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James C. Johnson  
*St. Cloud State University*

Diane J. McClure  
*St. Cloud State University*

Kenneth C. Schneider  
*St. Cloud State University*

Donald F. Wood  
*San Francisco State University*

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# SHORT-LINE RAILROAD MANAGERS DISCUSS CLASS I RAILROADS

James C. Johnson  
St. Cloud State University

Diane J. McClure  
St. Cloud State University

Kenneth C. Schneider  
St. Cloud State University

Donald F. Wood  
San Francisco State University

## ABSTRACT

Managers/owners of short-line railroads were queried about three issues: (1) How would you describe your company's business relationship with the Class I railroad(s) with which you interchange traffic; (2) Do you believe that mergers between Class I railroads have been good or bad for short-line railroads; and (3) Besides merger activity, what do you believe will be the most important trend for Class I railroads in the next 10 years?

## INTRODUCTION

Short-line railroads (defined herein as railroads with less than 250 miles of trackage) have been part of the transportation industry for many decades. Before 1970 their numbers had been in a long term decline. For example, in 1916 there were approximately 1,000 of these carriers, but by 1970 the number had shrunk to about 240 companies (Levine et al., 1982). The federal regulatory environment became more friendly

toward the formation of new short-line railroads starting in the early 1970s. This was precipitated by the bankruptcy of the Milwaukee Road and the Rock Island railroads. Because portions of these railroads could be operated profitably, the federal government enacted laws to facilitate the operation of the viable segments of the failed carriers. Specific legislation included: (a.) The 3-R Act of 1973, (b.) The 4-R Act of 1976, and (c.) The Local Rail Service Assistance Act of 1978 (Babcock et al., 1995).

Further encouragement of the short-line rail sector took place in 1980 by the enactment of the Staggers Rail Act. This law facilitated the formation of new short-lines by procedures that liberalized the abandonment of light traffic density trackage by the larger Class I railroads. (Class I railroads are defined by the Surface Transportation Board in terms of their annual revenues, adjusted yearly for inflation. Currently, Class I railroads have approximately \$260 million or more in revenues.) Much of the abandoned trackage became the new short-line railroads (Due 1984). Between 1980 and 1989, approximately 230 new short-lines began operation (Babcock et al., 1995).

The purpose of this study is to learn more about what managers of short-line railroads think about Class I railroads. To accomplish this objective, we surveyed about 450 owners/managers of short-line railroads. Specifically, this article will address the following topics: (a.) A brief literature review, (b.) A description of the research methodology utilized, (c.) An examination of the respondents' answers to this question, "Overall, how would you describe your company's business relationship with the Class I railroads with which you interchange traffic?" (d.) A look at how the short-line owner/managers answered this query, "Do you think the recent history of mergers between Class I railroads has been good or bad for short-line rail companies?" and (e.) An analysis of how the respondents replied to this question, "Besides merger activity, what do you believe will be the most important trend for Class I railroads in the next ten years?"

## BRIEF LITERATURE REVIEW

Short-line railroads are typically established when a Class I railroad spins-off their low traffic density trackage. For example, when the Burlington Northern and the Santa Fe railroads merged in 1995, the combined carrier sold about 2,000 miles of trackage to short-line railroads (Fairbank 1999). In 2000 the BNSF indicated that additional lighter density trackage will be spun-off to short-lines (Blanchard 2001c). Other rail industry observers believe that additional

Class I carriers will also continue to rationalize their route system (Kruglinski 2001). Class I railroads prefer to sell this trackage, because short-lines generate additional business that would have been lost if the trackage was abandoned (Due 1984; Landry and Ozment 2001a). Finally, short-line railroads are also involved in mergers. RailAmerica operates approximately 40 short-lines in North American and continues to add properties to its corporate structure. In late 2001 it purchased StatesRail, a privately owned company that operates eight short-line railroads (Gallagher 2001a; Rock 2002).

## Operating Characteristics

There are approximately 450 short-line railroads in the United States today (Pocket 2000). They operate in an analogous manner to commuter airlines that feed passengers between smaller cities and major city airports. Short-line railroads collect freight from shippers on light density trackage and transport it to the Class I main-line intercity trackage for delivery to the consignee, and vice versa. Rail industry management consultant, Roy Blanchard, noted,

The short-line thus is the bridge between the batch process of the Class I and the custom-made process of the small railroad (Blanchard 2001b).

Most, but not all (Turner 2001), short-line employees are non-union. While this typically results in lower wage rates, a more important advantage to management is the less restrictive work-rules compared to a unionized labor force. Thus, the locomotive engineer may operate the train in the morning, do track maintenance work in the early afternoon, and make sales calls in the late afternoon (Babcock 1995; Due 1984; Due and Leever 1997; Probing 1995).

## Problems

A recent survey of short-line railroad managers by Professors Landry and Ozment found that the most serious threat, as perceived by these

managers, involved their relationships with Class I railroads (Landry and Ozment 2001b). Here is a summary of the main problems involving Class I railroads: (a.) Short-lines receive an inadequate percentage of the total revenues when interlining with Class I carriers (Due and Leever 1997), (b.) After initially purchasing the trackage from the selling Class I carrier, it is so run-down from years of deferred maintenance, that the short-line cannot afford to bring it back to acceptable operating standards (Carroll 2001), (c.) A "paper barrier" is often imposed by the selling Class I carrier that mandates that the short-line must interline exclusively with them, even if other short-lines or Class I's have trackage that connects to the short-line railroad (Wilner 2000c; Wilner 2001a; Wilner 2000a), (d.) The Class I's will not adequately supply the short-line with rail cars during times of seasonal shortages (Due and Leever 1997; Gallagher 1999; Landry and Ozment 2001b; Kaufman 2000a), (e.) Class I railroads try to convince shippers to locate new facilities directly on the Class I's trackage, so the Class I does not have to share the rail revenue with the short-line (Burke 1997), (f.) Class I carriers desire to exclusively transport rail cars that accommodate 286,000 gross weight tons, and many short-lines do not have trackage or bridges that can safely handle this weight (Burke 1997; Gallagher 2000; Saylor 1999; Wilner 1999; Zarembski and Turner 2001), and (g.) Class I service standards are often so bad that shippers become frustrated and switch their business to the trucking industry (Duff 2000a; Gallagher 2000; Judge 2000; Kaufman 2000b; Vantuono 2001a).

Three additional problems that do not involve Class I railroads are: (a.) Short-lines are devastated when floods or storms wash-out bridges, tunnels and trackage, because they typically do not have the ability to re-route their trains around the problem (Due 1984), (b.) There may not be enough business located on their trackage to generate adequate revenues to stay in business, especially if many of the shippers are in the same business which then experiences an economic downturn in their

industry (Due and Leever 1997; Glischinski 2000; Prater and Babcock 1998; Wilner 2001b), and (c.) Federal Railroad Administration safety regulations often place unreasonable burdens on small railroads (Landry and Ozment 2001a; Landry and Ozment 2001b).

### Service Successes

The recent survey of short-line managers by Professors Landry and Ozment also asked respondents what was their greatest competitive advantage over the Class I railroads. By far the most common answer was their ability to provide shippers with customized service (Landry and Ozment 2001b). Service excellence increases sales. Burlington Northern Santa Fe CEO Matt Rose noted that in recent years, short-line railroad revenues have been growing at an annual rate of 7%, while Class I's sales are advancing only 2.5% annually (Blanchard 2001c; Gallagher 2001c). BNSF Vice-President Peter Rickershauser commented that,

Short-lines bring us business that we couldn't otherwise get, with a creativity that, quite frankly, is hard to match (Vantuono 2001a).

The BNSF obviously appreciates the service excellence of short-lines. Dave Garin, a BNSF manager, speaking at a rail industry conference about short-line railroad strengths, observed, "It's all about service, service, service, and you can do it best," (Blanchard 2001a).

An example of this customer friendly service is provided by the Indiana Rail Road. Its employees stress improved service reliability. They daily transport GE refrigerators with a dedicated 25 car train that runs from the GE factory at Bloomington, Indiana, to CSXT, a Class I railroad, at Indianapolis. Tom Hoback, CEO and President of Indiana Rail Road, said

I've always believed that if you could run a railroad like a business and not like a railroad, you could do well. We took a railroad that was going to be abandoned

in the 1970s and increased traffic more than five-fold (Blanchard 2001c).

### Class I Mergers

The railroad industry's "Golden Era" came to an end in 1916. Prior to this, railroads had a near monopoly on domestic intercity transportation. The only serious competitor was barge transportation on a few waterways and coastal, or intercoastal, shipping. Total railroad track mileage in 1916 was 254,000 miles, and it declined every year thereafter. The primary reason was the growth of the trucking industry (Stover 1961). Concomitant with the declining trackage came a decrease in the number of intercity railroads. In 1898 there were 836 Class I railroads (Thirteenth 1900), and by 1936 this number had decreased to 139 (Locklin 1938). What follows are the number of Class I railroads for selected years: 1970—71; 1980—42; 1990—16; 1994—13; and early 2002—7 (Annual; Association 2002). Prior to the 1980s, many rail mergers were "side-by-side," meaning that the two railroads in many cases served the same geographic area. After the merger, the duplicate trackage was often sold to short-line railroads. More recently the predominant form of rail merger has been the "end-to-end" type, indicating that each railroad prior to the merger served a different geographic area. These types of mergers involved less reduction of trackage (Burns 1998; Johnson and Whiteside 1975; Saunders 2001; Wilner 1997).

With only four major rail systems in the U.S.—Burlington Northern Santa Fe, CSX, Norfolk Southern, and Union Pacific—some shippers believe that rail management has become arrogant. Edward M. Emmett, president of the National Industrial Transportation League, (a large shippers' organization) noted,

Major rail customers continue to be frustrated not only by inconsistent service, but also by a[n] "imperial" attitude on the part of some railroads (Gottlieb 2001).

This situation, along with the service breakdowns that have occurred with recent rail mergers (some shippers refer to this as "track trauma" (North 2000; O'Reilly 1998)), led the Surface Transportation Board to declare a fifteen month moratorium on all Class I rail mergers that ended in June 2001. This action was taken after the Burlington Northern Santa Fe and Canadian National applied to the STB for permission to merge. These carriers have since withdrawn their merger application (Why 2000; Shoot-out 2000; Wilner 2000b).

The newly revised STB rail merger guidelines became effective in June 2001 (Rail 2001). They were designed to not just preserve rail competition, but to enhance it. Future rail merger applications must contain a "Service Assurance Plan," which details exactly how and why the combined carrier will be able to render improved service to their shippers. In addition, applications that contain "competitive enhancements" will be more favorably considered. These include trackage rights, reciprocal switching agreements, and improved efforts to work with short-line railroads (New 2001).

### RESEARCH METHODOLOGY

To address the aforementioned objectives, a survey of owners and managers of short-line rail companies was designed. The mailing list was compiled from Primedia Directories' *The Pocket List of Railroad Officials*. For purposes of this study, a short-line railroad was operationally defined as any railroad identified in the *Pocket List* that operates a system that includes a maximum of 250 miles of trackage. This definition is consistent with but not identical to the Surface Transportation Board (STB) "Class III railroad" designation (any railroad with an annual operating revenue of less than \$20.5 million) and/or to the Association of American Railroads (AAR) "local railroad" designation (any railroad with an annual operating revenue below \$40 million and less than 350 miles of track operated).

The actual mailing list was compiled as follows. There are a total of 725 railroad companies identified in the *Pocket List*. Of these, 125 were deleted for one or another of the following reasons:

- Company was identified as STB Class I or Class II railroad
- Company was identified as an AAR regional as opposed to local railroad
- Company was headquartered outside the United States
- No mailing address was included with the directory listing

Of the remaining 600 railroad companies, another 149 were deleted because of duplicated management or cross-over ownership so that any given individual would be asked to participate no more than once. The final mailing list consisted of 451 unique owners/managers. Each of these persons was mailed a copy of the questionnaire approximately one week following receipt of a postcard announcing the survey and requesting participation. In addition, each was sent a "thank-you" letter and follow-up copy of the questionnaire approximately ten days later, for a total of three separate mailed contacts. During this period, nine questionnaires were returned for bad addresses, reflecting a very high overall rate of accuracy in the *Pocket Directory*.

Of the 442 delivered questionnaires, responses were eventually received from a total of 114, representing a response rate of 26%. This level of participation is considered very adequate, especially given the professional nature and harried work lives of the sampled population of railroad owners and managers. Of these 114 usable responses, an additional seventeen were deleted because they represented companies that exceeded the 250 mile trackage limit set in the operational definition of a short-line railroad guiding this study. The remaining 97 companies comprise the data base of short-line rail companies on which the results reported herein are based.

## PROFILE OF RESPONDENTS AND RESPONDING COMPANIES

As measured by number of employees, the responding companies were quite small. The sample was divided almost evenly between companies with fewer than ten employees (49.5%) and those with ten or more employees (50.5%). One-fourth of the responding companies had fewer than five employees, and three-fourths of them had fewer than twenty-five employees. Company size was also measured by annual revenue, but those results are not presented here for two reasons. First, sixteen of the 97 qualified respondents (16.5%) chose not to disclose their annual revenue. Second, there is a significant and fairly strong correlation (+.504,  $p < .001$ ) between revenue and number of employees.

A different dimension of a short-line railroad's size is captured by the total miles of trackage it operates, that being an indication of the line's geographical coverage. About two-fifths (39.2%) of the short-line companies in the study operate with more than 50 miles of track (up to the qualifying limit of 250 miles), and three-fifths (60.8%) operate with fewer than 50 miles of track. Again, forty percent of the companies have fewer than 25 miles of track and fifteen percent have fewer than ten miles of track.

Just over one-third (36.1%) of the companies included in the study were formed before the 1980 Staggers' Act that substantially deregulated the U.S. rail industry. Another one-fourth (26.8%) were formed during the industry's tumultuous decade of the 1980s, and the remainder were started between 1990 and 2000.

Respondents were also queried about their own age and education. They are very highly educated. Nearly forty percent (39.2%) have earned a 4-year degree, and another one-fourth (24.7%) have received a graduate degree. Thus, only about one-third of all respondents (36.0%) do not have a college degree (but sixty percent of that group have some college education). Finally, almost six out of every ten (57.3%) are at least fifty years old.

## RELATIONSHIP WITH CLASS I INTERCHANGE RAILROADS

It is absolutely essential to the financial health of a short-line that it maintain a good working relationship with the Class I railroads to whom it bridges traffic. Without their Class I "partners," short-lines would have no way of connecting, literally or figuratively, with most of the rest of the world. Correspondingly, short-line owners and managers in the study were asked:

*Overall, how would you describe your company's business relationship with the Class I railroads with which you interchange traffic?*

Very Good                       Good  
 Neither Good nor Bad       Bad  
 Very Bad

Figure 1 contains the basic results pertaining to this question. Only a very few respondents characterized their relationship with Class I railroads as being negative. Just three of the ninety-seven participants said that the relationship was bad, and no one said that it was very bad. Conversely, half of the respondents (50.0%) said that their relationship with interchanging Class I rail lines was good, and another fifteen percent (14.7%) said that it was very good. In total, 64.7% of all respondents said that they have a good or very good relationship with their Class I "partners." The remaining one-third of respondents (31.6%) characterized the relationship as neither good nor bad.

Figure 2 can be used to compare the percent of respondents who said they have a good or very good relationship with their Class I interchange companies across various subgroups of the sample based on characteristics of the respondent or his/her company.

The difference involving number of employees was statistically significant at the ten percent level (chi-square = 3.01;  $p < .10$ ). Specifically, managers of companies with ten or more

employees were significantly more likely to say they have a good or very good relationship with their Class I interchange lines (73.5%) when compared to those from companies with fewer than ten employees (56.5%). Also, while not statistically significant, there was also a tendency for managers of older companies—formed prior to 1980—to more often say they have a good or very good relationship with their interchange railroads (76.5%) and for managers with a four year degree to say so (76.3%). Collectively, these were the only three subgroups in which more than seventy percent of managers felt their relationship to the relevant Class I roads was good or very good.

## CLASS I RAILROAD MERGERS' IMPACT ON SHORT-LINES

Since passage of the Staggers Act in 1980, there has been considerable merger activity involving the nation's Class I railroads. How has this frenetic situation been received by the owner/managers of short-line railroads? To investigate this issue, each respondent was asked:

*Do you think the recent history of mergers between Class I railroads has been good or bad for short-line rail companies?*

Very Good                       Good  
 Neither Good nor Bad       Bad  
 Very Bad

Please tell us why you responded as you did:

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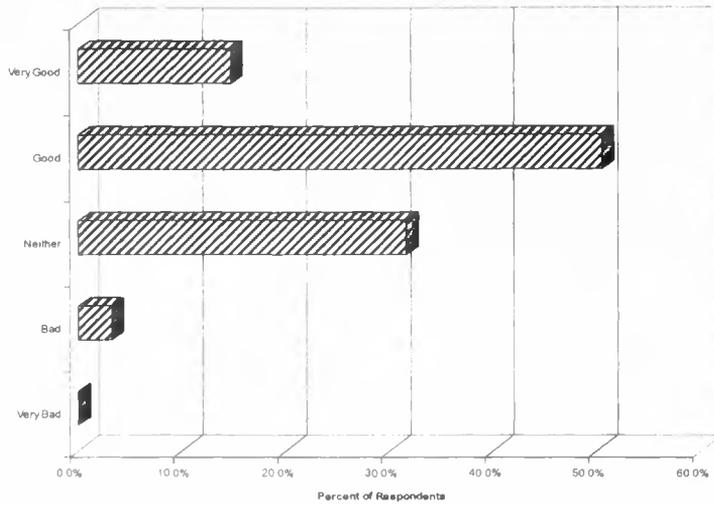
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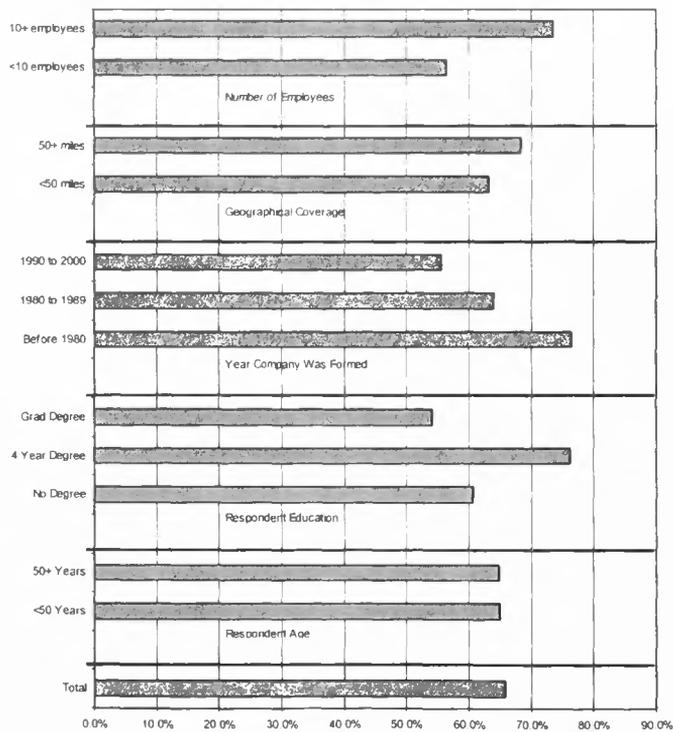
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Figure 3 presents the percentage responses to this question. Clearly, more respondents think the merger activity has been bad for short-lines than think the reverse. In particular, 37.6% of respondents think that the merger activity has been bad for their sector, and another 18.3%

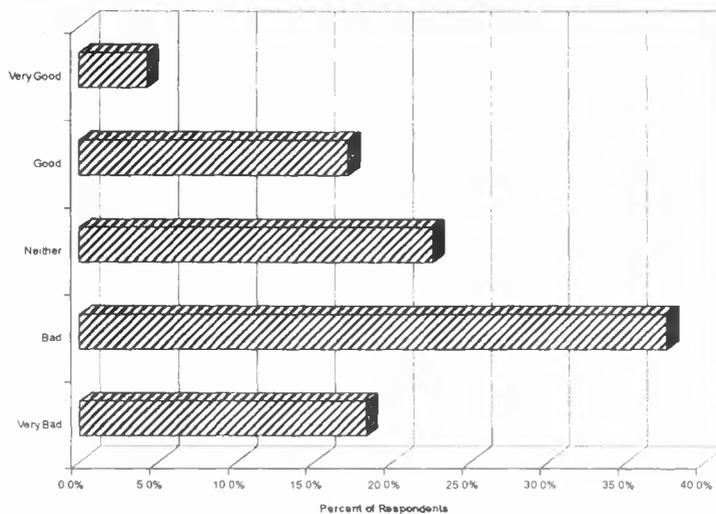
**FIGURE 1**  
**SHORT LINE'S BUSINESS RELATIONSHIP WITH CLASS I INTERCHANGE RAILROADS**



**FIGURE 2**  
**PERCENT INDICATING BUSINESS RELATIONS WITH CLASS I INTERCHANGE RAILROADS IS GOOD/VERY GOOD BY CLASSIFICATION DATA**



**FIGURE 3**  
**CLASS I RAILROAD MERGERS' IMPACT ON SHORT LINES**



**TABLE 1**  
**CLASS I MERGERS: CROSS-TABULATION ANALYSIS**

Class I Railroad Mergers' Impact on Short Lines:	Respondent Age		Respondent Education			Year Company Formed			Total Trackage		Number of Employees		Total
	< 50 Years (%)	50 + Years (%)	No degree (%)	4 Year Degree (%)	Grad. Degree (%)	Before 1980 (%)	1980 to 1989 (%)	1990 to 2000 (%)	< 50 miles (%)	50 + miles (%)	< 10 (%)	10 + (%)	
Good/Very Good	20.5	20.8	28.1	26.3	4.3	27.3	19.2	17.6	17.9	27.0	17.8	25.0	21.5
Neither	20.5	24.5	21.9	23.7	21.7	21.2	19.2	26.5	28.6	13.5	22.2	22.9	22.6
Bad/Very Bad	59.0	54.7	50.0	50.0	73.9	51.5	61.5	55.9	53.6	59.5	60.0	52.1	55.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.00
Base	(39)	(53)	(32)	(38)	(23)	(33)	(26)	(34)	(56)	(37)	(45)	(48)	(93)

think it has been very bad. Altogether, more than half of the respondents (55.9%) think that the Class I mergers have affected short-lines negatively, as compared to just one in five (21.5%) who think this activity has been good or very good for short-lines. (Note: The remaining 22.6% of respondents said the mergers have been neither good nor bad for their industry.) Overall, the short-line railroad industry has not reacted

well to the recent mergers involving their larger cousins.

Table 1 presents a set of descriptive comparisons of responses to this question across various subgroups of the sample. Generally, the contention that the recent merger history involving Class I roads has been bad or very bad for short line rail companies (representing 55.9%

of all respondents) was stronger than average among respondents who:

- Possess a graduate degree (73.9%) and/or are less than fifty years old (59.0%).
- Represent a company formed in the decade following deregulation (61.5%).
- Work for a short-line with fewer than ten employees (60.0%) or at least fifty miles of track (59.5%).

Please keep in mind, however, that the overall differences between subgroups in a given classification variable were modest; indeed, none was statistically significant at the ten percent level or less based on appropriate chi-square contingency table tests.

### **IMPACT OF CLASS I MERGERS ON SHORT-LINES: DETRIMENTAL ASPECTS**

Respondents were also asked to explain why they felt as they did about the impact of Class I mergers. Of the 54 owner/managers who thought that Class I merger activity was either "bad" or "very bad," we were able to categorize their responses into four general themes. Because some respondents mentioned more than one reason for their position, there were 84 rationales enumerated. Each of these general themes will be examined in the descending order of frequency that they were stated. In addition, six reasons (7.1% of the total number of explanations) were mentioned only once or twice, and they are not included in the discussion.

#### **Less Competition for Short-lines' Business**

The most common explanation why short-line owner/managers believe Class I merger activity has not been beneficial to them is that it has decreased competition for their business. Specifically, prior to the merger, the short-line was served by two competing Class I railroads, both of which desired to obtain more traffic from the short-line railroad. After the merger, with

competition often eliminated, there was no longer any reason to be concerned about the short-line's business, because as a monopolist, it was obtained by default. This explanation was stated by 25 respondents, representing 29.8% of the total number of reasons enumerated. Below are five typical respondent comments. Each of these statements is either a direct quotation or an amalgamation of the comments of two or more respondents.

- Without competition service gets worse, prices rise, and nobody cares any more.
- Concentrated power produces less competition from the connecting Class I railroads.
- Class I mergers have created giants that are extremely difficult to communicate with because of their arrogance. Actually you do not work with them, they "dictate" rates, and are generally unwilling to negotiate any aspect of service that you would like to provide to your customers.
- We used to have two Class I's that, at least at times, competed for our business. Now they have merged and we have been forgotten about in terms of meeting our needs, and those of our customers. Class I monopoly power is harmful to our long-term existence.
- When you have a monopoly, your attitude is different than when you have competition. This is exactly what is happening to Class I's today. They have a monopoly, and they know we know it, and they let us know in no uncertain terms that "it's our way or else—literally take it or leave it."

#### **Class I Merger-Related Service Breakdowns**

Twenty-three respondents (representing 27.4% of the total reasons) stated that as a result of recent Class I unifications, and the resulting service catastrophes, it has affected their business in both the short and long-terms. Here are four of their observations:

- Recent mergers, and the service disruptions that then took place, have focused rail management on merger integration and cost cutting, not on developing new business or improving service. In any case, the result is that frustrated shippers took their business to the trucking industry, and some of this traffic will never return to the rail system.
- First the Class I's merged. Then service levels suffered. The result—we lost business immediately and some of it has not come back and I don't think it will.
- As the Class I's try to digest their mega-mergers, service declines. This decline in service particularly impacts short-lines, because all we have to sell is service.
- Service has never been as bad as it is now and nobody at the super-roads seems to pay more than lip service to these problems. They just don't get it.

### **Class I's Have Minimal Interest in Single Car Shipments**

Seventeen respondents (20.2% of the total reasons) stated that mergers have hurt their business because the newly enlarged Class I railroads seem to have little interest in single, or a few car, shipments. Below are three of their observations.

- Today Class I's do not want to focus on the small moves—only on unit-trains, etc. These small moves are the “lifeblood” of short-line railroads. Their attitude is killing us and they don't seem to care.
- Class I's apparently do not desire to pick-up a small number of cars from short-lines. They just want high volume shipments between

major cities. Their marketing people do not understand our shippers' needs and furthermore, they don't want to.

- As the Class I's become larger, the more their personalized service to short-lines gets lost in the shuffle. They do not realize, or if they do they don't care, that all we have to sell is SERVICE!

### **Class I Bureaucracy Becomes Invidious**

The final problem with Class I mergers, as noted by 13 of our respondents (15.5% of the total complaints), was that the resulting bureaucracy of the enlarged railroad made it more difficult to work with the Class I railroad. Below are three of their statements:

- The merged railroad becomes even more distant from us. We become more and more isolated from them, and they have a harder and harder time identifying with our situation. Their bureaucracies are so mammoth that it becomes very difficult for them to make decisions in a timely manner. We can make decisions almost immediately, but what good does it do us, since we have to interline almost all of our traffic with them.
- The larger the Class I's become, the longer it takes them to respond to our needs and requests. Then when they finally do respond, they are less sensitive to our customers needs, both in terms of customized rates and services.
- Bigger is not better. It sure is slower when it comes to making decisions!

Table 2 summarizes the reasons why respondents believed that Class I rail mergers are detrimental to short-line railroads.

**TABLE 2**  
**DETRIMENTAL ASPECTS OF CLASS I**  
**MERGERS ON SHORT-LINE RAILROADS**

Reasons	Percentage
Less Competition for Short-Lines' Business	29.8
Class I Merger-Related Service Breakdowns	27.4
Class I's Have Minimal Interest in Single Car Shipments	20.2
Class I Bureaucracy Becomes Invidious	15.5
Miscellaneous	7.1
Total	100.0

**IMPACT OF CLASS I MERGERS ON**  
**SHORT-LINES: POSITIVE BENEFITS**

When respondents were asked their opinion about the Class I merger movement, 21 short-line owner/managers thought it was either "very good" or "good." When queried about why they took this position, we found that they cumulatively noted 28 reasons. Three statements were only mentioned once (10.7% of the total number of explanations) and are not included in the discussion below. Each of the two major explanations will be examined below in the descending order of frequency that they appeared.

**Class I's Will Only Offer Main-Line Service**

Nineteen respondents (representing 67.9% of the total number of positive explanations) thought Class I mergers were beneficial for their industry because of the future direction of Class I operations. These respondents thought Class I's will continue to heavily stress main-line intercity transportation service. Therefore, in many situations, the pick-up and delivery service will have to be provided by the short-lines. The result is the increasing importance of short-lines

to the rail industry. Below are five of their statements.

- Class I's do not want to be involved directly with customers. They desire to exclusively dispatch high volume, high speed intercity trains. We will become more and more important as the customer contact personnel with shippers/consignees. With our knowledge of each customer's transportation requirements, we will provide the "real people" customer service that all shippers/consignees desire.
- Larger railroads do not want to be bothered by a lot of switching at both ends of a shipment, mainly because their labor costs are prohibitively expensive. Nor do they want to be involved in shipments to smaller cities. Both of these situations are our "bread and butter." This explains why we are in a growth industry.
- As each Class I gets bigger after a merger, they become less customer acquainted. These mega-railroads do not care about the great majority of medium and smaller shippers/ receivers. This is great for us, because what they want out of us is our strength and passion.
- Switching is the bane of large railroads. It is our best service. Therefore, I love to see Class I mergers!
- Before the latest wave of Class I mergers, these large railroads were still trying to do their own pick-up and delivery. Therefore, they often did not want to try to work with me. Now they approach me and ask me to partner with them. It is an excellent division of labor. We are each doing what we do best.

**Accelerating Trend To Sell Branch-Line Trackage**

Six short-line owner/managers (representing 21.4% of the total number of reasons enumerated) stated that Class I mergers were beneficial to their industry because it would accelerate the sale of branch-line trackage to short-

line carriers. Below are three of their observations.

- Class I's will continue to spin-off low density trackage, which they are more and more defining as any trackage that is not part of their main-line system.
- Class I mergers are expensive. After the merger, to generate additional dollars to pay of debt, the combined carrier frequently sells off low traffic trackage.
- Labor costs are killing Class I railroads. These railroads can only operate efficiently and profitably on high volume main-line trackage. Especially after mergers, when top management must now "make their numbers" to show the wisdom of the transaction, is when additional spin-offs take place.

Table 3 summarizes the reasons why short-line owner/managers believe Class mergers are beneficial to their industry.

### OTHER IMPORTANT CLASS I TRENDS

Each respondent was also asked,

Besides merger activity, what do you believe will be the most important trend for Class I railroads in the next ten years?

We were able to categorize the responses into six general themes, each of which will be examined below. When answering this query, the 97 respondents noted 117 reasons for their responses. There were 16 answers (13.7% of the total number of reasons enumerated) that were only mentioned once or twice, and they are not included in the discussion below. Each of the explanations will be examined in the descending order of frequency that they were mentioned.

### Increased Utilization of Scheduled Trains

The most common response about future trends for Class I railroads involved the increased

**TABLE 3  
BENEFICIAL ASPECTS OF CLASS I  
MERGERS ON SHORT-LINE RAILROADS**

Reasons	Percentage
Class I Railroads Will Only Offer Main-Line Service	67.9
Accelerating Trend to Sell Branch-Line Trackage	21.4
Miscellaneous	10.7
Total	100.0

utilization of scheduled trains. This idea was noted by 36 managers, representing 30.8% of the total explanations given. This concept involves trains departing classification yards on set schedules, regardless of the number of cars that have been accumulated when the train is scheduled to leave (Vantuono 2001b; Ytuarte 2001). The effect of this type of train operation is far more delivery schedule consistency. Below are four respondent statements:

- Service, service, service—this is what will save the rail industry. The key to this is scheduled train operations, and the CN is showing the world how it can be done.
- Our industry will become almost irrelevant if service levels do not improve. If they don't, we will just get the bulk commodities that we get by default, such as coal, grain, sand, fertilizers, ores and bulk chemicals. The key to growth is consistent and reliable delivery schedules, and the key to this is scheduled train operations. It is as simple as that.
- Class I's must shift their orientation to being a service oriented business, from one that is operationally oriented. Scheduled train despatching is the obvious answer. At least I hope it is the obvious answer, because if the Class I's don't change, the industry will slowly die, and it will take my company down with them.

- Re-engineering their operations to function more like the trucking industry. That is, run more trains on set schedules. Shippers will pay for a reliable and consistent service.

### **Continued Class I Sale of Light Traffic Density Trackage**

Twenty-seven respondents (23.1% of all explanations) stated that Class I railroads will continue to sell their light traffic density trackage to short-lines. The reason is that Class I's will operate with a new paradigm. It will involve running trains primarily on their main-lines between major cities. Branch line trackage will be sold to the short-lines, which will then feed traffic to the Class I's. In addition, Class I's will desire to de-emphasize customer contact activities, such as pick-up and delivery services, which will be operated more efficiently by the short-lines. Here are three respondent observations.

- The new Class I business model will involve them operating high speed, frequently scheduled trains on their intercity main-lines. Short-lines will become their partners to feed traffic from shippers on lighter density trackage.
- Class I carriers will be in the "wholesale" transportation business. They will operate only on main-line corridors between major cities. The "retail" side of the rail business will be conducted by short-lines. We will be the customer contact people, who arrange pick-ups and delivery, and customize service levels for our shippers using the services of the Class I railroads.
- Customer relations and marketing in general is too labor intense for Class I's. They just desire to run their trains on the high traffic density trackage. We will more and more assume the marketing activities of the Class I's. Short-lines are starting to be appreciated by the Class I's for the essential services we provide.

### **Rail Industry Renaissance**

The 21<sup>st</sup> Century, according to 13 respondents (11.1% of all reasons), will experience a rail industry rebirth. The reason is that the highway system cannot continue to expand to accommodate additional traffic as the economy grows. In addition, automobile passengers will continue to press for governmental policies that shift truck traffic from the highway system to the underutilized rail industry. Here are three comments.

- Rail/truck intermodal shipments will be the norm for the 21<sup>st</sup> Century. It will happen because we as a country cannot afford to even maintain the existing highway system, let alone build new highway lanes. As this takes place, and it has to take place, we as short-lines will prosper along with the Class I's.
- Traffic must come off of the highways! They are too crowded now and the situation is getting worse year by year. Either traffic will go all rail, or it will be piggyback, but in any case it will be transported between cities by rail. This additional traffic will help the rail industry, and since the Class I's look to us to be their marketing departments, our importance can only grow.
- In my judgment, this question is a no-brainer. The rail industry will become more important by default. Traffic cannot stay on the horrendously crowded highway system. The only place it can go is to the rail system which already has a substantial amount of unused capacity. I just hope the Class I's don't drop the ball on this issue.

### **Labor Cost Reduction**

Ten short line-line owner/managers (8.5% of the reasons noted) said the most important Class I trend for the next decade is their reduction of labor costs. Here are two of their statements.

- The rail industry is plagued by high labor costs. This is because the industry is highly unionized. Many people do not realize that of the three major modes of domestic transportation, truck, rail, and air, the rail industry has the highest average labor costs (not counting management). The only way for the rail industry to survive is to reduce labor costs. They will do this by outsourcing as many activities as possible. Short-lines will perform the origination and delivery function, as well as most customer service functions. The Class I's will exclusively provide just train service between major cities, and all other activities will be outsourced to short-lines.
- Class I unionized labor rates must come down. Management will ask the craft and operating rail unions to allow cross-functional work-rules. Knowing rail unions, they will probably not agree to this. If this happens, and I'm sure it will, then Class I management will continue to outsource all but their main-line operations. This is why I believe the short-line rail industry will become more important in the future.

### **Governmental Funding of Rail Infrastructure**

Although traditionally the rail industry has provided their own right-of-way with no governmental funding, this may change. Some Class I senior managers have said that this issue is too important, and the capital requirements are so great, that it needs to be studied with an open mind (Gallagher 2001b). Eight respondents (6.8% of the total reasons) said that in their judgment governmental funding of the rail infrastructure will become the norm. Here is one comment.

- Class I railroads are not maintaining their rights-of-way adequately. Just recently the BNSF stated that they are cutting back on their right-of-way maintenance, because the railroad is not earning its cost of capital. Therefore, if we as a country are going to shift traffic from the highways to the rails, we must

have a rail system that can accommodate this additional traffic. That is why both the federal and state governments are going to have to get involved in funding the rail infrastructure. And Class I management had better swallow their pride and accept this financial help, just the way the truckers and airlines have for decades.

### **Federal Rail Re-Regulation**

Seven respondents (representing 6.0% of all reasons) thought that the rail industry would be re-regulated by the federal government because of the monopoly situation existing for many shippers today (Duff 2000b; Kertes 1998; Kruglinski 2001). This situation exists because there have been so many mergers that most shippers today are served by only one Class I carrier. Here is one observation.

- Class I's continue to alienate more shippers and community elected officials. This arrogance comes from being the "only game in town." It will lead to reinvigorated efforts to re-regulate the railroads, because there is not enough competition between railroads anymore. Any time an industry is federally regulated, its vitality is diminished. Hence short-lines will be hurt, because we are so dependent on the Class I's to provide the long-distance intercity movement.

Table 4 summarizes the Class I future trends as predicted by the survey respondents.

### **SUMMARY**

Short-line owner/managers were asked to describe their business relationship with the Class I railroads with which they interchange traffic. The responses were positive; with almost two-third's selecting the "good" or "very good" choices. They were next queried regarding their thoughts about how Class I railroad mergers have affected their industry. Here the owner/managers were less sanguine. More than half of the respondents thought these mergers had a detrimental impact on short-line railroads. When asked why they took this position, the three most

**TABLE 4**  
**MOST IMPORTANT CLASS I TRENDS**  
**BESIDES MERGERS**

Trends	Percentage
Increased Utilization of Scheduled Trains	30.8
Continued Class I Sale of Light Traffic Density Trackage	23.1
Rail Industry Renaissance	11.1
Labor Cost Reduction	8.5
Governmental Funding of Rail Infrastructure	6.8
Federal Rail Re-Regulation	6.0
Miscellaneous	13.7
Total	100.0

common rationales were: (1) Less competition for short-line business, (2) Class I merger related service breakdowns, and (3) Class I's have minimal interest in single car shipments. However, about one-fifth of the respondents thought that Class I mergers were beneficial to them. The two reasons for this position were: (1) Class I's will offer only main-line service, and (2) The accelerating trend to sell branch-line trackage. The final question involved short-line owner/managers perceptions of the most important trends among Class I railroads, not counting mergers. The three most common responses were: (1) Increased utilization of scheduled trains, (2) Continued Class I sale of

light traffic density trackage, and (3) A rail industry renaissance.

### CONCLUDING COMMENT

The railroad industry is composed of two components—the short-lines and the Class I's. This survey, in our judgment, conclusively illustrates the symbiotic relationship that exists between the two parts. They need each other. However, as this survey strongly indicates, only one of the two parties clearly understands this. Short-line owner/managers know that their destiny is tied to the Class I's. Unfortunately, it appears that from the viewpoint of short-line owner/managers, their importance to the Class I's is often not appreciated or even comprehended. As we gaze into our "crystal ball," here is how we see the future. We believe Class I carriers will continue to spin-off low traffic density trackage to short-line railroads. The Class I's will also outsource more activities that others can do more efficiently than they can. This will be especially prevalent with labor intensive functions, such as customer service activities and the pick-up and delivery of rail cars. The Class I's will specialize in what they do best—running scheduled trains on main-line trackage between major cities. The short-lines will feed cars between the shippers/consignees and the Class I's which provide the intercity transportation. As this relationship matures, both parties will desire to work together more closely for their own mutual benefit. The result will be a true "win-win-win" situation. Shippers/consignees will receive better service at less cost, while each of the rail partners becomes more efficient and profitable. We believe the 21<sup>st</sup> Century will experience a rail renaissance.

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#### AUTHOR BIOGRAPHY

James C. Johnson is professor of marketing and transportation at St. Cloud State University where he joined the faculty in 1976. He previously taught five years at the University of Tulsa. Dr. Johnson received a B.S. (Transportation) and M.A. (Economics) from the University of Arizona and a Ph.D. (Transportation and Marketing) from the University of Minnesota in 1970. His articles have appeared in *Journal of Transportation Law, Logistics and Policy*, *Journal of Marketing*, *Land Economics*, *Quarterly Review of Economics and Business*, *Business Horizons*, *Journal of Business Logistics*, *Transportation Journal*, and elsewhere.

#### AUTHOR BIOGRAPHY

Diane J. McClure is a senior research associate at St. Cloud State University. Ms. McClure's expertise is in computer software technology and survey design. She has participated in hundreds of research projects as an in-house technical consultant. Her articles have appeared in *Journal of Transportation Law, Logistics and Policy*, *Business Forum*, *Transportation Journal*, *Air Force Journal of Logistics*, and elsewhere.

#### AUTHOR BIOGRAPHY

Kenneth C. Schneider is professor of marketing and marketing research at St. Cloud State University. He received a B.A. degree in Economics in 1970 and M.S. degree in quantitative analysis in 1972. Dr. Schneider received a Ph.D. in quantitative analysis and marketing from the University of Minnesota in 1975. His articles have appeared in *Journal of Transportation Law, Logistics and Policy*, *Journal of Marketing*, *Journal of Consumer Research*, *California Management Review*, *Business Horizons*, *Transportation Journal*, *Journal of Business Logistics*, and elsewhere.

#### AUTHOR BIOGRAPHY

Donald F. Wood is professor of transportation at San Francisco State University where he joined the faculty in 1970. He received a B.A. (Economics) and M.A. (Economics) from the University of Wisconsin-Madison and a Ph.D. in economics from Harvard University. Dr. Wood is the co-author of *Contemporary Logistics* and *Contemporary Transportation*, and he wrote the "logistics" and "transportation" entries for the *Encyclopedia Britannica*.