The Railroad Week in Review
October 9, 2009

"Conditions have stopped deteriorating, but the sustainability and strength of the recovery are yet to be tested." – Railway Association of Canada

Out on the railroad again. On Monday I did a hundred-mile business car trip that included a few miles of cab time. The event was a financial preview of how and where the money is flowing on the Norfolk Southern-Pan Am Rail (PAR) rehab of the former Boston & Maine double track route between Ayer, Mass and Mechanicville, NY. This is of course the east-west core of the Pan Am Southern joint venture between the two companies.

This was totally new mileage for me (except for the first few hundred yards coming out of Boston's North Station). The first 35 miles were over track now owned by the Massachusetts Bay Transportation Authority (the "T"), a well-maintained double-track line of welded rail on wood ties in plenty of clean granite ballast. PAR retains the local freight rights and there were many signs that even in a down economy they are being kept busy.

The "T" joins the freight line from Portland at MP 313.5 (miles from Mattawamkeag, ME, where PAR predecessor Maine Central connected with the Canadian Pacific's Montreal-St John line), where PAR is building a new auto facility in the field between the two routes. T's ownership continues west to Fitchburg (MP 328) though the Pan Am Southern "Patriot Corridor" extends east to the intermodal yard at Ayer (MP 316).

Once on the PAR property we were on FRA Class 2 track where 25 mph has certainly been appropriate for the merchandise and intermodal mix of years past. Getting both tracks up to 40 mph is the goal here and it's that work we went out to see on this trip. I rode the head end for the next 20 miles and saw a road without a lot of tangent track as we rode up a one percent grade to East Gardner, elev. 1116, where the line flattens out a bit.

At Gardner the Providence & Worcester interchange was busy with a wide variety of car types and commodities. From here west to the Connecticut River bridge at East Deerfield the downgrade is mostly half a percent or less and it is here we really began to see the effects of the Pan Am Southern 800-tie-a-mile program. We passed the soon-to-be-restored interchange with RailAmerica's New England Central (ex-CV) at Miller's Falls and for the next few miles we were running along side a tie gang using brand-new PAR equipment.

When the work is done this will be a solid 40-mph railroad with gentle grades and curves. Already crews are running East Deerfield to Rotterdam Junction and back within the Hours-of-Service Law, saving the expense of taxis, lodging and deadheading. It's a superbly engineered route and with its bi-directional capability (Rule 261 to you ops guys out there) so capacity is not going to be an issue. Stay tuned.

The nation's freight railroads see both benefits of and drawbacks to the potential for track upgrades to accommodate more passenger trains regardless of speed according to a piece in Wednesday's *Wall Street Journal*. The consensus among the freight rails appears to be that more passenger service means greater public visibility and that's a good thing.

However, adding passenger trains to already busy freight main lines degrades capacity, especially if

you have freights at 50 mph and passengers at 80-plus, and that's not a good thing. As has always been the case, where a government-owned passenger agency wants to run passenger trains on investor-owned tracks, the former has to pay for the upgrades required for that service. And the interest is there. The *Journal* says 40 states plus DC have submitted $57 billion worth of projects, far outpacing the $8 billion available.

For en example of the kinds of conflicts that can arise, look at the HSR situation in New York. Proponents of a Buffalo-Albany high-speed passenger service operating at 90 mph or more over the present CSX mainline say "they are aware of railroad's concerns" and haven't fully addressed the infrastructure requirements. Well, they'd better.

From what I saw on my recent cab ride on this segment (WIR 9/4/2009, lead item) this bi-directional "261" two-track railroad handles the frequent freights and half a dozen Amtrak pairs pretty well, especially so considering the on-going maintenance required to keep stuff from wearing out under all these trains. But getting the passenger trains to 90 is going to require more track (re-install the third and fourth mains?), bridge upgrades and replacements, closer wayside signals and everything that goes with PTC.

Perhaps UP's Bob Turner summed it up best for the *Journal* reporter: "We don't benefit from adding that complexity to our system. There is no economic incentive for it -- that's for sure." This from a company that sees PTC alone costing them a $billion and a half and could ultimately cost capacity precisely at the time we need all the "green" transportation we can get.

And, speaking of money, the STB has determined that the railroad industry's after-tax cost of capital was 11.75 percent, up from 11.33 percent in the prior year. For the calculations and rationale, go to www.stb.dot.gov and pull up "Railroad Cost of Capital 2008, STB Ex Parte No. 558 (Sub-No. 12)." It's a good number to know because "the Board uses the cost of capital figure in evaluating the adequacy of individual railroads' revenues each year. It also uses the figure when determining the reasonableness of a challenged rail rate, considering a proposal to abandon a rail line or valuing a particular railroad operation."

For what it's worth, you can now get the STB's latest on your Blackberry or similar gizmo. Simply go to www.stb.dot.gov/stb/m.htm and get a screen directing you to all your favorite places -- filings, decisions, economic data, etc. *plus* a search engine. Clicking on Filings, for example, brings up a screen with only a few items, so if you're looking to see what's been filed recently, you'll just have to keep hitting the "Next" button. Click on a link and get the full item. It's a useful tool for entertainment during boring PowerPoints and you might even learn something in the bargain.

The Morgan Stanley Truckload Freight Index for October 2 finds that "truckload demand has improved as the US economy has stabilized and inventories have normalized, but truckload capacity remains abundant." Of interest to railroad merchandise commodity managers who have to cope with wide fluctuations in truck pricing, "Rates remain near the trough levels reached earlier this year and we see signs reefer pricing may still be eroding." UP, for example, tells me reefer truck rates have dropped as much as a third on cross-country perishables routes.

Such drastic swings in truckload pricing are going to hammer short lines in particular. At the recent UP Short Line Meeting the forest products commodity group said an oversupply of available truckers, lower fuel prices and smaller volumes have conspired to push rates down 20 percent to a buck-eighty a mile from two and a quarter in a matter of months.

Does that mean UP has to take 20 percent off its STCC 24 freight rates to compete? One should hope

not, but in any event it doesn't leave much upside to freight rates. Now consider the short line that gets an FAK handling fee of $400 per car. As rates stay flat and costs continue to go up, that $400 becomes a bigger piece of UP's yield on that car. And it's a disincentive to use a short line.

To get a handle on the truck competition, take a good look at Exhibit 14 toward the end of the M-S note. The $250-300 billion for-hire market represents about 60 percent of US intercity tonnage and almost a third of the ton-miles. There are literally "hundreds of thousands of carriers," most of which run fewer than a hundred trucks and 96 percent of which run 20 or fewer trucks. The name-brand public carriers -- JB Hunt, Schneider, Landstar, Heartland, et. al. -- touch less than a tenth of the total market.

Making it tougher still for both rails and the big truckers, M-S says it's an environment of "predominantly full trailer loads moving directly from shipper's dock to receiver's dock on irregular schedules" using trucking outfits with little if any fixed-cost network and whose primary assets are tractors and trailers. Driver turnover is high with many not staying a year, and labor costs run 40 percent of revenue. So margins are going to be thin: will work for gas.

With average shipment sizes running ten tons more or less, each load does not represent much inventory so irregular schedules really don't matter much. What I take away from this is that transportation buyers using the mom-and-pops get their props by hondling for pennies among a small number of regular vendors who can thrive in this market. These guys are best left to their own devices; the rails are better suited to guys who run supply chains and have some P&L responsibility.

The Railway Association of Canada started a new *Monthly Carload Trends Monitor* this week. The ten-page report tracks monthly changes in the carload traffic of the two Canadian Class I freight railways (CN & CP) across different commodity groups. Moreover, the month-to-month data is seasonally adjusted, allowing for more accurate month-over-month trend analysis. In the case of coal, for example, where August is always down relative to July, actual loads were off 4.6 percent but seasonally-adjusted were up 0.7 percent, saying, in effect, that the 2009 July-August delta was not as bad as it has been in the past.

Total August carloads ex-intermodal fell 19.6 percent year-over-year (AAR's August US carloads ex-IM were down 16.4 percent excluding US operations of CN and CP). Seasonally adjusted, metallic ores and metals were up a whopping 19.2 percent, chemicals up 5.1%, and non-metallic minerals and products (essentially aggregates, it would seem) increased 3.0 percent. In separate pages detailing each commodity group, RAC notes that "a bottom appears to have been reached" in metallic ores and metals and has a monthly bar chart to show by how much and when. Ditto the other growers as well as the downers. Auto, for example, hasn't moved much since February and neither has forest products.

The report offers an eye on the economy, noting that the Canadian GDP started to trend up in May, reversing an 11-month economic contraction. Happily, rail carloads began to move up at the same time, confirming the 12 percent surge in Canadian housing starts. The note concludes, "Conditions have stopped deteriorating, but the sustainability and strength of the recovery are yet to be tested."

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