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Should Rail "Bottleneck" Segment Pricing Finally be Revised?

Likelihood of New Rules Stronger than Ever, but No Action Likely Until 2010, Ed Wolfe Says

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Once again, the US Congress is considering a bill that would open up competition for so called "bottleneck" rail shipments, a move that would be good for shippers and bad for rail carriers. The industry has dodged this bullet in the past, but may not be so lucky in the next two years.

What is the issue all about?

The U.S. rail network includes many situations in which only one railroad, often now referred to as the "bottleneck carrier", serves either an origin or a destination of a potential freight movement (the so-called "bottleneck segment," but more than one railroad serves the rest of the line between origin and destination (the "non-bottleneck segment"). In other words, a shipper had two more carriers that serve both the origin and destination, but not the entire move, as somewhere along the way there is one or more "monopoly" segments.

Under current law, the "bottleneck carrier" has the option of either carrying cargo the entire length of the voyage or interchanging the cargo with another carrier over the non-bottleneck segment. The decision on routing is entirely up to the bottleneck carrier. This situation has been supported by rulings from the Surface Transportation Board (STB), which regulates US rail carriers, and subsequent court decisions after shippers groups sought to overturn the rule.

As a result, a shipper cannot insist on a separate rate for the bottleneck segment by itself. Or, if the rail carrier provides a quote for that segment, it is high enough (combined with a lower quote for the second segment) that a shipper cannot reduce costs by splitting the move between carriers. That situation enables the bottleneck carrier to charge what

Wolfe thinks there are two real paths for changes in the bottleneck situation. First, the change could be written into law. Second, the STB could undo its own mid-1990s decision, based on a greater overall appetite for regulation and the fact the initial decision was based on the dubious financial conditions of the rail carriers at the time. Today, the rail carriers' finances are much improved.

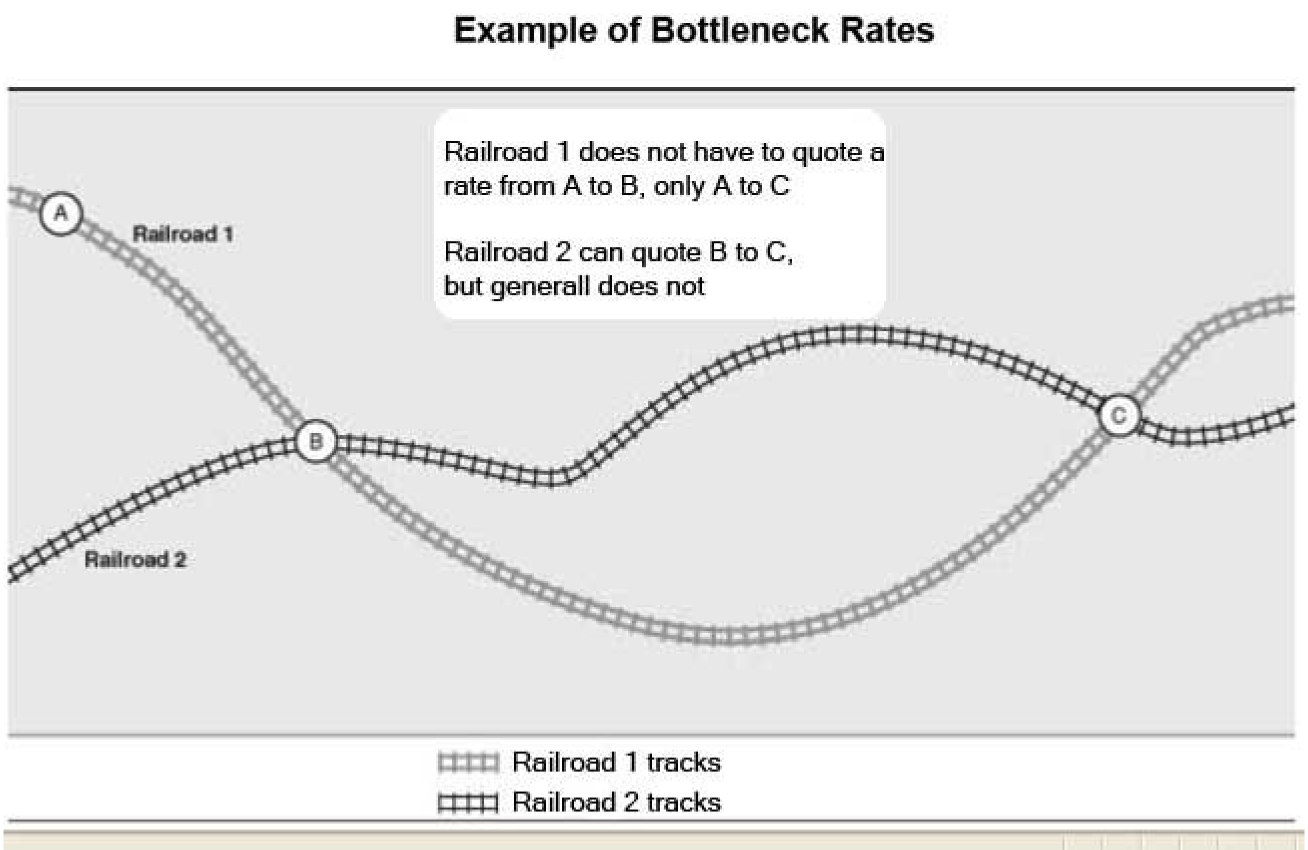
many consider a monopoly price for the entire trip. (See illustration on page 2).

Over the past few years, several bills have been introduced into Congress that would force rail carriers to bid on just the bottleneck segment, enabling shippers to receive two or more bids on the non-monopoly segments. And/or, the rates for the monopoly bottleneck segment would be regulated. But thus far, the bills have not been able to make it into law.

Ed Wolfe of Wolfe Research, a financial industry analyst focused on the transport sector, recently made some observations on the likelihood of such changes, based on a recent trip to Washington DC to meet with legislators and regulators.

According to Wolfe, a new "Rail Competition/Re-Regulation Bill will likely be reintroduced over the next 4-5 weeks."

Should Rail "Bottleneck" Segment Pricing Finally be Revised? (Con't)



While he expects the bill to include sections on bottleneck rates, overall he thinks the bill will be "watered down" from some earlier expectations.

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Wolfe estimates that about 20-30% of rail shipments overall fall into this "captive" shipper category, but that may overstate the case in a general sense, because a high percent of the captive shippers are coal producers/ users.

As always, however, shippers should be on the look out for unintended consequences. Wolfe says some rail carriers have warned that changes in bottleneck carrier rules might impact both costs and service on other routes.

Based on his discussions in Washington, Wolfe thinks it is unlikely any bill would be passed before the end of 2009.