within the freight industry.

Ethanol plants are sprouting up all over the place. Just this week the Oil Price Information Service sent out press releases on new or planned ethanol plants on the ICE, RailAmerica's Indiana & Ohio, the Ohio Central and Missouri's SEMO Port line. In addition to ethanol, we're seeing a growing interest in bio-diesel faculties as well.

As we've seen with the Iowa Northern (*TRAINS*, Aug 2007, page 35), short lines are ideally suited for serving clusters of producers that can only make 8-10 cars a day of the stuff. They can gather up train loads just like they used to do with country elevators before the Super Shuttles came along, giving the small producers the same transport edge as the ADMs and Bunges of the world. Moreover, the gathering capability spares individual producers the expense of building miles of tack and fields of tanks to store product pending shipment.

There's more to buying a shortline than dollars and cents. Assuming you already are in the business and are looking for other properties, it takes dollars and *sense* as well. If the target company and you both have the same approach to the business, well and good. But if there are cultural disconnects from EDI reporting to car hire to Class I relationships, the acquisition could be very expensive in terms of management time and risk.

Aligning poorly-fitting financial, operating and commercial aspects can severely disrupt a potential "tuck-in" acquisition. For example, HUBG had its eye on a firm in the same space but on further due diligence found that fitting the two companies together would have cost more than was comfortable. HUBG walked as a result, saving its powder for a better target. We've also seen shortline transactions where the controlling entity selected a culturally-mismatched operator with unfortunate results. The selection committee ignored its own ops quals check list and instead went for the guy with the biggest check book. Now they're looking for the un-do button.

Genesee & Wyoming's B&P unit has signed a 20-year agreement (terms not disclosed) to lease NS' 36-mile line from Buffalo to Machias, N.Y. This is an easy tuck-in because B&P currently uses the route south from Buffalo for overhead traffic under a trackage-rights agreement with NS. The lease is subject to regulatory approval and other closing conditions.

Operations are anticipated to begin in September 2007. Based in Rochester, N.Y., the Buffalo & Pittsburgh operates between its namesake cities on former Baltimore & Ohio lines. In the early 2000s, the B&P merged other G&W railroads into it. These lines include the Allegheny & Eastern, Pittsburg & Shawmut, and the Bradford Industrial Railroad.

Over the next two years, CSX will shift to decentralized dispatching of its 21,000-mile railroad network. Since 1988, the majority of CSX dispatching has been handled at the Dufford Control Center in Jacksonville. The 1999 integration of 42% of Conrail brought dispatching centers in Albany and Indianapolis into the fold; CSX also operates a center in Chicago to handle trains in that area. The end result of the shift will be to a "distributed, fully redundant architecture out of nine centers spread out across the eastern half of the United States," according to CSX.

The new plan calls for CSX to convert Dufford into a regional center employing 54 dispatchers, eliminating about 300 positions there, including several signal maintainer and management jobs. The dispatch offices in Chicago, Albany, and Indianapolis will be upgraded, and new dispatch centers will be opened at existing CSX facilities in Baltimore, Nashville, Atlanta, Cincinnati, Huntington, W. Va., and Florence, S.C.

IMHO it can't happen too soon. Centralized dispatching removes the very folks who ought to be closest to the rails far from them. WIR carried a "span of control" thread back in 1998 and it drew a fair amount of comment from the readership. From WIR for 6/6/98: "LAL's Bill Burt cites the work of Yale's Kent Healy, who 35 years ago wrote on the problems of scale in the railroad industry, noting that mid-sized railroads work best. A manager, said Healy, can only do so much in his span of control before things begin falling through the cracks.

"Places that worked well before time caught up with them include the Rio Grande, Lackawanna, NKP, and WP. Perhaps WC would fit the mold today. The fact remains that present class 2 and 3 railroads have managers whose span of control is small enough things don't fall through the cracks and where the service can be tuned to fit the need from day to day. It's how you keep carload velocity up, locomotive idle time down, overtime under control, and track maintained."

NS, for example, has always been decentralized and is so much so that you can run chop off any piece from the core and keep the rest of the system humming. That's what they did with New Orleans three days before Katrina hit. They asked their Algorithmic Blocking and Classification System and Operating Plan Developer to build a plan without New Orleans and two hours later it was done. Then they put it back in pieces as track was reclaimed. And the folks closest to the action were calling the shots all along.