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Rockin' Rail

By John Edwards

For years the rails sang the blues. Now they rock around the clock. Could rail transport soon be the leader of the pack?

For an industry with its roots in the 19th century, and that hit its heyday in the mid-20th century, railroads are still showing lots of life.

New customers, emerging technologies, and a refreshed physical infrastructure are all helping to inject new energy into an industry that not so long ago appeared to be rolling into history.

"The railroad industry is probably as healthy today as it has been in the last 30 years," says Patrick Hiatte, general director of corporate communications for Burlington Northern Santa Fe Railway (BNSF), Fort Worth, Texas.

Yet as the nation's railroads ride the express track into the 21st century, they also face a series of fresh challenges that threaten to derail recent advancements. A year-long traffic slump, shipper complaints, and the threat of tighter regulations are among issues dogging rail carriers' future.

"The crystal ball is still cloudy," says Deb Butler, executive vice president of planning and chief information officer for Norfolk Southern, Norfolk, Va.

Why Rail? Commodity, volume, and geography typically mandate a shipper's decision to use rail.

"Rail is most often used to move bulk commoditie:

such as coal, chemicals, and agricultural products shipped from origins and to destinations that are rail-served," says David A. Riddell, marketing manager, RSI Logistics, a third-party logistics provider headquartered in Okemos, Mich.

In recent years, improved intermodal service has made rail transportation a viable option for more products, helping rail carriers attract new customers.

"Intermodal shipping can be utilized for all commodities, from consumer goods to bulk liquids traveling in specialized containers," he observes.

Likewise, an increase in transloading terminals has allowed rail carriers to service shippers who may have otherwise relied exclusively on truck transport.

"Many shippers are not rail-served, but are able to utilize rail by going through transloading terminals," says Riddell. Such terminals offer shippers the benefit of long-haul rail combined with the speed and flexibility of local truck delivery, he notes.

Cost is another major factor companies take into consideration when deciding whether to ship by rail.

"There is a good chance that rail transit costs will be lower than truck for distances greater than 600 miles," Riddell says. "And, because of their weight or other handling requirements, many commodities are better suited to being moved via railcar."

Railcars can hold up to 220,000 pounds while trucks are generally limited to 44,000 pounds. "Railcars can also act as temporary storage for large quantities of material," he adds.

Riding High

Thanks to decreased regulation, higher trucking costs, and increased Wall Street interest, railroads are basking in the glow of a new golden era.

"Based largely on the effects of the Staggers Rail Act of 1980, railroads are able to get sufficient ROI to continue investing in business," says Hiatte.

The Staggers Rail Act essentially deregulated the rail industry, replacing a byzantine regulatory structure that had existed since the 1887 Interstate Commerce Act.

For the first time in nearly a century, railroads were permitted to determine where they ran trains and how much to charge.

Yet it took railroads more than two decades to take full advantage of their deregulated market. Unlike the airline industry, which was deregulated just two years earlier in 1978, high up-front costs and limited profitability potential spared established rail carriers from price wars with startups.

Instead, the Staggers Act spurred rail carrier consolidation and helped the then-struggling industry's remaining companies to control more miles of track and eliminate pesky competitors capable of driving down tariffs.

"Beginning in 2004, the demand for rail transportation exceeded the ability of the railroad industry to provide service, putting enormous pricing power in the hands of the railroads," says Robert G. Szabo, executive director, Consumers United for Rail Equity (CORE).

The Washington-based organization is a coalition of rail freight customers seeking changes in federal law and policy that would require railroads to provide competitive pricing and more reliable service.

Steadily growing revenue enabled the remaining major rail carriers - CSX, BNSF, Norfolk Southern, and Union Pacific - to upgrade their physical and technological infrastructures, which were greatly neglected during the industry's long dark period.

"Improvements to tracks, railcars, terminals, intermodal centers, and other parts of the physical infrastructure have contributed significantly to rail's revival," Hiatte says. "We've had some room for expansion capital, which in recent years has amounted to several hundred million dollars, largely because investing in rail infrastructure is now seen as a competitive use of funds."

Making Tracks

To boost both speed and capacity, railroads are currently on a track-building spree.

"They are not covering new territory, but are doubling up on tracks in many areas," says Anthony B. Hatch, a New York-based independent rail industry analyst.

BNSF, for example, is currently laying in the final stretch of second track on its Chicago-to-Los Angeles transcontinental line.

"Two tracks cover the entire 2,200- mile distance, with the exception of about 50 miles," Hiatte says. "We will fill in that gap over the next few years."

Rail carriers are also moving quickly to catch up with technology.

"Technology is becoming prevalent in the rail industry," says Matthew Menner, senior vice president of sales and alliances for Transplace, a 3PL based in Plano, Texas.

Most rail carriers have upgraded their internal information technology systems, installed wireless tracking and communications technologies, and are now using advanced locomotive and railcar management systems to slash maintenance costs and extend equipment lifetimes.

"Technology currently touches nearly every aspect of rail operation, right down to helping workers figure out where to repair tracks," Menner says.

BNSF views technology as a key competitive tool.

"We have implemented technology that expedites shipments at the hub centers, for example," Hiatte says. "Gate workers use handheld devices that print tickets showing incoming drivers exactly where they need to drop off their trailer or container."

Outbound, drivers visit a kiosk to receive a printout telling them where they can find their trailer or container for pickup. BNSF also uses a variety of Web-based e-commerce applications, RFID tracking, and a railcar ordering system protected by voice authentication security.

"Rail is going through a renaissance," Menner says. "Not only has it become fashionable to use rail for coal, grain, and other traditional commodities, it's also challenging trucking. T

"Thanks to the evolution of intermodal, significant volumes of freight - usually high- to moderate-value products - are now moving at least part of the way by rail."

But not everyone is pleased by the railroads' new prosperity. Take industry critic Szabo, for instance.

"Today, the four major railroad companies are darlings of Wall Street simply because they possess the pricing power that comes when demand for rail service exceeds the ability of the railroads to provide that service," he charges.

Over the last few years, the four major railroads have spent $6 billion to buy back their stock.

"Hedge funds are now buying into the railroads, and new aggressive investors are demanding that they double their rates in the next decade - because they have that kind of pricing power," Szabo adds.

Traffic Slowdown
While rail's long-term potential appears bright to many observers, the industry's immediate outlook is somewhat dimmed by declining traffic.

For the first eight months of 2007, total U.S. rail carloads were down 3.5 percent, reports the Washington-based Association of American Railroads (AAR).

Year-over-year traffic is down in most commodity categories, including crushed stone, sand, and gravel (down 10.6 percent); coal (down 1.6 percent); and motor vehicles and equipment (down 6.7 percent).

"While the current reluctant economy continues to soften rail traffic volumes, a recent preliminary GDP figure of 3.4 percent for the second quarter of 2007, up from 0.6 percent during the first quarter, is a hopeful signal of a return to more solid expansion," says Craig F. Rockey, vice president, AAR.

On the other hand, railroads aren't hurting too much from the diminished traffic because they have a free hand to raise rates, particularly on coal and chemical shippers who have limited or no other transport alternatives.

"These firms are literally held captive by the rails," says Szabo.

Starting in early 2004, rail rates began to rise. "They're up because the railroads can raise the rates," Hatch says.

But shipper complaints may be unjustified because rates have stayed low for a long time. "Companies were used to paying less, and now that they're not, they have an axe to grind," he adds.

But higher tariffs may actually be contributing to the current slump.

"Truck transport rates have become more competitive over the past year, and more shippers have converted lanes from rail to truck this year compared to previous years," says Riddell.

But despite recent rate increases, rail remains "the most cost-effective mode for transporting bulk materials over long distances," he says.

Return to Regulation?
While rail carriers have been left to play free in the market since deregulation in 1980, some signs point to the government taking more of an interest in the industry and its

practices.

"Proponents don't like to call it 're-regulation,' but it does come down to imposing regulatory barriers," says Norfolk Southern's Butler. "It would roll back the deregulation that came about in the 1980s, and add guidelines to the rates charged."

But changes in government oversight are already happening, including two significant Surface Transportation Board (STB) rulings this year, and more recently, Rep. James Oberstar's (D-Minn.) proposed legislation to introduce price controls and control rail network access.

The first STB decision declared that it's unreasonable for railroads to compute fuel surcharges that do not correlate with actual fuel costs for specific rail shipments.

"This ruling led carriers to adopt mileage-based fuel surcharge programs for most publicly priced carload shipments," Riddell says.

"While that made the system more fair, it also added an administrative burden as shippers needed to build the mileages into their freight cost models."

The second STB ruling on Sept. 5, 2007, changed the rail rate dispute process for small and medium-size shipments.

"Previously, only the largest shippers could afford to bring disputes before the STB," Riddell explains. "That is no longer the case. One facet of this ruling allows shippers of any size to use an expedited resolution process with a $150 filing fee to recover up to $1 million."

Moving Forward, Not Backward

Despite these recent decisions and Rep. Oberstar's pitch, Menner doesn't see a return to the days of tight government control over railroad pricing.

"Railroads have come under increased scrutiny over mergers and reciprocal switching, and some shippers do feel that the railroads 'have their way' with them," he says. "But I don't think we are heading back to anything even resembling the old days."

Still, one area where rail carriers would like to see more government involvement is the distribution of money. The railroads are currently asking Washington for a 25-percent tax credit for investment in expansion.

Szabo describes the request as an "unneeded bailout"; Hiatte calls it "a necessary investment for the future."

If rail carriers play their cards right, they can make significant gains on the trucking industry over the next few years, Menner says.

"Rail still has a lot to offer," he notes. "The United States faces significant roadway infrastructure challenges, as well as driver shortages, fuel supply issues, EPA emission requirements for engines, and more."

But Szabo believes that the outlook for businesses that rely on rail shipments isn't quite so rosy.

"The rail industry in the next few years is likely to look a lot like the current rail system unless there is further consolidation, which will result in even less competition," he says.

For his part, Hiatte sees nothing that points to a reduction in demand for rail services:

"Considering the issues truckers have to deal with - highway congestion, land use, and air quality - it seems evident there will be a continuing need to rely on rail transportation."