

“Consider Alternate Routes”...

*An introduction to America’s Stealth Industry,
and why you should care...*

...OR...



“Railroads – A Bridge to the Future”



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Pittsburgh Technology Council • September 28, 2012

I was thinking of how to introduce the rail industry, and given my miserable commute to/from Green Tree, I decided on the title, “Consider Alternate Routes,” which is a sign that you often see displayed on the Parkway West. The irony, of course, is that there is no alternate route, and I think that is uniquely Pittsburgh; I will talk more about this later.

However, my alternate title is, “Railroads—A Bridge to the Future.” This is a photo of our bridge across the Mississippi River. The original bridge at this location was defended by Abraham Lincoln, who was our first lawyer and went on to greater things; this is reflective of the rich history of the rail industry. The other photo is of a Soviet poster which says, “The October Revolution—the bridge to a glorious future.” This is a reminder that just because it’s in PowerPoint doesn’t mean that it’s true.

Agenda

First I want to give you some background on RDC and the rail industry; then talk about infrastructure because you can’t talk about railroads in isolation without talking about infrastructure; then discuss infrastructure in western Pennsylvania (or the lack thereof); discuss the rail industry in western Pennsylvania; then, why rail is important; and finally and most importantly, “What’s in it for you?”

Background on RDC

Railroad Development Corporation (RDC) is Pittsburgh-based and focused on emerging markets. One thing that I think is really important is my father’s business philosophy, which was to never be in business on your own; always have partners, because you get better ideas and better results. While we are a small

company of five employees (four of us are local and one is based in Mattoon, Illinois), everything that we have been able to accomplish has been through partnerships, which is the underlying theme today.

So today is Diversity Day. Below is a table of the diverse companies of which RDC is a shareholder. We are currently in the USA, Latin America and Europe; and we were in Africa and the Former Soviet Union. Even the tons show diversity, ranging from the Iowa Interstate hauling 13.5 million tons in the USA to operating in Guatemala and hauling roughly 150,000 tons before the public sector forced us to shut down.

Country	Entity	Length		Employees	Average Tons (in millions)
		Km	Miles		
CURRENT:					
USA	Iowa Interstate	954	592	215	13.5
Argentina	ALL Central	5,690	3,535	1,200	3.3
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	1.9
Germany	Hamburg-Köln-Express	450	280	60	Passengers – start up 7/2012
Colombia	Ferrocarril del Pacifico	196	122	135	Start up 7/2012
PAST:					Tons Last Yr of Investment
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)

USA: Iowa Interstate Railroad (IAIS)

For those of you who are fans of American folk music, the song “The Rock Island Line” is about our railroad. Originally this railroad ran from Chicago to Texas, Minneapolis, and Colorado. It now runs from Chicago to Council Bluffs, Iowa, and was created when the Rock Island liquidated in 1980.

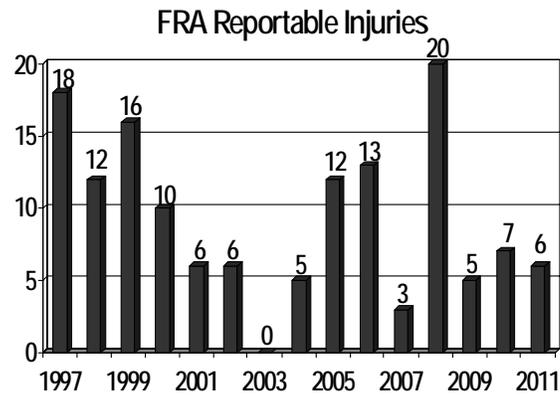


When I started in the rail industry, our job was “to turn the lights off with dignity” because we were a low-tech, obsolete relic of an industry that the central planners felt deserved to die. In contrast, the bright and shining era of the future was the airline industry. How things have changed!

On the subject of safety, the Iowa Interstate Railroad has won 2 Gold Harriman awards, which is the premier national award for rail safety. If you’ve got a safe railroad, it means you’re probably providing good service; if you’re providing good service, it means you get more business; and if you get more business, it means you make a profit. At IAIS, our mantra really is: “Safety is No. 1” and if you ask any of our employees, I believe that they will say the same thing.

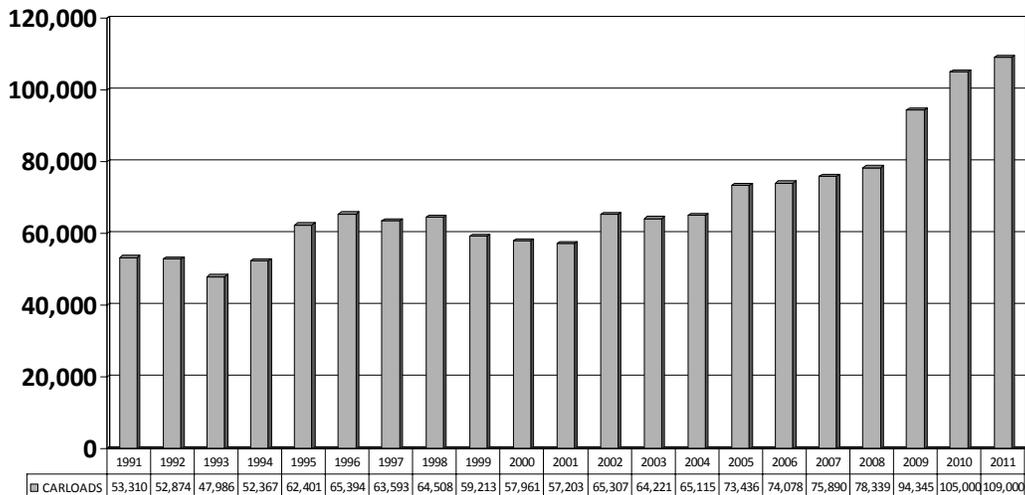


IAIS SAFETY



The graph below shows IAIS’ traffic levels which start at zero. The easiest way to misrepresent something is to use a graph that starts at something other than zero. We have been quite fortunate in that for 10 years our traffic was flat from 1991 to 2001, and then things like ethanol started to happen. Of course, in 1991 we knew someone would figure out a way to turn corn into fuel for SUVs!

IAIS TRAFFIC



This is a photo of our intermodal facilities; this is a



The on-topic message for this photo is the locomotives that

double-stack train hauling containers stacked two high. You can see trains like this locally on the side of Mt. Washington or at The Waterfront.

IAIS recently purchased from GE in Erie, PA, at the world’s most successful locomotive plant. And the diesel engines inside those locomotives were built in Grove City, PA.

Peru: Ferrocarril Central Andino (FCCA)

RDC also has an interest in Peru in Ferrocarril Central Andino which, until the Chinese built the line to Tibet, was the World’s Highest Railway. On this railroad, we also use GE locomotives from Erie, PA.



Germany: Hamburg-Köln-Express (HKX)

Interestingly in July, we started an intercity passenger business in Germany without a subsidy, which everyone knows can’t possibly happen because passenger trains lose money in the USA. I’m not going to say that this is a successful company yet, because we just started on July 23rd. However, what we learn from this may be exportable to the U.S. at some point, recognizing that the USA is a completely different environment and it is a gross oversimplification to say that this is something that could be translated to the U.S. My guess is that it probably can’t be, for a long list of reasons, but perhaps what is going on in Europe will cause us to look beyond our borders for other ideas.



RDC in Western PA: “Woulda/Coulda/Shoulda”

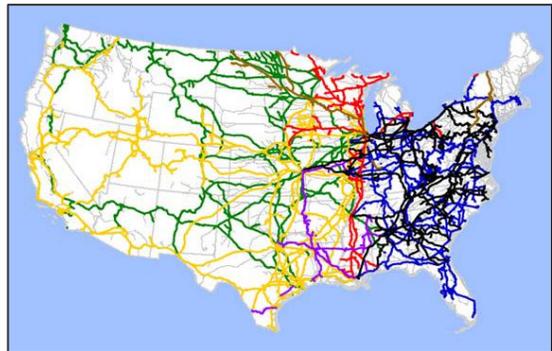
RDC has interests in railroads in Iowa, Peru, Germany, etc., so why not western Pennsylvania? Well, it is ironic to be speaking here at Station Square because in 1990, RDC tried to save the railroad right outside the window, the Pittsburgh & Lake Erie. But the Pennsylvania Department of Environmental Resources (DER) came after us and said that they would hold us personally responsible for every environmental crime that the railroad committed and that they would later tells us what those crimes were, and the penalty amount. Needless to say, the deal never happened, hundreds of people lost their jobs, and all of that contamination is still at McKees Rocks. So nothing was accomplished except jobs being killed. But I would like to take this opportunity to thank the DER for launching us into the international arena and for making RDC the visionary company that it is today. In other words, by getting thrown out of Pittsburgh, we were forced to focus elsewhere. And I wish that I could say this in a nicer way, but RDC’s accomplishments are despite being from Pittsburgh, and not because of it.

In 2008, RDC did have one more foray in western PA and it was the launch of the *Steel City Flyer*, which was an express bus from Pittsburgh to Harrisburg to accomplish two things: connect with Amtrak to the east coast and save Highmark \$1 million a year because they have a lot of employees who commute between Pittsburgh and Harrisburg. But we failed to ask the right questions, and I take personal responsibility for that. We should have asked Highmark if they were actually interested in saving \$1 million/year. The answer was “no” because their employees are paid \$0.55/mile and we would be taking money out of their employees’ pockets by saving Highmark money and making their time more productive. So, this was our mistake and we paid for it.



Background on the Rail Industry (“Railroading 101”)

The rail industry is the original “network” business. Those are not my words, but rather the words of my friend Eric Schmidt, the CEO of Google. The map shows by the various colors the various private sector railroads that run around the USA.



In Pittsburgh, there is CSX and Norfolk Southern, both of which are NYSE companies, but more importantly, there are roughly 600 privately owned railroad companies in this country, and some of them are as short as one mile. There is a railroad on Neville Island called the PAM (the Pittsburgh, Allegheny & McKees Rocks), and I am pretty sure it is less than one mile long. So this is a national private sector network that functions as a national network; owns and maintains its own infrastructure; and serves a segment of the economy which tends to be bulk traffic like coal, steel and even containers. If you look at the market share for ton miles in North America, it used to be 30% and now it is closer to 40%. And more to the point, not everything is delivered via the Internet.

When I started my career in the Age of Regulation, the airline industry was the future and the rail industry was the distant past. What we didn’t realize was that it wasn’t us, it was regulation. So deregulation liberated our industry and saved it. Perversely, deregulation has killed the airline industry. What a remarkable transformation; I am certainly very proud to be associated with an industry that has become a business as opposed to what was really a death watch in the mid 1970s. I remember being lectured by a number of people that I was not making a smart move by going into a dying industry. How wrong they were, but we didn’t know it at the time.

And since Pittsburgh loves using the term “World Class” especially when talking about ourselves, the U.S. rail industry really is a world-class industry. The fact that we have exported the North American model—private sector, deregulated rail transportation—is the best testament to that. If you look at what is happening in Latin America, which is a remarkable transformation by the way, the only private sector railways in Latin America are in Cuba and Venezuela. They took the North American model and grafted it into Latin America, and however dramatic the results are here, they are far more dramatic there. For example, Brazil’s transformation has been incredible. We have done very well, but the Brazilians have come even farther.

So now let’s talk about the rail industry from a historical perspective. Yes, we have a rich and complicated history, and our original lawyer was Abraham Lincoln, and there is plenty of nostalgia out there, but

sometimes it is a distraction. In terms of history, I prefer to focus on the Era of Regulation. I worked for the Rock Island in the summer of 1976, and that railroad’s Chicago to Omaha line is now the Iowa Interstate. I rode our passenger train The Peoria Rocket from Chicago to Peoria and it ran at 10 mph. We now run our freight trains on that same piece of railroad at 25 mph. That is what regulation did to our industry but fortunately the railroad renaissance occurred.

Why Infrastructure is Important

Railroads are an important piece of the infrastructure portfolio. Note the quote from the July 14th edition of *The Economist* which is quite relevant to Pittsburgh. I will highlight the most important part: “Even the most productive start-ups cannot help an economy held back by dilapidated roads, the world’s most expensive health system, underachieving union-dominated schools and a Byzantine immigration system...” Change the words to Pittsburgh, and think about it. Think about our local transportation infrastructure – our roads, the inability to keep Port Authority Transit running, etc. “The world’s most expensive health system” brings to mind the UPMC-Highmark war. “Underachieving schools” – despite the Pittsburgh Promise, Pittsburgh schools are still in a nosedive and there is no evidence that it is going to change. And “a Byzantine immigration system” – I read yesterday that Pittsburgh Promise is now going to target the Hispanic market, and that’s what is going to help? I hope so. It is remarkable the lack of diversity in western Pennsylvania; we have so far to go and the clock is ticking.

“...the next president should fix America’s ramshackle public services. **Even the most productive start-ups cannot help an economy held back by dilapidated roads**, the world’s most expensive health system, underachieving union-dominated schools and a Byzantine immigration system that deprives companies of the world’s best talent. Focus on those things, Mr. Obama and Mr. Romney, and you will be surprised what America’s private sector can do for itself.”
– *The Economist*, July 14, 2012

But the only thing that *The Economist* didn’t get right – “dilapidated roads” – was that it should have said: “dilapidated infrastructure”. When I think of all the time I’ve spent on my own commute, and how productive I could be if I had the “socialist lifestyle” of the Europeans, actually using public transportation and working instead of sitting behind the wheel, I am sure I could be 10 to 20% more productive in my job if I did not have to rely on road transportation.

“Infrastructure” is a word that the American public learned to spell in 2007 when the interstate highway bridge in Minneapolis collapsed. All of sudden it became personal because as Americans we identify ourselves as automobile drivers. When an interstate highway disintegrates, then it becomes personal.



The problem with infrastructure is that it is a long-term investment and is not particularly sexy. Think about the Pittsburgh Water & Sewer Authority and the last time anyone ran for mayor based on an improved water system. But living in Oakland we put up with major water main breaks several times a year as they are only patching things together. Why? Because we don’t really care. Well, at some point we have to start caring. The fact is that infrastructure is a driver, or in Pittsburgh’s case a constraint on, economic and social growth.

How many in attendance today got here on Port Authority Transit or on foot? Two. Comrades, I am in solidarity with you.

Next, let's discuss why rail is important in any discussion about infrastructure. I am a freight rail guy and we're getting into passenger transportation, so it is a stretch for me to talk about rail-based urban passenger transportation. But we talk a lot about "smart growth." Smart growth is typically a subway system with high-rise apartment buildings built around the subway, and one model is Toronto. Toronto has evolved based on where the subway goes. A more extreme example but a realistic aspiration would be "wise growth" which would involve private sector components, for example, in public transportation. But it would also involve the public sector staying out of the real estate development business, and not picking winners and losers. In Pittsburgh that might involve shutting down the URA (Urban Redevelopment Authority), and letting the marketplace decide which development makes sense or not.

In Pittsburgh, we do not have transit-oriented development; we have development-oriented transit. For example, let's take a steel mill site and turn it into a shopping mall so we can all feel good about how far we've come. But how are people going to get there? I do see people at the Waterfront waiting for buses, and it's a good thing that Port Authority Transit has figured out a way to serve those markets. But imagine the cost of serving an increasingly fragmented market. The location of the Pittsburgh Technology Council itself is in a former steel mill site which is impossible to get to on public transportation without changing buses downtown, and anyone making a lifestyle decision is going to have to consider, *what if there is no Port Authority Transit 2-3 years down the road?*

Additional roles for rail in economic development especially revolve around freight. Earlier this week we read about how we should feel good about the economic development in the Strip District. But this should not be at the expense of access to rail freight via the Allegheny Valley Railroad, and good for them for challenging the URA on this one.

Another role for rail is access to jobs. How do employees at your local Starbucks or those who work beside you get to their jobs? Mobility is a human right. I can't state it any other way and that includes the access to transportation.

Infrastructure in Western PA: You Can't Get There From Here

Pittsburgh is now recognized as a World Class City in that we stand side-by-side with New York and Los Angeles in having 1 of the Top 10 Worst Highways in America. The difference though is that both NYC and Los Angeles also have public transportation systems. Yes, it is hard to get LA drivers out of their cars, but even they have developed a public transportation system over the last 20 years that is working fairly well as they acknowledge that sitting in their cars 1.5 hours each way is a drain. The only other comparable commute that I've heard of is in South Africa under Apartheid, where the typical commute was 2 hours between the townships and their jobs. One of the things that brought Apartheid down was the drag on the economy and the expense on a system that was so unproductive that people were literally sleeping on their feet. Los Angeles has at least solved that problem by giving people a choice; but we don't have those choices in western Pennsylvania.

We do have a light rail system in Pittsburgh but it doesn't go to Oakland; it goes to the stadiums; and it runs for *free*. And the riders are complaining about delays because the system wasn't built to accommodate 10 or 20 football games a year; so what do they want, their money back from their free ride? It cost \$0.5 billion. There is something wrong with that when we can fund a light rail system to stadiums but we can't run the basic system Port Authority Transit system. Many jobs unfortunately cannot be served by public transportation, including where I work. Even getting from Oakland to the Pittsburgh Technology Council requires changing buses downtown; you could walk faster than doing it by bus.

So I would argue that Pittsburgh is really Third World and not World Class, but that is really an insult to the Third World. If you go to places in Latin America, Africa and Asia, you will find very good levels of public transportation. If you stand on the street corner at midnight in Argentina, there are private sector mini buses running every 3 minutes. My daughter lives in Kenya and there is a well-developed bus system there. Anything that depends on the public sector is at-risk, which interestingly is why the rail industry has done so well because we do not depend on the public sector for most of what we do.

Then there is Amtrak, which is not perfect, but it is a minimal national network, which in its highly imperfect way can still serve as a jumping off point for something better. For instance, I’ve stopped driving to Washington and I take Megabus and come back on Amtrak, which is a very efficient and productive way to travel. Additionally, driving to Harrisburg and taking the train to New York is more reliable and time competitive than flying. So there are these little nuggets of potential out there.

Why Rail Is Important

Rail is important because it is part of the infrastructure portfolio, provides congestion relief, and contributes to economic development. And interestingly, rail is a flexible, national network of strategic importance. There is a lot of business out there that is moving by rail that no one ever thought of. When traveling to the airport on the Parkway West, there is a rail yard on the right near Green Tree. That rail yard was empty until about 4 years ago; now it is busy with sand cars for natural gas fracking.

So, there are many new and interesting industries that no one had thought of that the rail industry is right there ready to serve. When fracking came along and the demands for sand evolved, fortunately we had this national network which has the capacity to adapt flexibly. In the West, there are movements of oil by rail, which hasn’t happened since WWII because of the threat of U-boats off the coast. We can’t build pipelines fast enough, and as energy markets change, i.e. oil or natural gas vs. coal, the fact that there is this flexible, national network standing by is not just valuable but strategic.

Additionally, rail is not dependent on public funding which is why we have been able to maintain and improve our infrastructure even as the highways, waterways and the air traffic control system enjoy a continuous decline thanks to their dependence on public sector funding.

A Global Perspective

Please note that I am saying that the U.S. rail system is better than the Europeans. A comment I often get is, “Why can’t we have trains like they have in Europe?” One important thing to mention is that the Europeans are asking, “Why can’t we have railroads like the USA?” The Europeans are speaking about freight service, which in Europe is a disaster as far as freight is concerned, even as we aspire to have a European level of passenger service. It is a very interesting two-way street. The fact is that the U.S. model has served as a model for the world, and the best example of that is railway restructuring and privatization in Latin America, Australia, and even in parts of Africa. That model came from North America.

Another comment that has come up a lot is, “Why can’t we have a rail network like China has?” China has embarked on truly visionary and bold growth in its network, and China is the ultimate environment. But the fact is that the Chinese standards are U.S. standards. If you took a locomotive from the USA and put it in China, or brought a Chinese locomotive to the USA as we’ve done with steam locomotives, the technology is basically the same. The problem lately is that the Chinese industry has been, to a certain extent, based on reverse engineering or outright theft of intellectual property from elsewhere, including

the USA. And that has come back to bite them because there was a high-profile accident in which apparently a signal system was reverse engineered and they only got it 99% right. I’ve been told that intellectual property in Asia is culturally not felt to be the property that we consider it to be in North America. Therefore, when doing business in that environment, you need to keep in mind that there is a certain amount of theft that is behind the supply industry. I wish I could say it in a nicer way.

A Network Business

Let’s discuss rail as a network business. It is certainly a compliment to our industry when the CEO of Google describes us as a network business. The rail industry is the original network business in that 175+ years ago when the industry began, the idea was to link the whole network through common standards. While that has proven quite effective in terms of moving freight anywhere, it also means we have some lowest common denominators as far as equipment standardization, etc. and to some extent that prevents radical leapfrogging of technology. But a more important point is that our industry was revived by deregulation, not technology. It saved our industry and that is what is driving it.

“Higher Speed Rail”

Another topic that has gained recent attention is passengers. I will certainly give the Obama administration great marks; President Obama is the first president to mention rail in a State of the Union speech in many generations. I will also comment that I think the high-speed rail program as advanced by the Obama administration, while not necessarily oversold, hasn’t come to grips with the reason why rail systems work in other places, and that is the transit links. High-speed rail systems work primarily because they are linked to transit systems. And that is a piece of the puzzle that really has not been addressed in the plans for high-speed rail. It is better described as *higher* speed rail by the Obama administration, and unfortunately, that has made them easy targets for political attacks. To put it another way, when the French built the first high-speed line from Paris to Lyon, they didn’t really build it from Paris to Lyon; they built it from someplace outside of Paris to someplace outside of Lyon because they used the existing rights of way to get into the cities, and that is a strategy which has worked quite well worldwide. But someone who wanted to attack that project could have said that they wanted to build this high-speed line from a cornfield south of Paris to a cornfield north of Lyon, why do it? So I think a better understanding of how it needs to work and also better communication as to how it could come together with transit, etc. is needed at this point. Again, I emphasize that transit links are probably more important than high speed, because it is about getting from door to door and not about the maximum speed.

What’s In It For Me? – Manufacturing Perspective

Since you are a manufacturing audience, let’s talk about what the industry offers in terms of opportunities. I would like to highlight that the industry has been driven by institutional progress more than technological progress, meaning things like deregulation and interoperability, i.e. that equipment needs to be compatible to a certain extent with equipment from 100 years ago because it is a network. Technical solutions need to evolve in a way that is consistent with both the market and the institutional environment of the unique network business that is the rail industry. Partial answers include intermodalism, where for example, trucks are used to provide the connection to/from rail terminals. But the core business is moving carloads of freight from private sidings to private sidings. And anybody on the supply side needs to understand that.

In Pittsburgh and surrounding regions, we do have a number of local companies that are in fact world leaders. The most obvious example is GE in Erie where they build the world’s best locomotives. I am proud to say that the Iowa Interstate is one of GE’s smallest customers; we bought 14 locomotives from them. And there are other companies such as Wabtec and Union Switch & Signal that are in the technology side of the business with signal and control systems. And the basic nuts and bolts include the track where L.B. Foster is a global leader in that regard, and I am proud to say that we have bought track material from them for our rail affiliates in a number of countries. Even our own Iowa Interstate developed a low-tech dispatching system that is appropriate for most of the railroads out there, which are relatively unsophisticated in terms of what they need to be to serve their specific markets.

If you are on the manufacturing side, the opportunity to do business with these companies is available. Please also keep in mind that Pittsburgh is served by two major railroads—the Norfolk Southern and CSX, as well as a number of smaller railroads. So it is a very diverse industry as seen even in Pittsburgh.

Let me close by repeating that RDC is a small company, multi-cultural, and based on partnerships. There are plenty of opportunities out there for a diversity of companies, and it is always best to work with partners. I encourage you to look to our rail industry as a source for both business opportunities and a potential for employment.

Thank you very much.

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