THE RAILROAD WEEK IN REVIEW

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"Our legal analysis calls into question whether we legally may operate any freight or passenger service on mandated lines where PTC has not been installed." — Carl Ice, President, BNSF

What happens if PTC isn't fully operational by Dec 31, 2015? BNSF President and CEO Carl Ice says if the deadline isn't extended "stakeholders may need to make preparations or alternative plans well before the current December 31, 2015, deadline."

In his September 9, 2015 letter to Senator John Thune, Chairman of the Senate Committee on Commerce, Science, and Transportation, Ice writes that BNSF has concluded that the law prohibits *any* (emphasis his) trains from operating on "lines that are part of the FRA-approved PTC Implementation Plan," not just hazmat and passenger trains. As for its common carrier obligations, "BNSF believes that the common carrier obligation is tempered by reasonableness," and that it's not reasonable to expect BNSF to break the law in the name of common carriage.

Nowhere in his letter does Ice say categorically that BNSF *will* shut down lacking an extension. But he points out the impossibility of running all his non-hazmats over lines not slated for PTC simply because there's no room. And if there's no room for BNSF's own trains, surely there's no room for interline traffic with other lines, effectively shutting them down, too. Short lines will be truly screwed because they're paid by the car: no cars, no paycheck.

Union Pacific President Lance Fritz also wrote Thune. "It is our plan to embargo all [toxic by inhalation] traffic as well as passenger traffic on our railroad. [Toxic by inhalation] traffic would be embargoed several weeks prior to Jan. 1, 2016, to ensure an orderly shutdown and clear our system of [toxic by inhalation] carloads prior to the end of the year." NS President Jim Squires says they may take the government to court, claiming lack of due process by the FRA and the feds in creating the PTC deadline.

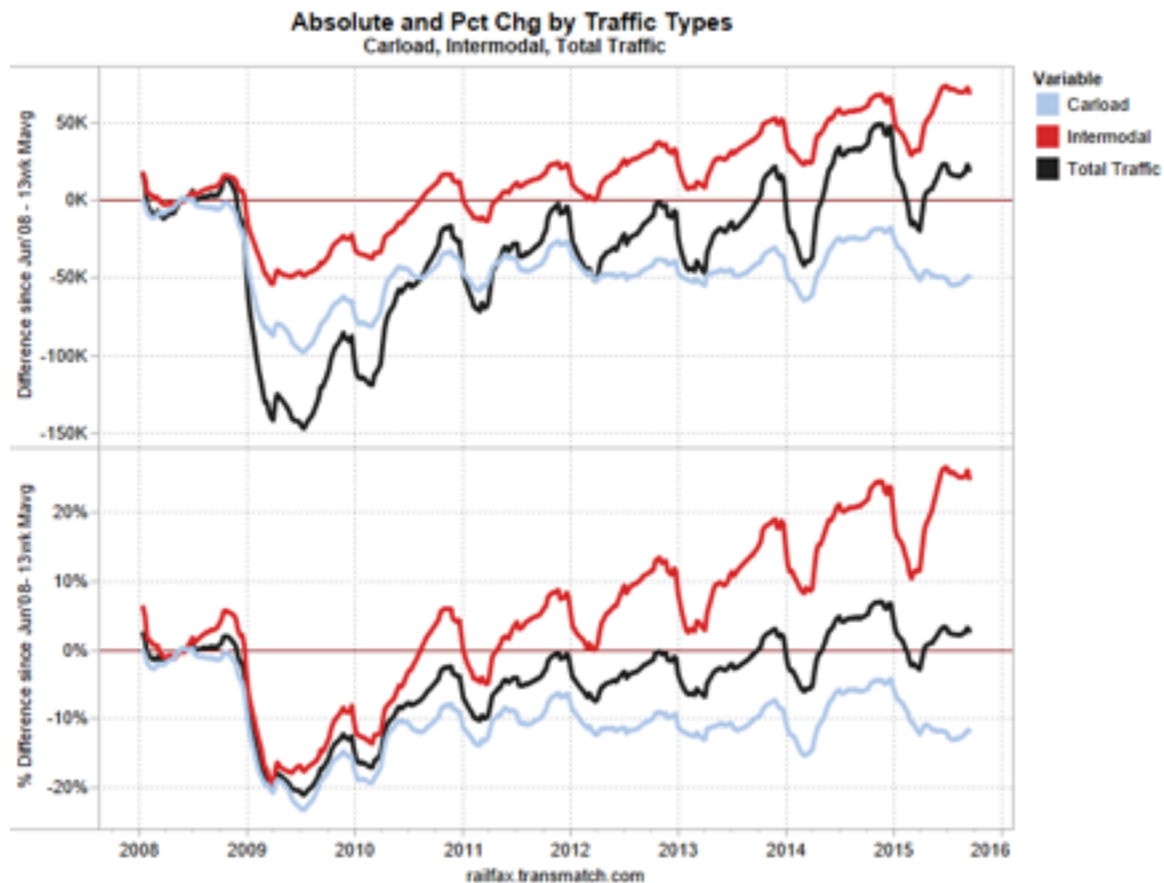
Washington-watchers tell me there is legislation floating around the hallowed halls of Congress that, if passed by the end of October, will grant a three-year extension. A friend writes that the odds heavily favor this being fixed in time. From his note, I'm willing to say the votes are there to support the legislation; however, given that my friend sees a one percent chance the vote fails, I'm happy to see Carl Ice setting the stage for the resultant unpleasantness.

There are signs we may yet see the reasonableness Carl Ice cites. On Wednesday, the GAO issued its own study concluding that Congress should extend the deadline railroads have to install positive train control on the FRA's designated PTC line segments. And give the FRA the authority to do so. The stakes are certainly high. Says the AAR,

> Freight rail customers representing huge segments of the U.S. economy have warned of potential disruptions that could result should Congress fail to extend the deadline. For example, earlier this month nearly two dozen agricultural organizations urged Congress for an extension, saying that American farmers will face a fertilizer shortage if rail lines are unable to move critical products such as anhydrous ammonia, an essential fertilizer component."

To say nothing of coal, needed to keep the lights on in the 30 percent of communities still on the coal-fired grid, chlorine for water treatment, ethanol to meet the gasoline mandate, and corn to feed the food chain. Recall that PTC was hastily passed by Congress after Chatsworth, and the fallout is an unintended consequence of failing to do the what-if analysis. So not only do the commuter rails stop, you can't get gas for your car because there's no ethanol. Catch-22.

Year-to-date North American Class I total revenue units slipped another six-tenths of a percent in Week 36. The AAR weekly report has commodity carloads — including coal, auto, and crude oil, ex-intermodal — down 3.8 percent. Those three carloads groups account for 40 percent of Class I carloads and are down 6.5 percent; back them out and what's left — the



commodity groups the short lines depend on — are down only one percent. But…

Whereas the Wall Street analyst notes look at total vols from an investment viewpoint, here we care about trends that affect the non-Class Is, essentially the core commodity business of all railroads. So if coal, auto, and crude are down more than everything else, that suggests everything else is doing less worse than the other three. Maybe.

Drew Robertson's volume charts (above) show intermodal clearly on the rise and carload (coal, crude, auto — everything not in a box on a flatcar) essentially unchanged for five years and trending down this year. That means, going back to the AAR data, carload vols are going nowhere and the only saving grace is the rails' ability to raise prices at a faster rate than operating expense goes up, thus increasing operating income, and goosing earnings-per-share with share buybacks.

There is a way out. Short lines have shown repeatedly that their local hands-on approach can yield increased carloads where distant Class Is have fared less well. Moreover, with the shift away from coal and toward intermodal and oil-based energy, what were once busy coal feeder lines are now moribund branch lines with high per-car fixed costs and lots of low-rated traffic. And what were light-density lines parallel to high-density core routes now serve as escape routes to add capacity between key OD pairs. (See BNSF on Montana Rail Link, NS on the CFER.)

So take the capital cost and variable expense off the ex-coal lines and put it into the lines that are now handling more traffic than they were built for. Lease the now light-density lines to Class II and III railroad operators and let them find new uses for old lines even as they relieve the Class I of the branchline capex and variable cost burdens. Quarterly operating expense comes down, revenue (even after paying the new operator) has a chance to recover, and earnings can go up without blowing capex dollars on share repurchases. Any takers?

Rising tide lifts all boats dept. BNSF this week announced new expedited intermodal services between Chicago/Twin Cities and the PNW. According to the Service Advisory on the BNSF website customer page, "BNSF has been engaged in a multi-year expansion project to add capacity and improve rail service consistency and reliability. The new schedules being introduced provide BNSF intermodal customers with service designed to meet their needs along the northern tier."

Increasing intermodal speeds means increasing the speed of all trains. There simply isn't enough room to park every manifest, grain, and oil train to keep the line open for the faster intermodal jobs, which means you have to keep all the trains moving. Consequently, I can see short lines starting to pre-block for the distant node to minimize dwell time and increase car-miles per day. And that's the way things ought to be.

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