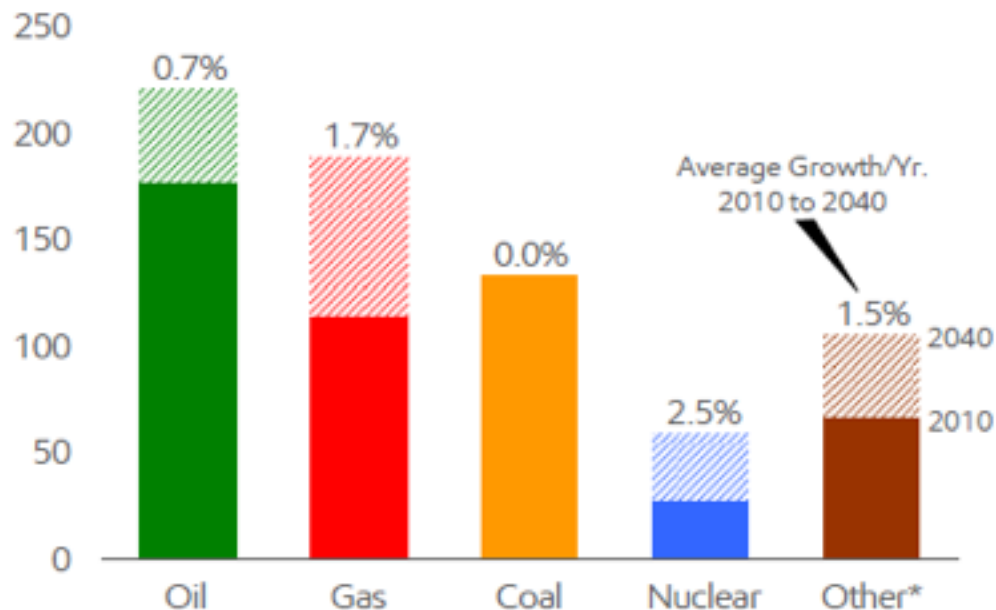
THE RAILROAD WEEK IN REVIEW

April 4, 2014

"ExxonMobil's 2014 outlook shows that global energy demand is likely to grow by about 35 percent through 2040." — Rex Tillerson, Chairman & CEO, ExxonMobil

ExxonMobil forecasts oil, gas and coal will continue dominate global energy consumption, providing about 80 percent of the total fuel burn. Moreover, says Tillerson,

> The use of natural gas will rise by about 65 percent and it will become the second most widely used source of energy surpassing coal. Natural gas is increasingly recognized as a reliable, affordable and clean fuel for a wide variety of applications, and its growth was supported by advanced technologies that are unlocking abundant resources. We expect global demand for the least-carbon-intensive fuels — natural gas, nuclear and renewables will rise at faster than average rates led by power generation requirements.



Source: Exxon-Mobil Fourth quarter 2014 Analysts call, courtesy seekingaplha.com

In other words, coal demand is flattening out and retaining its position as a base-load fuel for perhaps a third of electric power generation while nat gas provides peak load as well as base load fuel where the economics warrant. Oil remains the dominant transportation fuel, which Tillerson describes as having "about two thirds of its increase driven by expanding transportation needs."

Separately, Tuesday's *Gartman Letter* specifically cites West Texas and Marcellus:

> Everyone knows the stories of West Texas and the Eagle Ford and Permian Basin fields, just as everyone knows - or should know -about the Williston Basin and the Bakken field in western North Dakota. True, there are huge frackable fields scattered all across the country, however, according the the Energy Information Association, in 2013 Texas supplied 35 percent of the US crude oil production and North Dakota supplied 12 percent of it. Both were up by nearly a third from the year previous.
>
> The real production story is in the Marcellus shale formation, being closest to the population centers along the eastern Seaboard. The Marcellus Shale field stretches from eastern Tennessee, northeastward up through West Virginia, on into Maryland, northward into Pennsylvania and extends all the way to the St. Lawrence River where it abruptly stops. Attention must be paid.

Iowa Pacific Holdings has two railroads in Texas tapping into the Permian Basin and the North Shore Group in north central Pennsylvania is well-positioned in the Marcellus dry-gas zone, which really got its start north of Interstate 80 and south of the New York State Line. GWR's Ohio Central Railroad is in the process of building wet-gas facilities in eastern Ohio.

Friends reporting from the STB Access hearings last week caused me to wonder whether it's really a zero sum game. If Paragon Paper is captive to the Fallen Flag & Eastern and can only get competitive rates to points local to the FFE, then Paragon has to look elsewhere to get products to its customers local to the Fiddletown & Copperopolis. Truck, transload or intermodal are about the only alternatives.

If, on the other hand, the F&C interchanges with the FFE at a point 20 miles from Paragon's location, and has rights to serve Paragon over the FFE, might not the FFE see an increase in total cars over the branch, lowering FFE's fixed cost per unit? To be sure, the F&C doesn't get in for free and must pay some toll for the access. But it seems entirely possible the FFE could see more total cars on the line and thus have more cars to contribute to the line's upkeep.

Then there's competition. Fact is, there's a lot less competition among railroads for the freight dollar than there was when Staggers was signed 30 years ago. The Act allowed rails the freedom to set rates where there was competition with - in 1975 anyway - 56 Class I roads competing for the transportation dollar.

Back then, rather than having only a single-line haul option, Paragon's distant customer could be any number of railroads away. Let's put Paragon in Williamsport, Pennsylvania, where he is served by the PRR, Reading and NYC. For a customer in Charlotte, NC, he can go PRR-N&W-Southern, PRR-Southern-Norfolk Southern (the original NS, by the way), Reading-B&O-RF&P-Seaboard, or any combination of those and other roads. Not any more, with NS having sole access to Williamsport over its Lycoming Valley handling line connection, itself NS only.

The gloves are coming off in Canada, too. In Monday's press release, CN Chief Executive Claude Mongeau is quoted thus: "The faster space is created at country elevators, the more grain, from the most farmers, will be able to move to market." Says to me Claude is chiding elevators for sitting on cars, farmers are not getting grain quickly to the elevators, and - reading between the lines - destination facilities for not turning cars quickly.

Not to put too fine a point on it, Mongeau adds there is a "lack of coordination across the supply chain." Specifically, he wants the elevators "to step up to the capacity they claim to have, and do so in the corridors that will benefit Canadian farmers the most." He concludes,

> Unfounded railway bashing by grain stakeholders and the government's ill-advised legislation to unfairly punish the rail industry are unfortunately about to set Canada's grain handling system backward. We steadfastly believe that ensuring commercial alignment and encouraging supply chain collaboration are much better ways to build a stronger transportation infrastructure to the benefit of Canadian farmers."

I'm reminded of a conversation I had some years ago with CP's then-President Rob Ritchie about freight rates for grain and some brokers complaining that they were being charged more than their competitors. Here's what I wrote in the December 9, 2005 Week in Review:

> The guy who invests in the asset gets to say how that asset is best used. Says CP's Rob Ritchie, "We will price around those who do not understand the full logistics supply chain." By that I take it CP will price to those who can turn the assets and those who cannot appreciate the value of proper asset utilization may find themselves priced out of the market.

So here we are eight years later with complaints still being raised about rail service and the availability of cars. If in fact CN's Mongeau is talking about car dwell-times at loaders and unloaders, maybe it's time CN starts to "price around" supply chain collaboration.

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