



The **IOWA** **INTERSTATE** story

A regional railroad's hard sweat
and pure dumb luck

by Fred W. Frailey



Iowa Interstate's "heritage" ES44AC, seen rolling through Davenport, Iowa, honors its Rock Island roots. Tom McNair

The "Made in Hollywood" version of *The Iowa Interstate Story* might begin like this: Henry Posner III stands in a field of head-high Iowa corn. Spreading his arms wide, he looks up and exclaims, "Why, if you could just turn corn into fuel, think of the railroad you'd create!" Then comes thunder, the heavens open, and God gives man ethanol. Posner makes a fortune.

Cut! Pretty good, but he never said that. So how about this? Henry Posner III and three associates sit in a Pittsburgh office just big enough to hold their chairs and a single desk, atop of which sits a telephone. They've just been unscrupulously outmaneuvered in a quest to buy the Pittsburgh & Lake Erie



Henry Posner III.
Bill Metzger

and are nursing their outrage. Then the phone rings. On the other end is a co-owner of the Iowa Interstate Railroad. We need money! Now! Help! Ten years later, Posner's initial investment turns into sole ownership of the Interstate, just before corn-created ethanol becomes the additive of choice in gasoline. Posner makes a fortune.

Real life can sometimes be as fascinating as what appears on the silver screen. In the 22 years since *TRAINS* last looked at this Chicago-Council Bluffs, Iowa, railroad, the Iowa Interstate came close to collapse, then

rose again rapidly. Today it owns the newest, biggest locomotives, runs 17,000-ton freights, and provides intermodal service. Coming soon: Centralized traffic control and possibly 79-mph passenger trains. Its roster even includes two modern made-in-China steam locomotives. And if it's drama you want, the struggle for control of the Iowa Interstate a decade ago would make any screenwriter envious. Gather your Coke and popcorn, and enjoy the tale.

Birth of a regional

When the Chicago, Rock Island & Pacific breathed its last on March 31, 1980, shippers



On newly ballasted track, Iowa Interstate makes its first revenue run through North Peoria, Ill., on June 22, 1987. Roger D. Kujawa

on its main line between Chicago and Council Bluffs were left high and dry. Then began a scramble. Metra bought the commuter trackage to Blue Island and Joliet, Ill., 40 miles. For \$2 million a year, Baltimore & Ohio (soon to become CSX Transportation) leased the main line from Joliet to Bureau

and down the Peoria branch to Henry, Ill., the next 88 miles, to reach shippers along the industrialized Illinois River. B.F. Goodrich, meanwhile, formed the Lincoln & Southern to buy the rest of the Peoria branch and give its chemical plant at Henry a second rail outlet. Other operators ran

pockets of track in the Quad Cities and Des Moines. Finally, on June 1, 1982, the six-month-old Iowa Railroad leased the entire 375 miles between Bureau and Council Bluffs. Starting on a shoestring, Iowa Railroad lived precariously.

To the rescue of this route came the



Iowa Interstate at 6:15 a.m. Tuesday, November 9, 2010

Listening in:

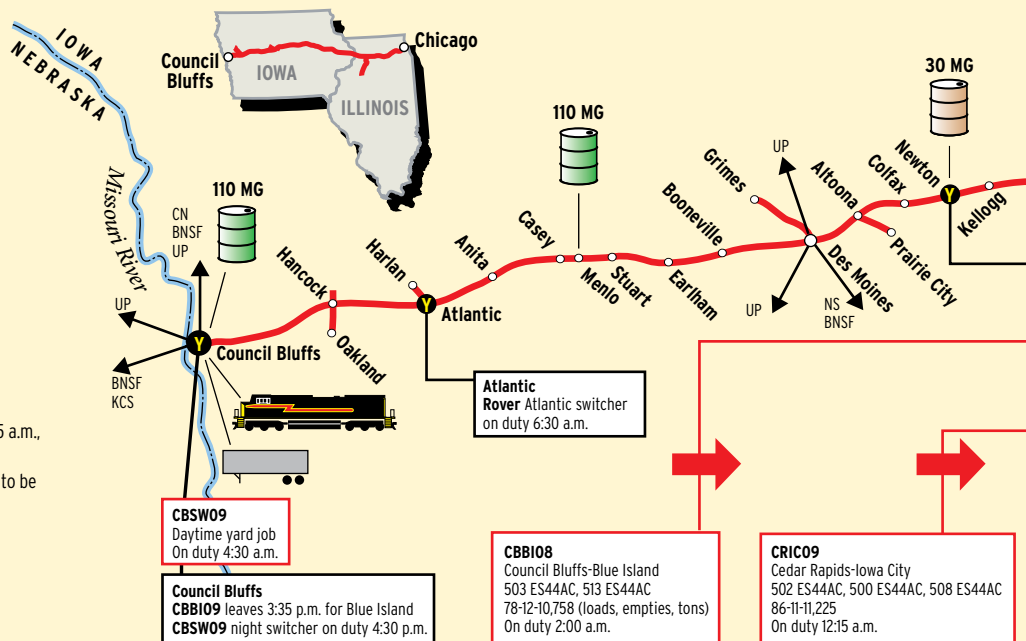
Iowa Interstate road: 161.220 (AAR 74)
Iowa Interstate yard: 160.305 (AAR 13), 160.320 (AAR 14)
CSX: 160.290 (AAR 12), 160.230 (AAR 8)
Metra: 161.340 (AAR 82)

Train number **CBBI08**
Origin-destination Council Bluffs-Blue Island
Power 503 ES44AC, 513 ES44AC
Loads, empties, tons 78-12,10,758

- 50 MG Million gallons
- Ethanol plant
- Biodiesel plant
- Intermodal ramp
- Locomotive shop
- Iowa Interstate
- Connection
- Trackage Rights
- Yard
- Job working at 6:15 a.m., November 9, 2010
- Yard job(s) or train to be called later

0 Scale 60 miles

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state of Iowa; such shippers as Maytag, Pella, and Pioneer Hi-Bred; and the Cedar Rapids & Iowa City Railway, or Crandic, which connected with the former Rock Island at Iowa City. They pooled their resources, formed a company named Heartland Rail, and for \$31 million bought the Bureau-Council Bluffs property in 1984 from the Rock Island estate. With that came trackage rights over CSX and Metra between Bureau and what would become its small freight terminal in Blue Island. A second company, Iowa Interstate Railroad, was formed to replace the Iowa Railroad and actually operate the route [see "Iowa Interstate: Humility and Profits in the Heartland," TRAINS, June 1989].

Iowa Interstate was the creation of Paul Banner, Harry Meislahn, and Paul Victor, all experienced railroaders, Banner having been Rock Island's last executive vice president. They cobbled together a locomotive roster descended mostly from Illinois Central GP7 and GP9 road-switchers (many rebuilt as GP8s and GP10s) and ran their first train on Nov. 4, 1984. In 1985, the railroad handled 31,584 carloads and generated revenue of \$11.6 million. The next year, Meislahn left the Interstate and Banner succeeded him as president, with Victor overseeing operations.

Over the next five years, according to TRAINS, the railroad lost a cumulative \$15 million. There wasn't money enough to pay



For Iowa Interstate, reaching Chicago was paramount. A freight crew builds its train at Blue Island, Ill., while a Metra SW1 (of Rock Island lineage) looks on. Steve Smedley

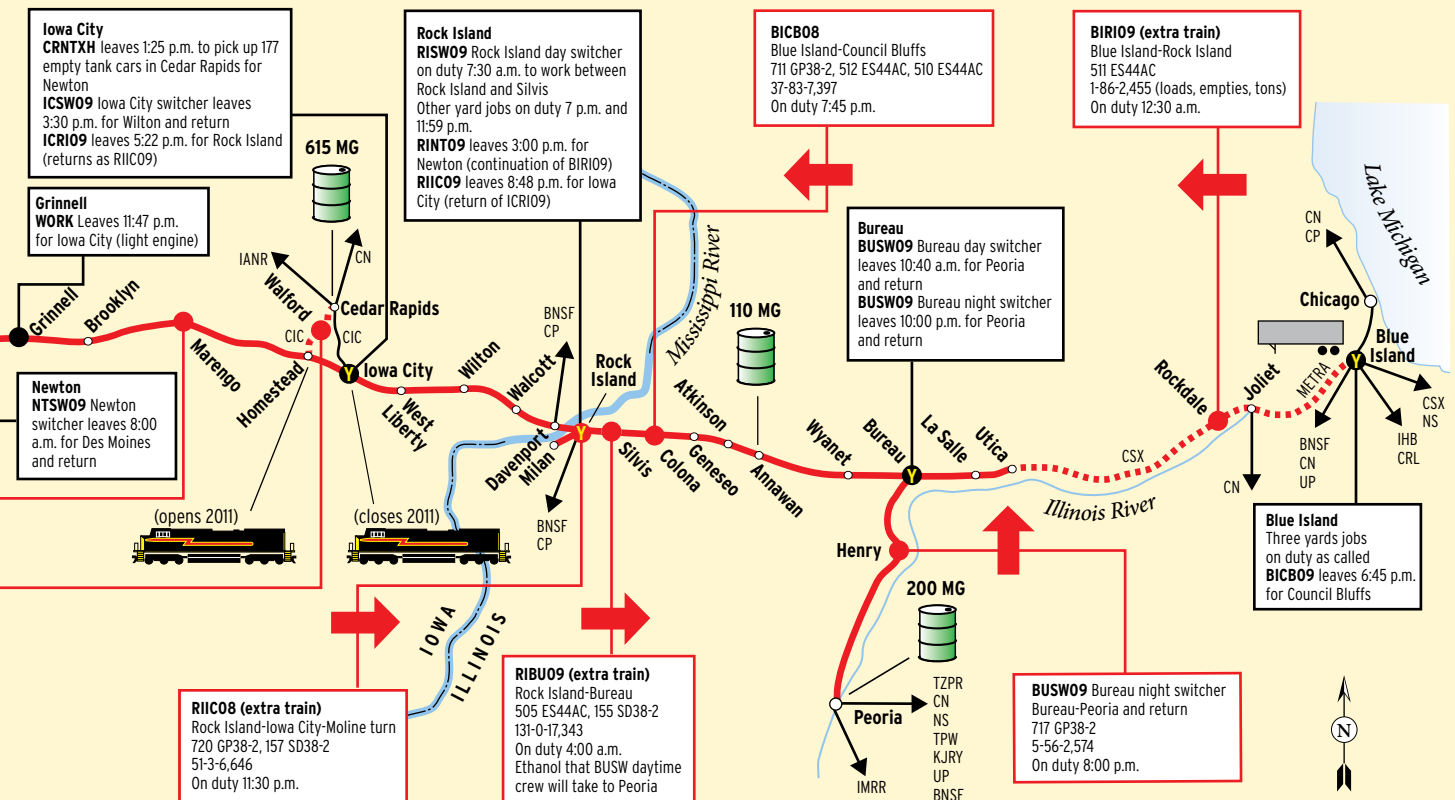
the bills, service the debt, and improve the property. One of the earliest employees, Dennis H. Miller, describes it as a 40-mph railroad perhaps good for 25 mph because of slow orders. "If you didn't fix them," he adds, "they just got worse and worse."

In 1990, while seeking to refinance the railroad's debt, Banner got an offer from Chicago West Pullman, a shortline owner, to buy the Iowa Interstate. But that deal collapsed early in 1991 when CWP, also embroiled in a failing airline investment, couldn't find financing. By then the rail-

road owed considerable sums to other carriers as part of their division of revenues, and any of those creditors could have tipped it into bankruptcy. Hence, the call for help to Henry Posner.

Enter the entrepreneur

The first Henry Posner, a Polish immigrant who ended up in Pittsburgh early in the last century, created his family's initial wealth during the Great Depression, in the billboard and neon sign businesses. His son, the second Henry Posner, who died this





The diesel terminal at Iowa City, Iowa, will be replaced later this year with a new shop at Homestead. The road rosters 14 ES44ACs, 22 GP38-2s, and eight SD38-2s. Robert Kaplan

year at age 92, succeeded his dad and created a second fortune by investing in a Pepsi distributorship before Pepsi's ascendancy against Coca-Cola. Would Henry Posner III continue in the family businesses? No. In 1969, at age 14, he bought his first issue of *TRAINS* and entered a new world. Maybe he had his grandfather's brains, but the trajectory of this unapologetic train-lover had been forever altered. After graduating from Princeton University, Posner spent a decade with Conrail, initially as an assistant trainmaster in its Detroit-Toledo corridor, working 6 p.m. until 6 a.m. with one day a week off. By 1986, he managed accounts of food-product shippers from Conrail's New York City sales office.

That was the era when big railroads shed unwanted routes large and small and new regionals emerged, starting with Chicago, Central & Pacific in 1985, and Indiana Rail Road and MidSouth Rail in 1986. To hell with corporate life! Fortunes were being made and lost, and Posner ached to join the ranks of those entrepreneurs.

So Posner left Conrail and with his family's financial backing created Railroad Development Corp. in 1987, with himself as chairman and business partner Robert Pietrandrea (from L.B. Foster, the railroad

supply company) as president. Posner describes Pietrandrea as "my polar opposite in almost every respect and my source of wisdom and strategy. Bob is why we've gotten so far." For four years the two men tried without success to buy a railroad. Often they fell afoul of greater fools — that is, competing bidders for a railroad spinoff willing to pay stupidly high prices. (For Posner's rendition of the Pittsburgh & Lake Erie affair, a disaster of a different sort, go to www.rrdc.com, click on Position Papers, and then on "P&LE — The Final Years.")

The Iowa Interstate opportunity was not low-risk. True, this was a tested railroad, but also a marginal one (some would say failing). Iowa Interstate could not produce a financial statement. There was a shoebox of unpaid bills totaling \$8 million. "What Iowa Interstate had been doing," Posner says, "was paying off all the small creditors but holding off the big ones, the logic being, if you owe the bank \$100 you've got a problem, whereas if you owe the bank \$100 million the bank has a problem." A smart way to handle debt, maybe, but it doesn't work indefinitely.

Posner and Pietrandrea, however, were willing to take a chance. As Posner later put it: "We had a general idea of what we were

getting into, and some confidence that with a combination of capital and luck we could manage our way out." So in August 1991, RDC invested \$1.2 million to stabilize Iowa Interstate's finances. For that, it got a 20 percent stake in the railroad. It also got a piece of paper giving it an option to buy the other 80 percent of Iowa Interstate and all of Heartland Rail, owner of the track structure, at any time during the next 10 years. Paul Banner and Paul Victor sold their interest in Iowa Interstate to Heartland, which thereby became the operating railroad's 80 percent owner. Banner, then age 70, retired. Today, Victor is president of the New York & Atlantic Railway on Long Island, N.Y.

In subsequent years, RDC made some incredibly profitable investments in privatized railroads overseas. But it's unlikely that any worked out as well as this first venture, in Iowa Interstate. It just took a long time for the wisdom of that investment to become apparent.

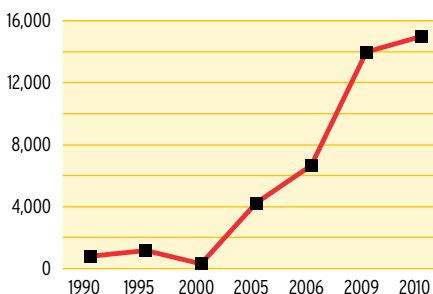
The fight for control

The railroad waxed in the 1990s, alongside the ups and downs of Iowa agriculture. CSX alumnus Fred Yocum, whom RDC had hired to run the P&LE before that deal fell through, replaced Banner as president until his own retirement in 1998. Posner credits Yocum with keeping creditors calm until they could gradually be paid off. Otherwise, RDC and Posner maintained what he calls an arms-length relationship with Iowa Interstate. In any event, as a minority investor, he was not in a position to call the shots.

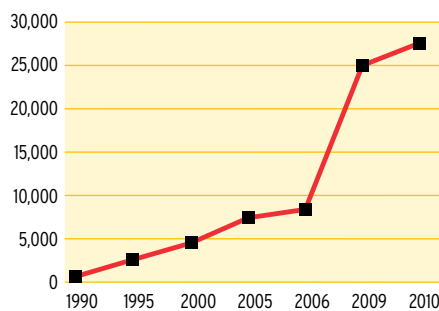
Increasingly, the corporate leadership came from Archer Daniels Midland, the agribusiness conglomerate. Ironically, ADM has but one small elevator on the Iowa Interstate. But it had a big problem: Its huge corn-processing mill in Cedar Rapids connected to Chicago & North Western, which the giant Union Pacific bought in 1995. Iowa Interstate kept ADM from becoming captive to UP by virtue of its link to Cedar Rapids via the Crandic. To further protect its interests, ADM became Heartland's (and therefore Iowa Interstate's) majority shareholder in 1995, by buying a new stock issue and the shares of some other owner-shippers. And by 1997 or 1998, Archer Daniels Midland leapfrogged appliance maker Maytag, based in Newton, Iowa, to become Interstate's biggest shipper.

So Posner and Pietrandrea were in a pickle when, in July 2001, they dropped their atomic bomb, exercising Railroad Development Corp.'s option to buy the rest of Iowa Interstate, plus Heartland Rail. ADM was not just Iowa Interstate's big Kahuna; it was also quite content to remain in charge. A retired ADM executive, Jon Roy, was Iowa Interstate's president then. For sure, this multinational company would not be

DDG/Feed loads



Ethanol loads



happy and could easily retaliate against the regional railroad by diverting traffic.

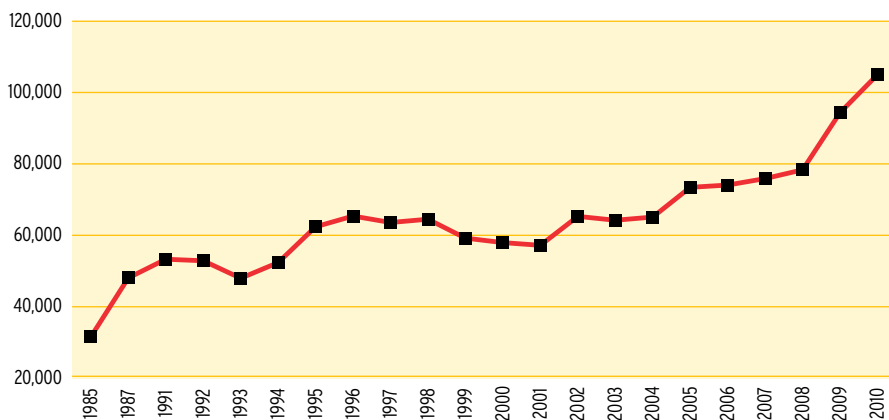
But as Posner saw it, what choice did they have? Once their 10-year option to buy expired a few weeks later, RDC would be “a minority shareholder forever in a company where we had no influence. Why bother with that?”

So began two and a half years of walking on eggshells. Terms of the option required RDC to pay a nonrefundable \$1 million to Heartland. Then RDC and Heartland each hired an appraiser. If the appraisals differed by more than 10 percent, a third appraiser would reconcile the two numbers. This sounds simple, but it was not.

Predictably, the appraisals came in worlds apart. RDC’s appraiser, veteran railroad consultant Charlie Banks, evaluated the Interstate not by its liquidation value, but by what it was worth as an ongoing business. “To do this,” Banks explains, “you look at future cash-generating potential.” With Iowa Interstate’s history of losing money and the low crop yields in 2001, Banks says his valuation of the company came in quite low. Actual numbers were never made public, but L.E. Peabody & Associates, the appraiser for Heartland (which is to say, ADM), came up with a value believed to be several times higher.

A lot of time went by before a third appraiser was mutually agreed upon. Some of that time was spent in courtrooms, litigating details of the option and appraisal process. When finally selected, the third appraiser settled on a valuation

Iowa Interstate growth in carloads



believed to be closer to the one advanced by Banks. But thanks to the squabbling, RDC didn’t take control until Jan. 1, 2004, at which time Posner became Iowa Interstate’s non-executive chairman.

Did Archer Daniels Midland retaliate against RDC for kicking it out of an ownership position? Not at all. While the railroad needed ADM, ADM needed Iowa Interstate just as much.

Red ink turns green

Had RDC’s option lasted another year or two, the selling price of Iowa Interstate might have risen substantially, because something strange occurred: In May 2002, the railroad began making money. Jon Roy,

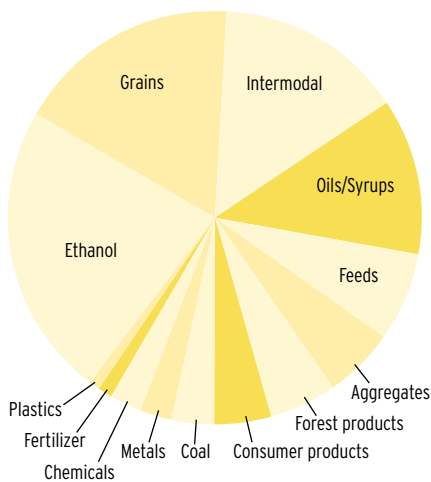
the former ADM man running the Interstate, left in mid-2002, and everyone agreed on Dennis Miller as the new chief executive, which he remains to this day. Since joining the railroad in May 1985, this former Rock Island Lines wire chief and train order operator had held about every job, from locomotive engineer to VP of customer service. “I ran the place while all the litigation went on,” he says. The owners were preoccupied with their disagreements.

As Miller tells it, the events resemble a snowball rolling downhill. He brought in three new road foremen of engines, front-line managers “who knew what they were

Iowa Interstate acquired the famous shield logo from the Rock Island’s trustees, and began placing it on diesels in the mid-2000s. Steve Schmollinger



Iowa Interstate traffic distribution



doing,” and a new superintendent over them. Those managers reinstilled discipline in the operations. Safety benchmarks improved (the railroad won its first Harriman gold medal on the basis of its 2003 safety record), and trains consistently departed their origins on time. This led to substantially lower car-hire costs. Customer satisfaction shot up, and the railroad began *being offered* more business — not just farm products, but also steel, scrap metal, cement, and paper. When Whirlpool bought Maytag in 2006 and closed the Newton plant a year later, Iowa Interstate scarcely missed what had been its biggest customer a decade earlier.

In 2002 Miller drew up an application for a low-interest, \$32.7 million Railroad Rehabilitation & Improvement Financing (RRIF) loan from the Federal Railroad Administration, then sat on it until ownership of the railroad was settled. With Posner’s blessing, he filed the application in early 2004 and got the money a year later. Of

that, \$22 million went to root out deferred maintenance of the track and the rest to retire old debt. “That got rid of slow orders,” Miller reports, “and made the difference of night and day.” The railroad also began a five-year maintenance cycle to keep the track in good shape.

Miller applied for a second RRIF loan of \$9 million in late 2005 and got the money in 2006, to cleanse the locomotive fleet of the last old road-switchers and standardize with 22 2,000-hp Electro-Motive GP38-2s (as well as four SD38-2s bought separately).

By then, the traffic snowball was becoming an avalanche. In May 2006, ADM announced it would double the size of the Cedar Rapids corn-processing plant, creating an ethanol refinery that has become the country’s largest. A host of other would-be refiners revealed plans to locate beside Iowa Interstate, and three of them actually did: in Council Bluffs; Menlo, Iowa, also on the west end of the railroad; and Annawan, Ill., between Bureau and Rock Island. Plus, a biodiesel plant opened in Newton. All this business would come on line from 2008 through 2010.

So what had once been a hand-to-mouth enterprise now had to adapt, and quickly, or be overwhelmed. The beauty was the railroad could now afford to expand. Says Mick Burkart, who came to Iowa Interstate in that period to become chief operating officer: “If we went with SD40-2s, we’d need 30 more locomotives, giving us 70 diesels altogether, and we had neither the facilities nor the mechanical people to deal with that many.” So back went Miller for a third RRIF loan, this one \$31 million to pay for 12 4,400-hp ES44AC locomotives that General Electric assembled in 2008 on the tail end of a CSX order. Told by GE in 2009



that it had two more ES44ACs needing an owner, Iowa Interstate bought those, too.

A thrilling conclusion

That’s not all Iowa Interstate did. In 2006, it bought the Lincoln & Southern from Goodrich successor PolyOne, gaining ownership between Henry and Peoria, and assumed the CSX lease between Henry and Bureau and east on the main line to Utica, Ill., 32 miles in all, giving it greater control over its operations. It began running its trains directly in and out of Cedar Rapids in 2004, using trackage rights on Crandic’s former Milwaukee Road branch that intersects the Interstate main line at Yocum Connection, 25 miles west of Iowa City. And in 2006, on a field that had been Rock Island’s receiving yard in Silvis, Ill., just east of the Quad Cities, the railroad began building a new storage yard that, when completed this year, will include nearly 11 miles of track capable of holding 850 cars.

The Silvis yard mostly benefits ADM, and highlights the close relationship between Iowa Interstate and its No. 1 account. The once- or twice-daily turns in and out of Cedar Rapids bring most of the ADM loads (ethanol, feed, syrup, starch, and the like) to Rock Island and Silvis. Lacking waybills, they’re held in storage until ADM sells the commodities. Then the railroad builds unit trains or blocks for its scheduled trains to move the cars out. Says Burkart: “This holding, switching, and building of trains is why regional railroads can get the business, as it’s something the big railroads don’t want to do.”

The next big change you’ll see is a new



“Hawkeye Express” football specials (using Iowa Northern equipment) are an Interstate tradition, running from Coralville to University of Iowa games at Iowa City. Robert Kaplan



Two GEs hustle east at West Liberty, Iowa, in January 2010. Tom McNair

locomotive facility near Yocum Connection, close to the community of Homestead, Iowa. It will replace the shop in Iowa City, now bursting at the seams.

By 2015, you might even see twice-daily passenger trains between Chicago and Iowa City, using Iowa Interstate for the 105 westernmost miles from a junction with BNSF Railway at Wyandot, Ill. The federal government in 2010 awarded Illinois and Iowa \$230 million for improvements (on Iowa Interstate, rail, ties, sidings, CTC, and positive train control) to start the service. Whether that money ever leaves Washington, D.C., or Iowa agrees to subsidize its share of the service, were open questions as this issue went to press. But bear this in mind: In late 2011 Railroad Development Corp. will begin running its own unsubsidized passenger trains in Germany, between Hamburg and Cologne. Chairman Posner calls this a test of whether you can make money hauling people atop steel rails. If it works in Germany, you can almost count on his trying to do the same across the Iowa Interstate, given the right circumstances.

Remember those 31,000 carloads the Interstate handled in 1985? Make that 78,000 cars in 2008 and 105,000 in 2010. The company hired employees right through the Great Recession. Posner says that what used to be the railroad's total revenues is now the extra cash left over each year.

For all of that, the railroad isn't bulging with freight trains. But those that do run tend to be huge. A Tuesday last November

is illustrative. The night before, westbound BICB left Blue Island for Council Bluffs with 120 cars, meeting on CSX track west of Joliet its eastbound counterpart, CBBI, with 137 cars weighing 17,600 tons. Waiting for BICB to pass Silvis was a 131-car, 17,000-ton extra train of feed bound for Peoria. Behind BICB out of Blue Island was another extra train taking 87 empties, plus 50 more picked up at Bureau, to west end ethanol plants. That day's regular Cedar Rapids turn from Iowa City hauled 90 cars (12,000 tons) to Rock Island before returning to Iowa City with some empties. This is a Class II railroad that looks like a Class I.

So ends *The Iowa Interstate Story*, to this point. For sure, the outcome today is far happier than seemed likely a decade or two or three ago. What have we learned? That you can struggle for years to find a winning strategy and get nowhere. And conversely, that the proverbial heavens can open and deluge you with business you never dreamed existed. Posner is the first to say that waiting for pure dumb luck to trickle down is a viable corporate strategy, if you're patient enough. Fortunately, he was. **I**



Conductor Stan Thomas lines a switch at Walcott, Iowa, to let his train, BICB, out on the main after a meet with its eastbound counterpart on Nov. 9, 2010. Fred W. Frailey

>> Conrail can openers in Peru?

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