

RAILROAD WEEK IN REVIEW

July 16, 2021

“If Oberman is to preserve—from his time with the Illinois Racing Commission, Chicago City Council and Chicago Metra—a reputation for no-nonsense full transparency, he should announce that henceforth, when the Board considers merger applications and policy-oriented matters (such as reciprocal switching/competitive access, revenue adequacy, ratemaking standards and processes), there will be more public hearings, oral arguments and open voting conferences.” — Frank Wilner for Railway Age, July 12

“While underscoring that the STB is an independent agency and that maintaining its independence is vital, I welcome the nationwide policy contained in this new Executive Order. The President’s emphasis on improving the competitive landscape across the entire economy fits well with my view of the Board’s mission in the current rail environment.” — STB Chairman Martin Oberman, July 9 Statement

“A CP-KCS transaction would diminish the pressure for downstream consolidation by preserving the basic six-railroad structure of the North American rail network: two in the west, two in the east and two in Canada, each with access to the U.S. Gulf Coast.” — CP President Keith Creel, June 29

“I have wondered ... whether the combination of the reductions in workforce, the interruptions in service, the demarketing all implicate the common carrier obligation that railroads have and have had really since the beginning of the railroad industry. And it’s something that I continue to focus my attention on.” — STB Chairman Martin Oberman, MARS, July 12

The July 9 Executive Order from President Biden covering competition in general has little to say about railroads in particular. Just that “The President encourages the [STB] to require railroad track owners to provide rights of way to passenger rail and to strengthen their obligations to treat other freight companies fairly.” But Amtrak already has rights and they have to pay and stay out of freight’s way. Treating other railroads “fairly” is in the eye of the beholder. With only seven Class Is, there must be interline cooperation or everybody loses.

But, as usual, the devil is in the details. By way of background, the White House has released a “Fact Sheet” noting that “in 1980 there were 33 ‘Class I’ freight railroads, compared to just seven today, and four major rail companies now dominate their respective geographic regions.” The Fact Sheet correctly notes that the railroads can “privilege their own freight traffic” and document concludes such actions make it “harder for passenger trains to have on-time service,” and allows track owners to “overcharge other companies’ freight cars.”

And so it is that in the EO “the President encourages the Surface Transportation Board to require railroad track owners to provide rights-of-way to passenger rail and to strengthen their

obligations to treat other freight companies fairly.” And so it does, as shown above. My take is the President is giving the STB license to act more aggressively in the interest of the shipping public. Wilner says that Oberman is well-suited to accomplish that quite well, and the non-Class I railroad community will benefit from the added daylight.

Maybe more easily said than done. A recently retired friend who did yeoman service for a Class I railroad in law and finance fears that “that most commerce lawyers have gotten out of the habit of being ‘real lawyers’ — questioning witnesses, conducting cross examination, presenting openings and closings. All of which used to be *de rigeur* for any such practitioner.

“One of the problems is also that many of the STB Board members are not schooled in legal practice either — even though the practice does differ from the courtroom. It’s been an odd minuet for many, many years now. Most of the hearings that have been held have been purely for show. Mostly witnesses are reading prepared statements with little to no interaction or interplay. It would fun to see that come back again (at least from my perspective).”

I can see some challenges for “captive” customers. Though the EO mentions the need for Railroad A to treat Railroad B “fairly,” the actual interchange between railroads for reciprocal switching is time consuming, as shown by [this excellent AAR video](#). Some caveats, however.

Agreed that the video operatins are complex, but many of the moves shown were inefficient. For example, the video counts each change of direction as an action...some might see this as a stretch, but I don’t. The tag line was that reciprocal switching is very complicated. The weakness of that is it tells everyone that railroading is very complicated. The customer doesn’t care.

Of course, short lines and Class Is do this every day with whole trains. And for a successful Class I variation on the theme, take the Toyota interline switching operation between CN and CP in Cambridge, Ontario. The additional complexity is it is not a single car shipment but more like 30-40 outbound auto carriers per day that need to be pre-tripped before loading. That said, it is the same each day and muscle memory has built up in the local switching crews... it works even with varied volumes by destination. Basic PSR in action: same way, every day.

This AAR fact sheet and accompanying exhibits is impressive. It starts with the EO Recommendations and applies them to specific railroad activities and the financial results thereof. Look closely at the links to Final Rate Review and Forced Access. Though the points are well taken, I still think there are places where the Class I roads have overreached. Try the reported RVC ratios on STCC 28 moves (6x?) or bunching customer cars due to fewer train-starts and the constructive placement charges incurred as a result.

I can’t see “forced access” working to the benefit short lines. Let’s say your direct Class I connection’s service has become unreliable. Meanwhile railroad B connects with your guy — railroad A — a short distance from your interchange. Your customer wants to try railroad B.

That means B short-hauls A. But your division or handling fee comes from A. Short-hauling means less revenue for A and your handling fee shrinks accordingly. (You may have more control if you're an ISS road and can negotiate your own divisions.)

As the AAR interchange video (“excellent video link,|” above) linked to one of the fact sheets shows, positioning cars for competitive access can be cumbersome, take days to accomplish, and add operating costs for the railroads. Therefore, I’m not holding my breath for short lines to be directly affected by any Competitive Access regulation.

Unfortunately, the language of the EO conjures up visions of Red locomotives on Green’s railroad: “The Secretary of Transportation shall consider rule-makings pertaining to any other relevant matter of competitive access, including bottleneck rates, interchange commitments, or other matters.” In actual practice, however, there are other ways to do competitive access short of ‘forced, physical’ access. Prescribed switching rates, for one thing. Another is setting up neutral terminal operators like the Chicago Belt or IHB and others such as you find in St. Louis and Houston.

When it comes to rates, the biggest problem is that the STB has made it almost impossible to challenge a rate as unreasonably high. The standard is extremely difficult to meet and the evidence you need is very expensive to assemble. As a result — to put it bluntly — the Class Is have capitalized on the rate-challenge awkwardness to keep jacking up rates even as they have been cutting service and firing people left and right.

At the same time the Class Is have been buying back stock, raising dividends, and setting records for earnings. I’m afraid the railroads will only have themselves to blame for the fallout of this kind of short-term, non-customer based thinking. I’m hopeful the EO and a change in the STB’s processes will encourage the railroads to return to their roots as service providers, and quit all this financialization for the benefit of a few.

KCS kicks off the 2Q2021 earnings season Friday. I will give you my take on the results along with those reporting next week next week. I just felt this whole EO discussion needed to be aired, especially as it affects the non-Class I railroad community.

The Railroad Week in Review, a compendium of railroad industry news, analysis, and comment, is sent as a PDF via e-mail 50 weeks a year. Individual subscriptions and subs for short lines with less than \$12 million annual revenue are \$175. Subscriptions for Class I railroads and shortline/regional operators with more than \$12 million annual revenue are \$599 per year. To subscribe, click on the Week in Review tab at www.rblanchard.com. © 2021 Roy Blanchard