RAILROAD WEEK IN REVIEW

February 3, 2017

"Three STB Members have voluntarily surrendered the distinction of the STB as an independent regulatory agency not subject to Executive Branch control." — Frank Wilner

A friend writes concerning my comments that the shortline construct these days is as much about market development as it is on labor cost savings, is right on target (WIR Jan 27). I'm referring to several instances of Class I line sales or leases that were more about business development than anything else. For example, the Class I leases to a local operator a somewhat high cost, low market share switching operation in a market under-represented by the Class I sales force.

The transaction yielded some per-unit savings in operating expense, but the Class I bet was the local operator could ramp up business for all the reasons I mentioned a week ago. Over the next few years, the short line was indeed successful and that franchise is booming. My friend:

> Some of it might have happened anyway, but other developments were fully attributable to the short line's presence and expertise, including a massive inbound carload increase for a one-time onesie/twosie receiver that the short line relocated to a larger facility adjacent to its property. At the same time, the short line shed excess track miles without losing a carload OR losing developable trackside real estate.

I could go on with more examples, but you get the drift.

Carbuilder production trends provide an excellent preview of railroad transportation demand going toward. The *Railway Age* Newswire for Jan 30 provides a detailed breakout by car-type — which I'm attempting to summarize in this table.

Orders for new cars dropped 12% in Q4 and the backlog dropped 14%, suggesting shippers and railroads see less need either to replace what's wearing out or to add to the fleet to accommodate new business. The only growth story is in covered large-cube hoppers of the sort typically used for grain and plastics. The small uptick in tank cars orders makes tank cars and covered hoppers of all sizes account for 72% of all orders, up from 60% in the third quarter.

	4Q	3Q	% change
Orders	4,866	5,526	-11.9%
Delivered	14,914	15,375	-3.0%
Backlog	66,681	77,640	-14.1%
Non-tank	3,977	4,645	-14.4%
Cov Hopper	2,629	2,341	12.3%
Pct orders	54%	42%	
Mid-cube CH	1,284	1,678	-23.5%
Large-cube CH	1,150	744	54.6%
Small-cube CH	195	0	nm
Tank	889	881	0.9%
Tank+CH	3,518	3,303	6.5%
Pct orders	72%	60%	21.0%
Source: RSI			

Railway Age concludes, “We think the industry backlog continues to trend toward a more ‘normalized’ concentration of car types consisting of 28% tank, 24% small-cube covered hopper, 19% medium-cube covered hopper and 11% large-cube covered hopper.” With this caveat: Industry data implies a net cancellation of 911 railcars, mostly covered hoppers, roughly equally across all cubes.

In other words, short lines doing business in grain and plastics will be encouraged by these numbers; those with large concentrations of boxcar and gondola traffic less so.

The STB seems to be waiving its status as an independent agency. Frank Wilner writes Jan 31, also on the *Railway Age* Newswire, “Expediency over principle describes a unanimous vote Jan. 27 by the three Surface Transportation Board (STB) members—Acting Chairman Ann Begeman, a Republican, and Democrats Dan Elliott and Deb Miller.” As Wilner tells it, the three have “voluntarily surrendered the distinction of the STB as an independent regulatory agency not subject to Executive Branch control.”

The trigger was a Reince Priebus “Memorandum for the Heads of Executive Departments and Agencies” saying that “the effective date of rules already published in the Federal Register, but that have not become effective, will be postponed for 60 days, to give The Executive Branch time for further review.”

Wilner, and I quote: “Whoa. Further review by the Executive Branch of lawful rule-makings by a congressionally created independent regulatory agency—one considered an ‘expert body’ by the federal judiciary that routinely gives ‘great deference’ to STB expertise?” Looks to me like the STB is trying to keep a low profile — expedience over principle, as Wilner so accurately says.

The implications for shippers and short lines are scary, indeed. If the STB makes a decision, on, say, competitive access or paper barriers, that the White House in its “review” finds objectionable, that decision can be set aside. Makes one wonder about our so-called Rule of Law.

Regarding Hunter Harrison and CSX, I think there’s less to this than meets the eye. When Hunter took over IC, it was a north-south railroad in an east-west world that had lost its focus. He scheduled everything around the grain train turns and proved his Precision Railroading concepts. Then he went to CN. We know how that worked out. CP is a lot like the Rock Island because everywhere they went, somebody else went better, and they didn’t charge enough. So stop going where you don’t need to go (Albany, Harrisburg) and start charging market rates where you can. None of those shoes fit CSX.

CSX has taken what I’ve called five angry railroads—C&O, B&O, L&N, SAL, ACL—and made them play nice together. The OR is safely into the 60s and headed lower. There is a young, talented bench (Frank Lonegro, Cindy Sanborn, Fredrik Eliasson) that’s come up with the company, and a short line program that is the longest-running and best-supported in the industry.

The route structure is an efficient Jacksonville-New York/NJ-Chicago triangle, with the Washington tunnels getting closer to a true I-95 corridor. The intermodal hub-and-spoke strategy provides more flexibility than the NS Corridor theme, and fourth-quarter merchandise carloads were 65% of revenue and 43% of volume. Coal is down to 19% and 14%, respectively.

In summary, I think CSX already practices Precision Railroading and knows there is yet more to do in taking out cost, removing redundancies, and adding value to its transportation product. Hunter Harrison may have proven he can be the right medicine for curing sick railroads, but CSX does not strike me as a candidate for the HH cure. (Of course, it could be Hunter thinks that CSX is worth more in pieces than as presently constituted. Is that where he is headed?)

The 45G shortline tax credit for track maintenance and rehab has taken another step toward permanence. The ASLRRA announced Tuesday that the House has introduced the "Building Rail Access for Customers and the Economy" (BRACE) Act. The current tax credit expired Dec 31, as it has every year for five years, severely limiting short lines' ability to plan and fund projects.

The 45G program allows shortline and regional railroads to file for track improvement credits up to $3,500 per mile of track owned or leased by the railroad. The tax credit has been active since 2004, going through a series of short-term extensions, many times being extended retroactively.

ASLRRA says the tax credit has enabled shortline railroads to increase their infrastructure investment by 180% —more than $2 billion — over the past 12 years. As a result, non-Class I railroads are putting 24 to 35 percent of earnings back into track and bridge rehabilitation. Kudos to the ASLRRA and its members for getting sponsorship for making the 45G credit permanent. Now to get the bill passed by the House.