

PASSENGER TRAINS ON FREIGHT RAILROADS — Yes, It's a Business

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Henry Posner III
Chairman

I am a train rider and in fact, when I joined NARP I was a high school student and I recall making doodles in my textbooks when the word "Railpax" was first announced. Since I keep everything, I still have those textbooks and I also have the handwritten tickets that I issued as an Amtrak Campus Representative when I was a college student.

When I was at Princeton, Ross Capon came and stayed in my dormitory and slept on the floor. Just to give you an idea of Ross's dedication to this organization, it was circa 1975 and the whole idea that NARP needed to go out and raise money from new sources was just beginning. So I am very proud to be here today and to acknowledge the great respect Ross enjoys amongst the freight railroads; he burns with a quiet fire which commands both attention and respect. This is a small organization but it's disproportionate to its size and I think the reason is because Ross Capon has been at the throttle for such a long time.



Ross Capon and Henry Posner III

But look at our demographics: for the most part we are a group of white males who are approaching retirement age, so where is the next generation of people to come from? I think there are some positive indicators but I would like to leave that to the end.

This is an exciting time to be talking about passenger rail in this country and elsewhere. And it's great to have this opportunity to be in the same space-time continuum as Karen Rae who I think has put all of the issues on the table as far as the relationships between the freight railroads and the passenger railroads. And fortunately, everything that I was prepared to address today is either complementary or at least non-overlapping with what she said.

My agenda is relatively simple: a brief background of who RDC is; to talk about what I think the significant events of the last several decades have been as impact passenger rail; and to draw some conclusions and to make some predictions.

Background on RDC

RDC is a small, privately held company based in Pittsburgh (which explains how I got here: on the Capitol Limited and Pere Marquette). We focus on Emerging Corridors in Emerging Markets, which quite often means not just railroads but railroads and pipelines, railroads and ports, etc. And everything we do is

based on joint ventures. My background is that I’m a former Conrail operating guy and my territory included the passenger territory in New York City where we would run 125-car freight trains in broad daylight out of Oak Point around the wye at Mott Haven Junction, the old “bullet through the propeller trick,” crossing all 4 tracks coming out of Grand Central; it worked just fine.

The other part of my background is that I worked for the Rock Island when the Rock Island had gone bankrupt but had not yet liquidated. One comment in response to a question asked earlier today: While it’s true that the freight railroads “made a deal in 1971,” the Rock Island did not join Amtrak. That deal was made with a gun to the railroads’ heads; so if you want to talk about extortion, extortion was holding a gun to the Rock Island’s head and saying that you have to pay to get out of the passenger business; the Rock Island said, “No, we can’t afford it.”

RDC is in the freight business, but even though we are in the freight business, we are not necessarily, as was suggested earlier, “greedy” people who “lack vision.” The table shows the number of railroads we’ve been involved in, not just the Iowa Interstate Railroad (which by the way is a Class 2 railroad, not a short line). We were among the first into Latin America with rail privatization in Argentina, and we took over the abandoned national railroad in Guatemala which regrettably is not functioning anymore, but that’s not our fault. We are partners in the World’s Highest Railroad, in Peru. And in the past we were direct investors in Africa; I therefore know that Africa is not a country, but rather a continent. Malawi is a landlocked country in southern Africa whose only access is the railway through Mozambique; what an adventure that was! And Estonia was the only former Soviet railway to be privatized, which is why I learned Russian; we were actually in the intercity passenger business there and we sold our stock interest in the international, unsubsidized service, for a profit, to other private sector investors.

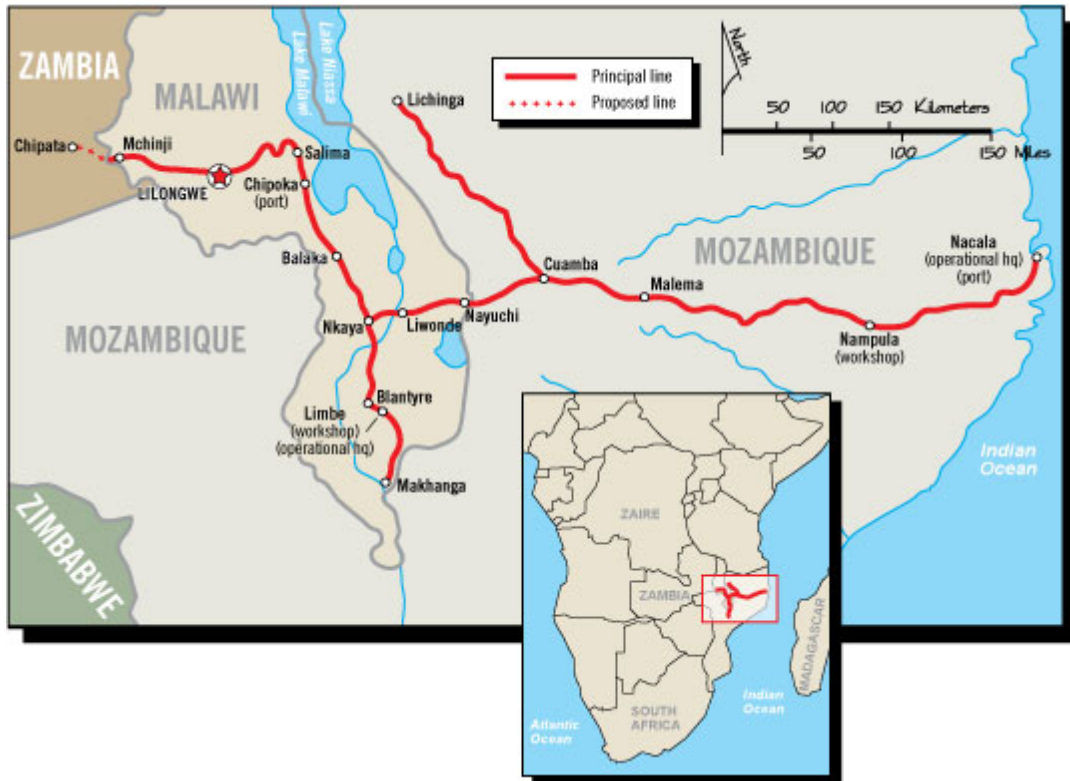
RDC Freight Railways:

CURRENT:	Entity	Length		Employees	Tons Y. 2009 (in millions)
		Km	(Miles)		
USA	Iowa Interstate	954	(592)	206	11.7
Argentina	ALL Central	5,690	(3,535)	1,200	2.3
Argentina	ALL Mesopotamica	2,704	(1,680)	300	1.0
Guatemala	Ferrovías Guatemala	322	(200)	13	N/A
Peru	Ferrocarril Central Andino	535	(332)	431	1.8
					Tons Last Yr of Investment
PAST:					
Malawi	Central East African Railways	797	(495)	417	0.22 (2008)
Mozambique	CDN-Nacala Corridor	873	(542)	404 Rail 209 Port	0.2 Rail (2008) 0.9 Port (2008)
Estonia	Eesti Raudtee	693	(431)	2,345	44.4 (2006)

To the extent that there is money to be made and that passenger service is a business, that is the thesis that I want to address today. The other interesting thing is, and I’ll just leapfrog on Karen Rae’s comment that foreign countries all want to talk about how we do freight service in the U.S. This is exactly right. We are in a joint venture in France with the national railway infrastructure company to try to save their freight branch lines. So you have Americans saying, “Why can’t we have trains like in Europe?”, and Europeans are saying, “Why can’t we have trains like in America?” The difference of course is that Americans are talking about passenger trains and Europeans are talking about freight trains.

RDC – Passenger Businesses

Next let’s discuss where RDC has been in the passenger business – both in Africa (Malawi and Mozambique) and currently in Peru; our ill-fated foray into the domestic passenger business in the USA with the Steel City Flyer; our future plans for Amtrak on the Iowa Interstate; and our new unsubsidized intercity business in Germany, where we will be starting next year.



RDC Passenger — Africa: The Nacala Corridor

As noted by the map (above), Malawi is a landlocked country and its only access from a rail perspective is through northern Mozambique. The railway in Malawi handles passengers in a Canadian style where there are light density lines with poor roads. There is an explicit annual subsidy for the train which hauls not only passengers, but also parcels. A lot of local produce goes into town on the train, so it is a mixed passenger and freight service.



Malawi



Northern Mozambique



In Mozambique, it is the same story except in that particular concession the passenger service was baked into the overall deal. So as part of the deal to privatize the railway, it included the obligation to run passenger service. I have traveled on these trains and it is not to an American standard, but in terms of basic local transportation, we made these trains better, which we are proud of.

RDC Passenger — Peru

In Peru, our railway company is the Central Andino. Just as a reminder, everything we do is a joint venture and almost in all cases we are minority shareholders in conjunction with local investors. The fact is that we put the passenger train on in order to make money and to benefit the local economy after the railway was privatized. We now run a monthly tourist service, sometimes twice a month in the peak season, with no subsidy on what used to be the World’s Highest Railway. Now that the Chinese have built the line to Tibet, it is the World’s 2nd Highest Railway. Most tourists ride the train to Macchu Picchu but don’t ride our train, which we are working on as I would argue it is the world’s most spectacular in terms of scenery and engineering.



RDC Passenger – USA – Pennsylvania

The Steel City Flyer was an ill-fated effort on our part to try to bring the benefits of the higher-speed Amtrak service east of Harrisburg to western Pennsylvania, recognizing that getting a second train to Pittsburgh was literally going to take years even given the improved transit time from Harrisburg to the east.



We knew that a lot of people drive from Pittsburgh to Harrisburg to catch the train east, and we thought if set up a feeder service to Amtrak at Harrisburg, it would be an interesting business. The key to making this work was that we had identified a core business, which was providing transportation for the health care conglomerate Highmark; they have a lot of staff traveling between Pittsburgh and Harrisburg. Highmark told us that we could save them \$1 million a year by putting this service on, but we failed to ask the right question, “Is it worth it to you to save \$1 million a year?” Highmark’s answer was, “No, it’s not.” Highmark pays their employees \$0.55/mile, so they would be taking money out of their employees’ pockets that they feel entitled to; so they drive their cars back and forth to Harrisburg. Apparently their first priority was taking care of their employees as opposed to saving \$1 million, so if you wonder why health care is so expensive, here is an example.



The results were therefore disappointing. Also, the Steel City Flyer was never able to get into the so-called Harrisburg intermodal terminal. The terminal was subleased from Amtrak to the city who in turn subleased it to Capitol Trailways who in turn subleased certain aspects of it to Greyhound, who saw us as a competitor.

RDC Passenger – Germany

On a happier note, in Germany we are in the process of setting up a high-speed intercity business between Hamburg and Cologne. The name of the company is Hamburg-Köln Express.

We bought used trains in Austria and negotiated a trackage rights agreement with the German infrastructure company, so we have the trains and the slots and we are geared to start the service in late 2011.

It is very complicated but we are already several years into this process, and we will soon be in the for-profit intercity passenger business in Europe. As a business, it is an important step for us because it will be our first venture in western Europe and our first major venture in the passenger area.

RDC Passenger – USA – Midwest Corridor

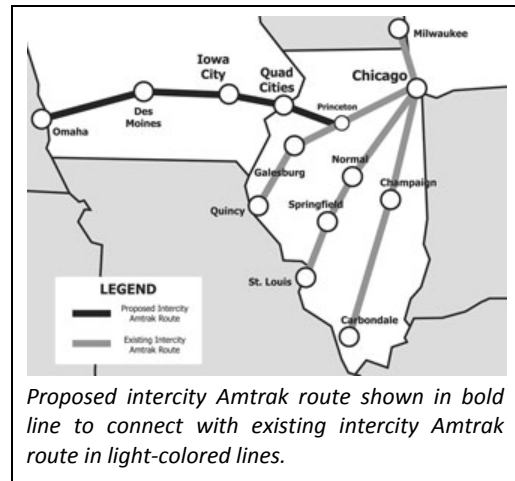
The Iowa Interstate is the Omaha-Chicago line of the former Rock Island. I worked for the Rock Island during the summer of 1976 and rode the Peoria Rocket. Now recall my earlier comment that the Rock Island was too poor to join Amtrak, so the Rock Island ran its own trains for years after Amtrak started. I rode the Peoria Rocket on a Friday out to Peoria and the top speed in some sections was 10 mph. We now run our freight trains at 25 mph on those same sections, which were abandoned with the liquidation of the Rock Island in 1980; this was a railroad that the central planners said was a surplus, duplicate parasite of a railroad which in the era of regulation deserved to be extinct.

Well, the folks in Iowa did not agree with the central planners and they put their money where their mouth was by getting a loan from the state of Iowa, secured by the scrap value of the track, as well as putting in equity. The end result is that the Iowa Interstate was formed and survived; and things have happened like deregulation and the emergence of ethanol and other interesting types of business that no one had even thought about at the time, and that certainly no central planner would have had on his/her radar screen. The bottom line is that the Iowa Interstate is now approaching 100,000 annual carloads of traffic; we can also make the claim that we have the youngest locomotive fleet in the industry as we have replaced our relatively new locomotives with brand new GEs – 14 brand new GE locomotives all purchased within the last 2 years.



One of the prime lessons is that in order to have passenger service you need a healthy freight business. We are in fact going to be the Amtrak route to the Quad Cities and on to Iowa City. The plan is to depart Chicago on BNSF and there will be a new track connection constructed at Wyanet where trains will drop down onto the Iowa Interstate. (For those of you from New Jersey, this is a duplicate of the Aldene Connection.)

So Iowa Interstate will be on the Amtrak route map; we have said for many years that we want to have this service, and now it is almost upon us. This is a great thing!



Significant Events

Now let’s step back and talk about the significant events on the passenger side of the industry. Sometimes I think we tend to suffer from Boiling Frog Syndrome and not appreciate what is happening around us: if you drop a frog into a pot of boiling water, it jumps out; but if you put the same frog in a pot of water and slowly raise the heat, the frog doesn’t know it’s being boiled and won’t jump out. I’m sure you’ve all done this in science class, right?

I would argue that you can bookend what’s going on in the emergence of a private sector alternative for passenger service in this country by exactly 2 events — beginning in 1987 with Tri Rail and ending in 2010 with the Virginia Rail Express contract being won by Keolis. In those intervening years the idea of right of ways being purchased for passenger service has evolved, but more importantly, passenger operators are emerging.

In 1987 it was Kershaw on TriRail, and between 1987 and 2010 there are numerous commuter rail operations that have sprung up being operated by third parties, ranging from Kershaw to BNSF. So we have private for-profit companies operating passenger service. True, it is short distance, but it is happening. And last year, all of sudden we have a President who has included the word “rail” in a speech to the nation, which in several generations is the first time that rail has really been on the national agenda.

And this year, in 2010, Keolis, which admittedly is a subsidiary of the national railway of France, but nonetheless is a third party passenger operator, was able to secure a commuter contract within sight of the nation’s Capitol. This was a high profile conflict, but more importantly, this is not a revolution but an evolution because this has really been going on since 1987. Who would have thought, especially as a NARP member since 1969, that this national interest in intercity rail would be part of the national agenda as opposed to “nostalgic elites opposing innovation” and all of the other stereotypes that have been leveled at the users of public transportation? My favorite quote is: “Riding light rail from your public-housing high-rise to your government job.” We as a society are doing better than that and we can do much better.

Conclusions

First and foremost, and I think Iowa Interstate is the poster child for this, we must have a healthy freight railroad system if we're going to have passenger service. Second, passenger is a business. There are dozens of for-profit companies in Europe running passenger trains. Third, the fact is that there are multiple passenger operators already established. Fourth, the question of liability comes up a lot, but it can be dealt with any number of ways. One interesting way that I have heard in the past, and is certainly not my idea, is Amtrak as a franchise authority where Amtrak would provide the overall liability protection for the underlying operators, including insurance. Finally, I think that it's important that we have diversity of passenger operators. By diversity I mean people thinking in different ways, trying different things and often failing. That is the short line story. We have the world's most successful rail freight business and we are the envy of the world precisely because we have a diversity of companies out there. You may not like all of them; you may not agree with all of them; and some of them will fail. But there is a lot of thinking going on at the industry level.

Predictions

Now I would like to make a couple of predictions. First, that we will see private operators not just on commuter service but also on regional passenger service. I think states are going to be more demanding of our industry when it comes to value for money in establishing regional services. While I don't want to single out BNSF for this, I do think they have been the most thoughtful about the whole issue of passenger service. It's a fact that they do run passenger trains from Chicago to Aurora and elsewhere around the country. So what's to prevent them from running another train to some place like Rock Island, Illinois? I think that's not only possible but also it may be done in a relatively cost-effective way because, for example, in New Jersey they are cutting up Comet I cars which are like Horizon cars. So there is equipment available in this country which in modified form could be put into intercity service for a fraction of the cost of building new. It does seem like that every time there is new equipment it has to be built from scratch including the re-creation of an entire industry, which one could argue hardly exists in this country, every time there is a car order. So why re-invent the wheel when we could recycle what we already have in the interest of making this service affordable and defusing the arguments of the people who are against us and telling us how expensive it is?

Another thing that I would like to point out, if you look at how the freight railroads have reacted to passenger service, note that in some cases they said that their first choice was Amtrak because you always want to deal with "The Devil You Know," but second choice is, "We would rather run it ourselves before we have some third party come on our railroad." This is why I think you might see some of the Class 1s stepping up to the plate and running regional service. We certainly at the Iowa Interstate might be interested in running it if liability issues were addressed, just not as a core business. But in a couple of years we will be learning more about it because we will be running in Europe in an intensely competitive passenger market.

I would also like to predict that there will be controversy inevitably for passenger service in this country because the main market for Amtrak is not the passengers, it's the politicians. Remember "Harley's Hornet" and how when Harley Staggers, who is arguably the savior of the U.S. rail industry, loved trains so much that I think at one time there were 3 passenger trains running across West Virginia, one of which was a turbo train?

When you get into these controversies, the question is, “What is the role of the private sector, especially when at the federal level people love to play with trains?” On the other hand, if it was privatized, then you wouldn’t get your turbo train in West Virginia or whatever your particular agenda is. What struck me recently was that the governor of Wisconsin decided that for his state the Talgo train was the ideal type of train. How is it that the governor of Wisconsin has become such an expert on passenger trains that he decided that Talgos are perfect for the Wisconsin market? Is it because their catering facilities are the best for dispensing cheese? But politics is not our core competence so I will cut it off at that.

The other thing is the definition of the private sector. Keolis is owned by the national railways of France so can you really say that this is a private sector thing? So you have the national passenger railway of America competing with the national passenger railway of France. Presumably the consumer is the beneficiary because someone had to cut their price. I would predict that there are going to be some pointed discussions in that regard.

And finally, there is a cultural concern that I have (and I do not speak for the rail freight industry; this is Henry Posner III, NARP member since 1969, and Chairman of one of the smaller railroads in this country that will be handling passenger service): when you’re dealing with freight railroads, there is a culture of public service which goes back generations. We have been the victims of regulation; we have survived that and brought the industry back precisely because we are diverse and because we are survivors. So when you look at how the freight industry behaves, just keep in mind the cultural legacy of where we’ve come from. And please keep in mind my anecdote about the Peoria Rocket running at 10 mph in the era of regulation; that is not what we want to go back to. Culture is everything and in our experience working in Africa, Latin America and Europe, culture explains so much.

More importantly, there is the culture of safety; the freight railroads have never been safer. The Iowa Interstate has won 2 Gold Harrimans in the last 5 years and my #1 vision for the company is to win another Gold Harriman for the third time. Because if you’ve got a safe railroad you’re more likely to be providing good customer service; if you’re providing good customer service, then you’re likely to have more business; and if you have more business, yes, you’re going to be profitable. At the Iowa Interstate our safety culture continues to evolve and I would argue that is going on everywhere in this industry. This is why some of these concerns come up from the freight railroads. The whole idea of high-speed rail came as a lightning bolt and the industry is struggling to be responsive to the national vision for passenger rail without compromising our core business, which is serving as the underpinning of the freight transportation network where we move, as Karen Rae pointed out, 40% of the ton-miles in this country. We can move a lot more but we cannot undo the transportation policies of the last 50+ years.

This ends my remarks. That being said, I just would like to make a couple more remarks in picking up points about the future of NARP, etc.

For the rail industry, a big question is, “Where is the next generation going to come from?” The demographics of the industry are not unlike the demographics in this room. You have relatively advanced age and if you couple that with the seeming criminalization of being interested in trains, it is not exactly fertile ground for where the next generation is going to come from. That being said, I’m very optimistic about the future because I see a lot of people really interested in trains, and a good example of that is the Princeton “Save the Dinky” Facebook page. Five thousand people are passionately enraged about a self-styled transportation guru who decided it was a good idea to re-launch his political career based on spending capital dollars to pave the branch line to Princeton for a busway and take Princeton

off the national rail network. These 5,000 people were not particularly organized but by force of will, they have ground this guy to a halt. To be fair to New Jersey Transit, they responded to the needs of the community; if the community says that they don't want trains anymore, they stop the trains; if they want a bus, they'll put a bus on. It was clear to everybody that the community does not want the busway. Those 5,000 people for the most part are exactly the type of people who we need as members of NARP. And the fact that for a 3-mile line you can get 5,000 Facebook members is cause for optimism.

Another optimistic thing is that a couple years ago I was riding from San Antonio to Chicago on the Texas Eagle on a Saturday evening and the train stopped in Dallas. Standing on the platform across from me was a standing-room only commuter train. Next platform over were light rail vehicles whizzing by (presumably transporting government workers back to their public-housing high-rise tenements). At any rate, Texans riding trains! I would have never thought you would get a Texan on a train.

One interesting statistic that I heard in Germany and that I've also heard about the USA is that for people under the age of 25, the percentage of them that have drivers' licenses is actually declining. Presumably that's because people live in communities where you can use transit. A most interesting point that Karen Rae made in her presentation is the link between high-speed rail and local public transportation. When you take the train from London to Paris, you do not go over to the Hertz counter and rent an SUV to drive across Paris; instead, you take the Metro. In fact, in my pocket I have transit cards for London, Paris, Washington, and New York; but interestingly not for Pittsburgh because the private sector company that ran the world's largest light rail system at the time, I believe, until 1964 was destroyed because at that time light rail vehicles were called trolleys, which everyone knew were inefficient. Certainly I would call the renaissance of light rail another cause for optimism!

Thank you.

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