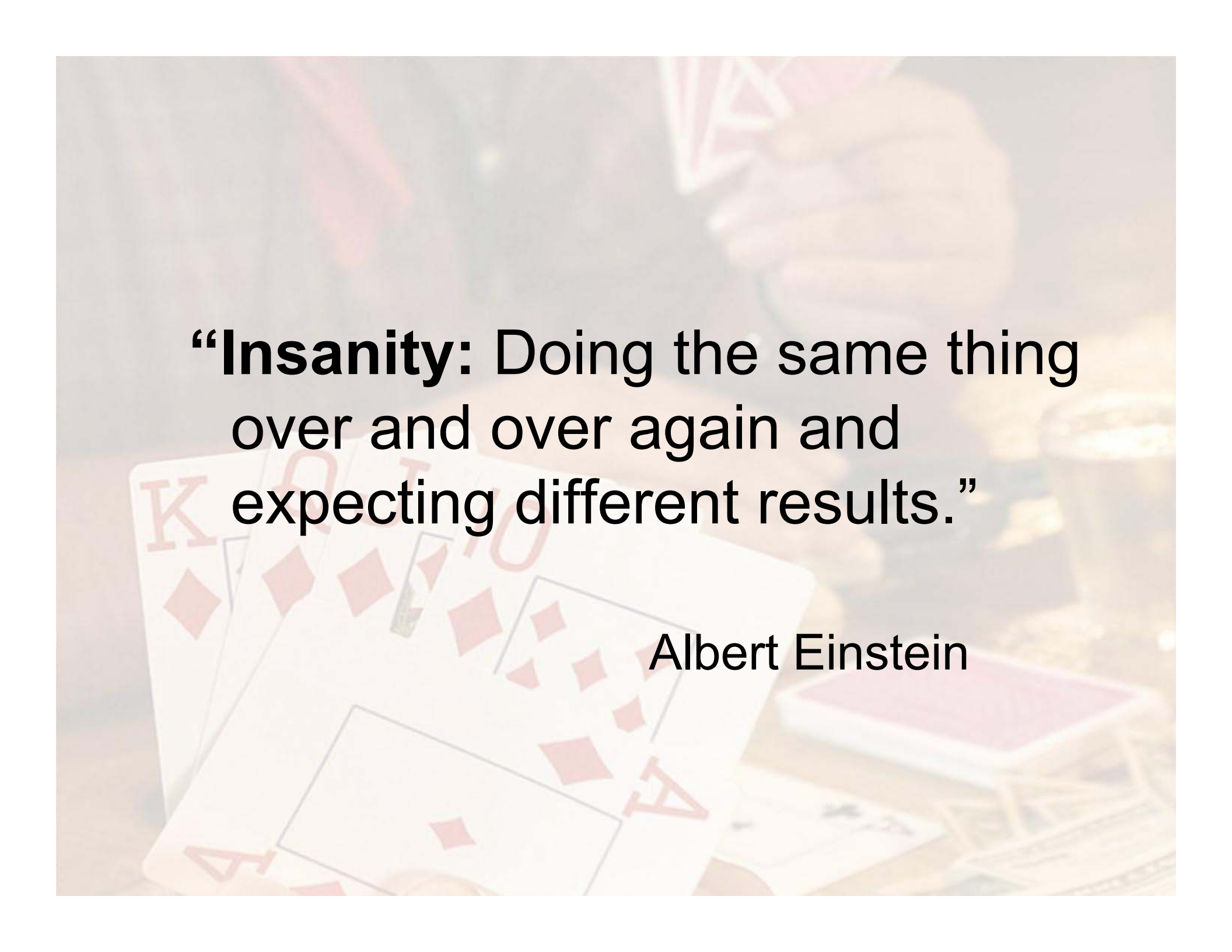


Northeast Association of Rail Shippers  
October 1, 2014  
University Park, PA

# The Rail Rate Negotiating Game has Changed

Michael R. Behe  
*USRail.desktop*





**“Insanity:** Doing the same thing over and over again and expecting different results.”

Albert Einstein

# Agenda

- Rail Market Power
- Traditional “Request for Proposal” (RFP)
- Your Negotiating Strength
- Alternative Ideas for your RFP
- Wrap Up and Questions

# Rise of Competition

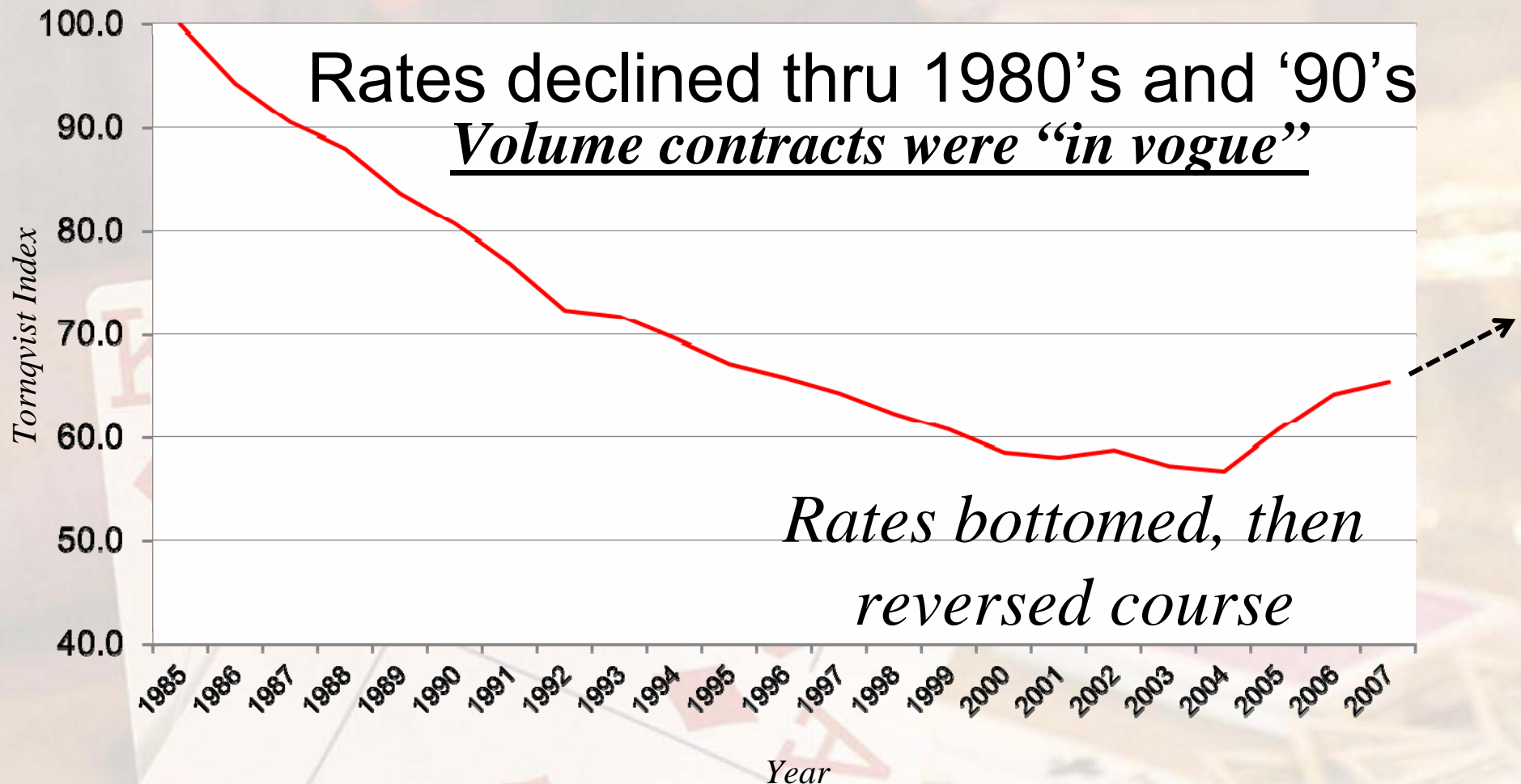
- Staggers Rail Act of 1980
  - Independent rate-making
  - Intra-modal price competition
- Pricing freedoms had shipper-favorable impact in the 1980s and '90s
  - Volume and % of volume discounts
  - Refund contracts
- Spin-off of hundreds of short lines

# Decline in Competition

- Fuel cost rise reduces motor carrier threat
- Traffic growth straining capacity
- Fuel surcharges
- Mergers reduced routing options
- “Routing Protocols” are a further threat

# STB Rail Rate Index 1985-2007

Real Revenue Per Ton-Mile (1985=100)



Source: Christensen Associates/2009 and STB's Waybill Sample

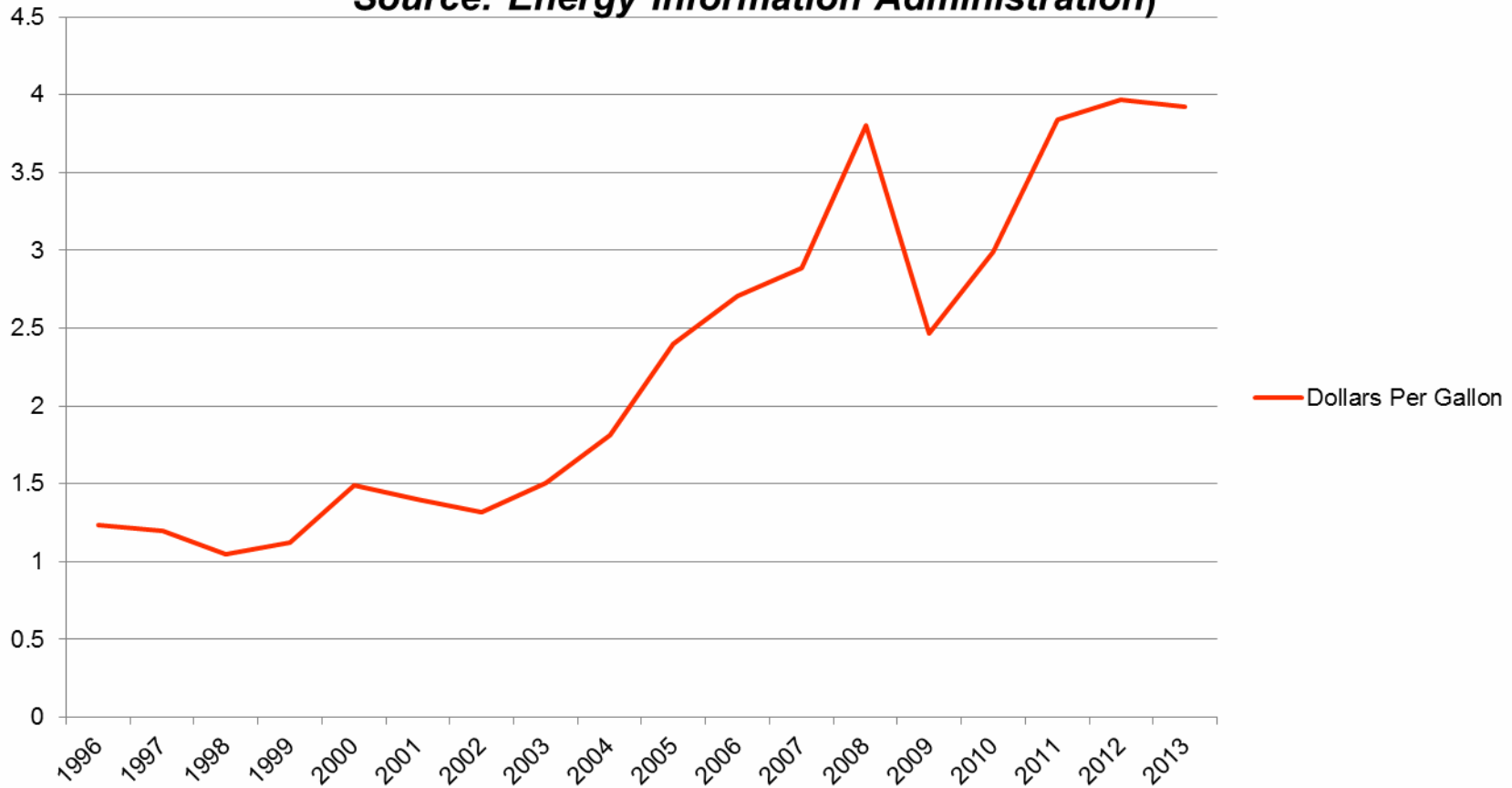
# Rails' Market Power

- Fuel Prices
- Industry Consolidation
- Growing Pains

# Fuel Prices

## U.S. No 2 Diesel Retail Prices

Source: Energy Information Administration)



**Railroads are 4x more fuel efficient than trucks**



# Rail Industry's Consolidation

January 1, 1985 = 28 Class 1 Railroads

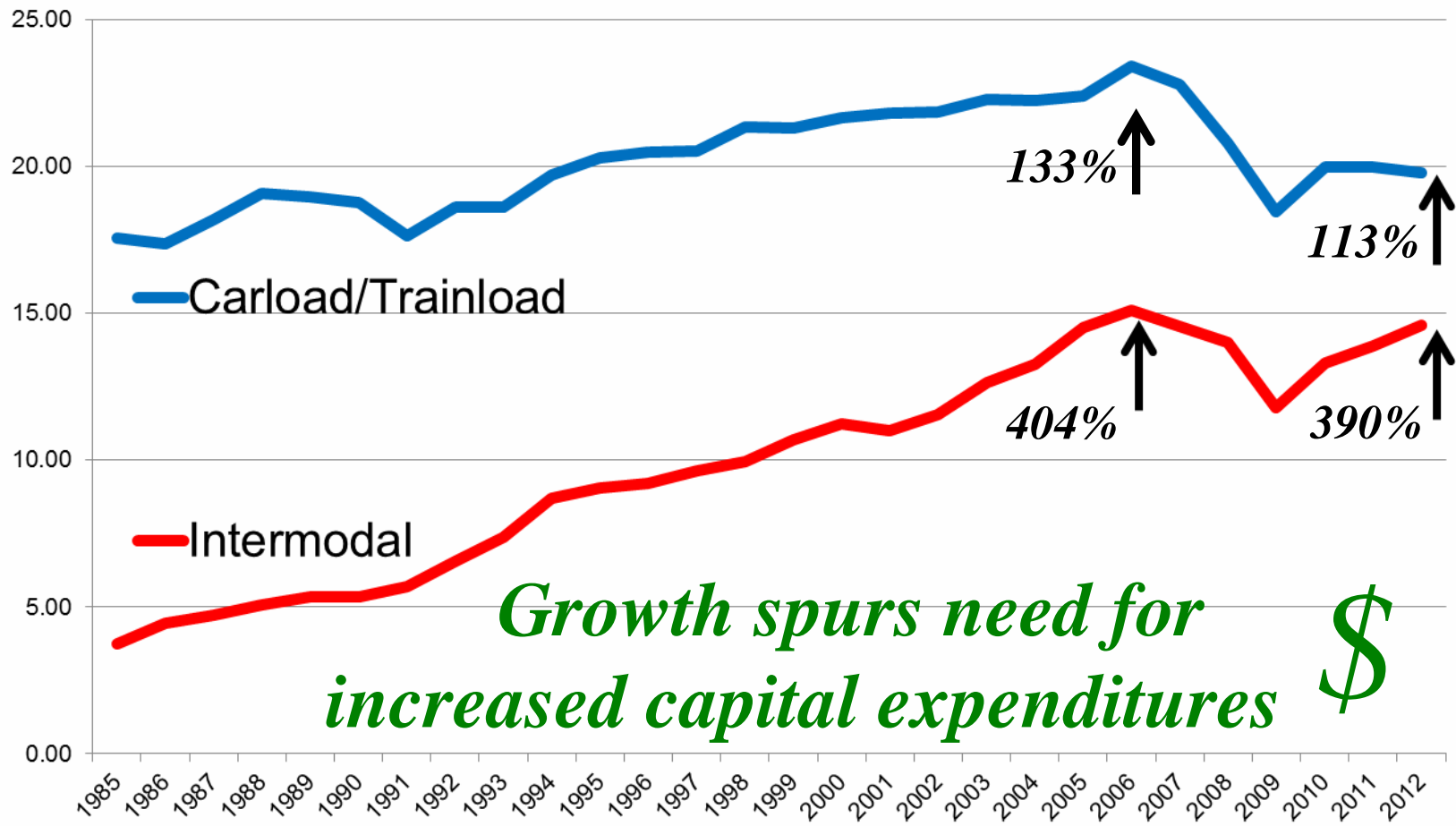


Today = 7 remain, only 2 in most regions



Loss of routing options.  
Increase in “reciprocal switch” charges.

# Intermodal Growth 3+ x Carload/Trainload




*Growth spurs need for increased capital expenditures \$*

↑ % increase over 1985

Source: Christensen Associates/2009 and STB's Waybill Sample

# Traditional RFP

- 'Bundle' volume
  - Carriers 'bid'
  - Evaluate 'bids'
  - Negotiation
  - 'Award' traffic
- 

# Bundled Traffic

- Bundle all the traffic we can
- Belief is more volume equates to lower rates
- Little or no 'up front' analysis
- Send out lanes-spreadsheet (the RFP)
- Hope for carriers' "best effort" responses

# Evaluate 'Bids'

- 'Science' employed varies greatly
- Scrutinize volume lanes (where \$'s are)
- Compare bids in competitive lanes
- What 'strings' have carriers attached?

# Bid then Negotiate

- Until now we've pretended it's a competitive bid
- No surprise; It's a negotiation after all
- Plays right into the hands of RR holding the most traffic captive

# Award Traffic

Emergence of:

Market Share Winner	Market Share Loser
<p>Competitive traffic “dominated” by carrier with most captive traffic</p>	<p>Focus on maximizing margins</p> <p>Retribution?</p>

# Negotiating Strength

- Volume matters less than it used to
- Relative profitability of traffic
- Ratio of competitive traffic to captive



# Negotiating Strength

- RR's view of the relationship
  - Relative amounts of captive traffic
  - Perception of how they've been treated in the past
  - Clarity as to what will bring gains or losses
- RRs' market shares: who's gaining/losing?

# Can you play smarter?



RR uses as leverage... ... to secure greater participation.

**CAPTIVE TRAFFIC**

**COMPETITIVE TRAFFIC**

... to secure better rates. Shipper can use as leverage...



# Alternatives to consider

- Invest in up-front analysis
- Establish goals for this contract...and the next
- Clarify each others values & establish process ground rules
- **Negotiate captive first, then bid competitive**
- Consider options to 'all at once' bundling

# Up Front Analysis

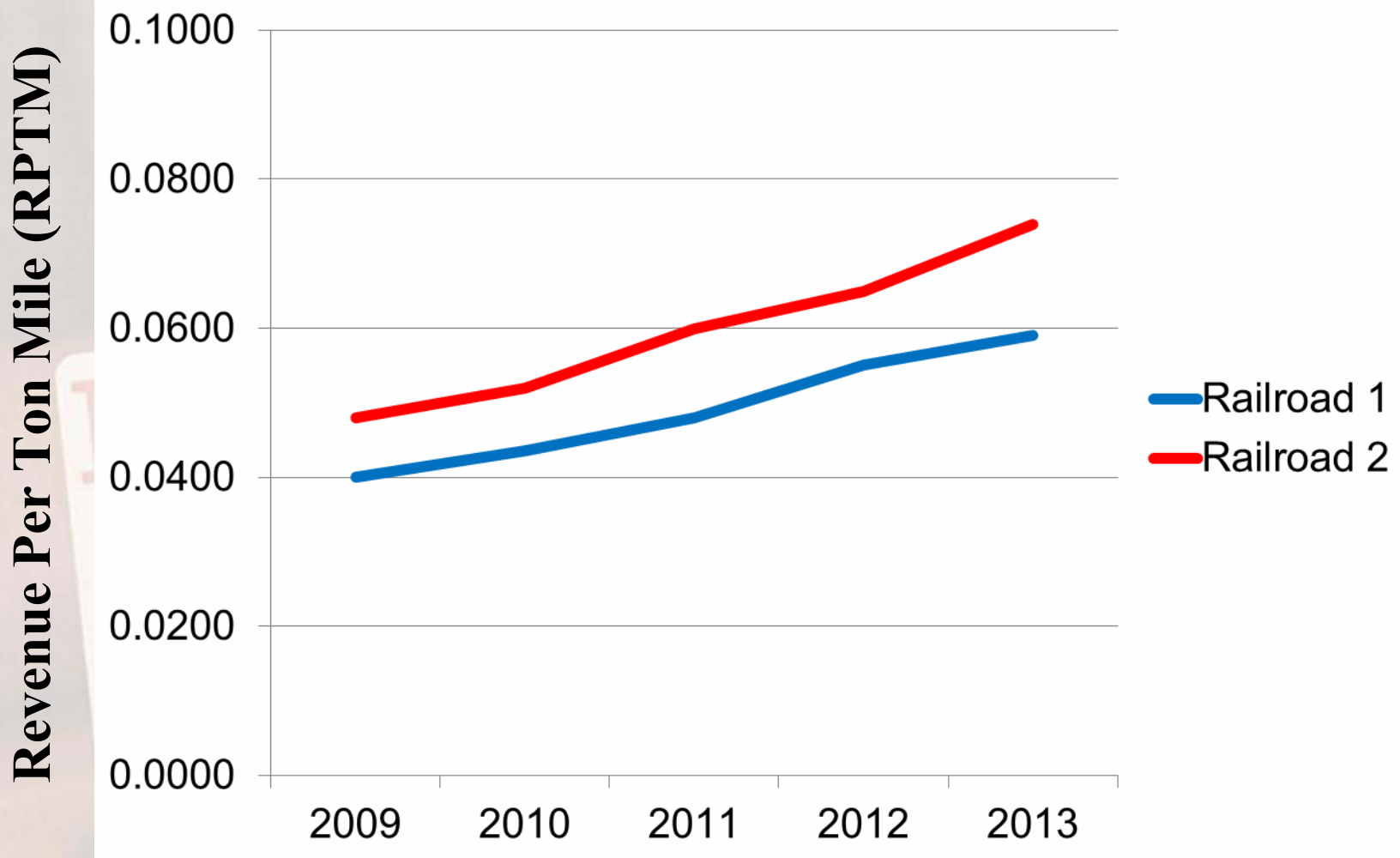
- Separate captive from competitive
- Competitive/Captive ratio for each carrier
- Benchmark rates:
  - Best rates and best lanes
  - Worst rates and worst lanes
- Evaluate carriers:
  - Captive rates (RR1 vs. RR2)
  - Captive vs. competitive rates

# Revenue Per Ton-Mile Comparison

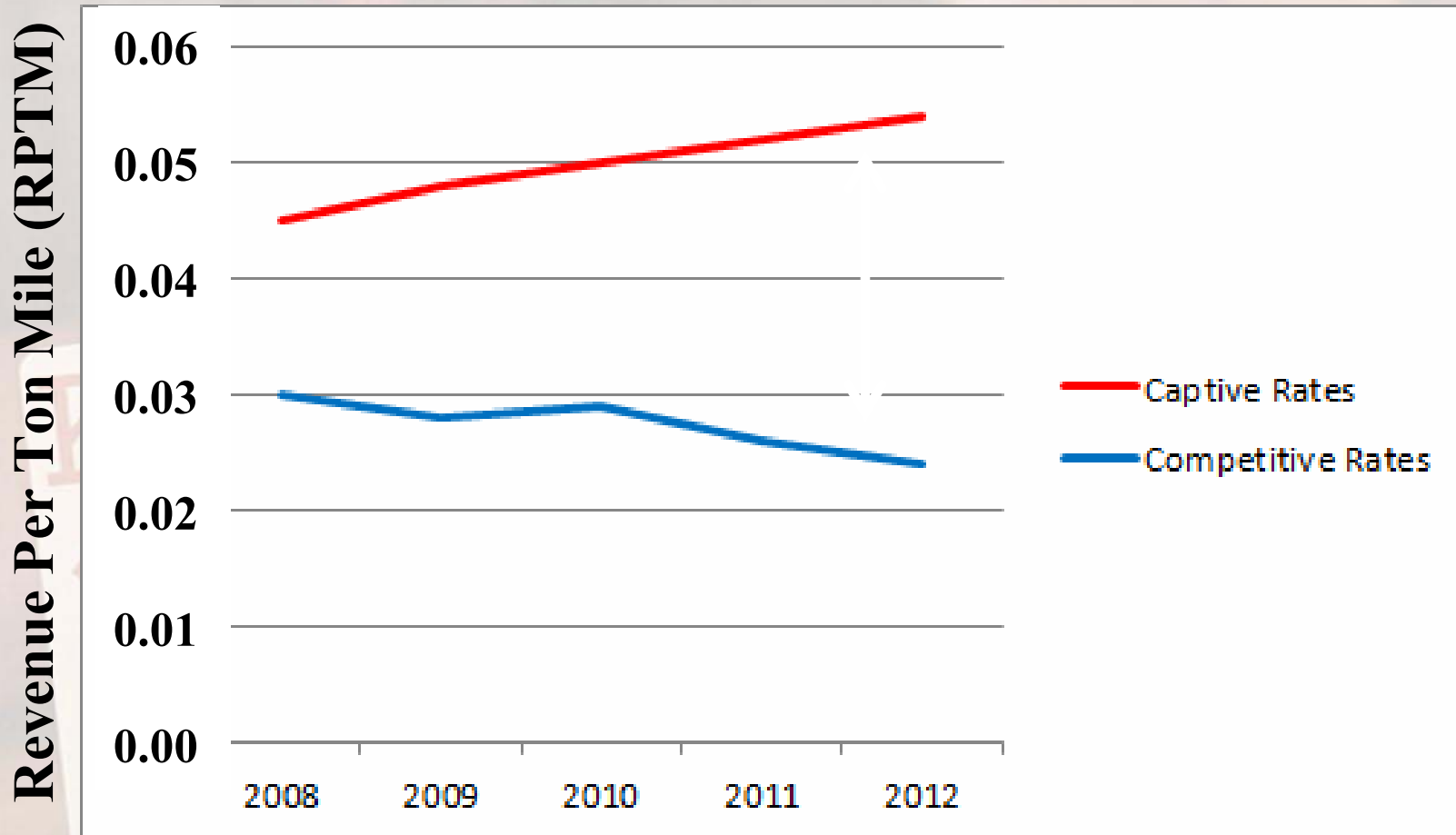
<u>Captive Lanes Only</u>	<u>RR 1</u>	<u>RR 2</u>
Carloads	4,000	1,500
Rail 'Spend'	\$16MM	\$7MM
Average haul	750	690
Avg. RPTM	\$.056	<b>\$.071</b>

**RR2's 1.5 cents/ton-mile premium equals \$1.5 MM additional spend!**

# Captive Premium Trend



# Captive vs. Competitive rate relationship



## Establish Goals, Examples:

- Hold overall initial increase to 2.5%
- Reduce RR2's captive premium by 15%
- Reduce costs by 8% in 10 worst lanes
- Increase RR2's participation in our competitive lanes
- 3 year terms: 1/2 expire mid-year, 1/2 yr-end
- Escalator index: All-LF with .75% minimum, 3.5% maximum



# Values and Ground Rules

- Captive rates are negotiated
- Advise carrier if 'failing' based on captive rates
  - Competitive lanes won't be in RFP
- Competitive rates (may be selectively) bid
- Award of competitive traffic will be influenced by captive rates and conformity to our values

# Negotiate then Bid

- Tell the RR what you want:
  - Captive rate anchors
  - Contract(s) term(s)
  - Rate index, watch that minimum!
- Tell them what they'll gain...or lose.
- The more the RR has to gain or lose, the more aggressive your anchors can be.
- No competitive traffic? You can still throw out (conservative) anchors.

# Can you enhance your power?

**By taking action you currently are not taking:**

- **Up-front analysis**
- Establish Goals, this round and the next
- Clarify what you value, and what you'll reward
- **Propose captive rates** to start the negotiation
- **Award competitive traffic with one eye on the next round**

# Can you enhance your power?

By not taking action you are currently taking:

- Don't treat all bidders equally
- Selectively hold back competitive lanes in RFP if carrier is not treating you fairly

Note—"The use of power always entails cost and risk."

Dr. Chester L. Karrass

# Can you enhance your power?

By preventing your opponent from taking action he is presently taking:

- Resist carrier attempts to apply 'strings'
- Reject captive rates tied to competitive traffic

Note—"The use of power always entails cost and risk."

Dr. Chester L. Karrass

# Can you enhance your power?

By taking action with your opponent that you are currently not taking:

- Alternatives to 'all at once' RFPs
- Rule 11 pricing
- Goal sharing, and up-front horse trading
- Volume commitments

# Wrap Up

## Can you enhance your power?

- **By taking action you are not presently taking?**
- **By not taking action you are presently taking?**
- **By preventing your opponent from taking action he is presently taking?**
- **By taking action with your opponent that together you are not presently taking?**

**From “*The Negotiating Game, How to get what you want*”,  
Dr. Chester L. Karrass**



**“90% of the game  
is half mental.”**

**Yogi Berra**





# ***The Game has Changed***

## ***Q & A***

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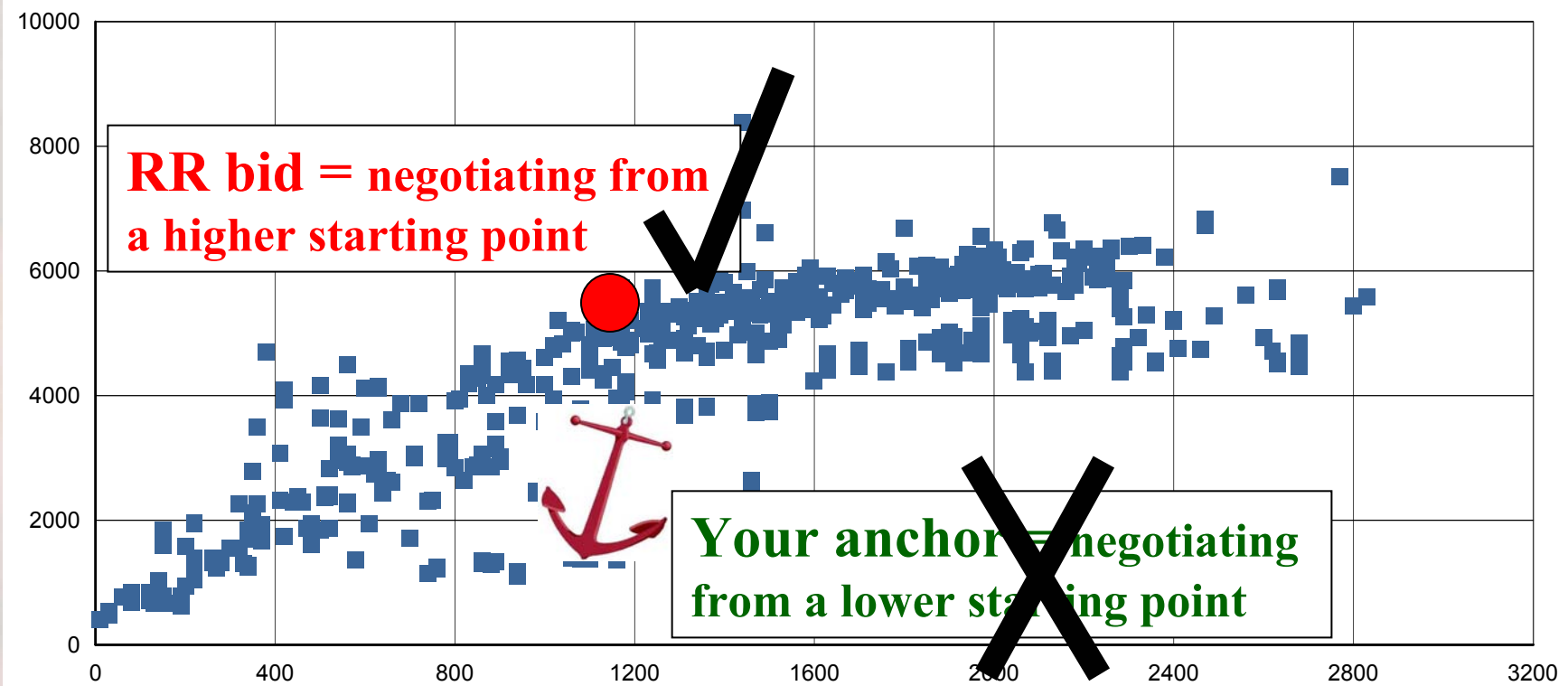
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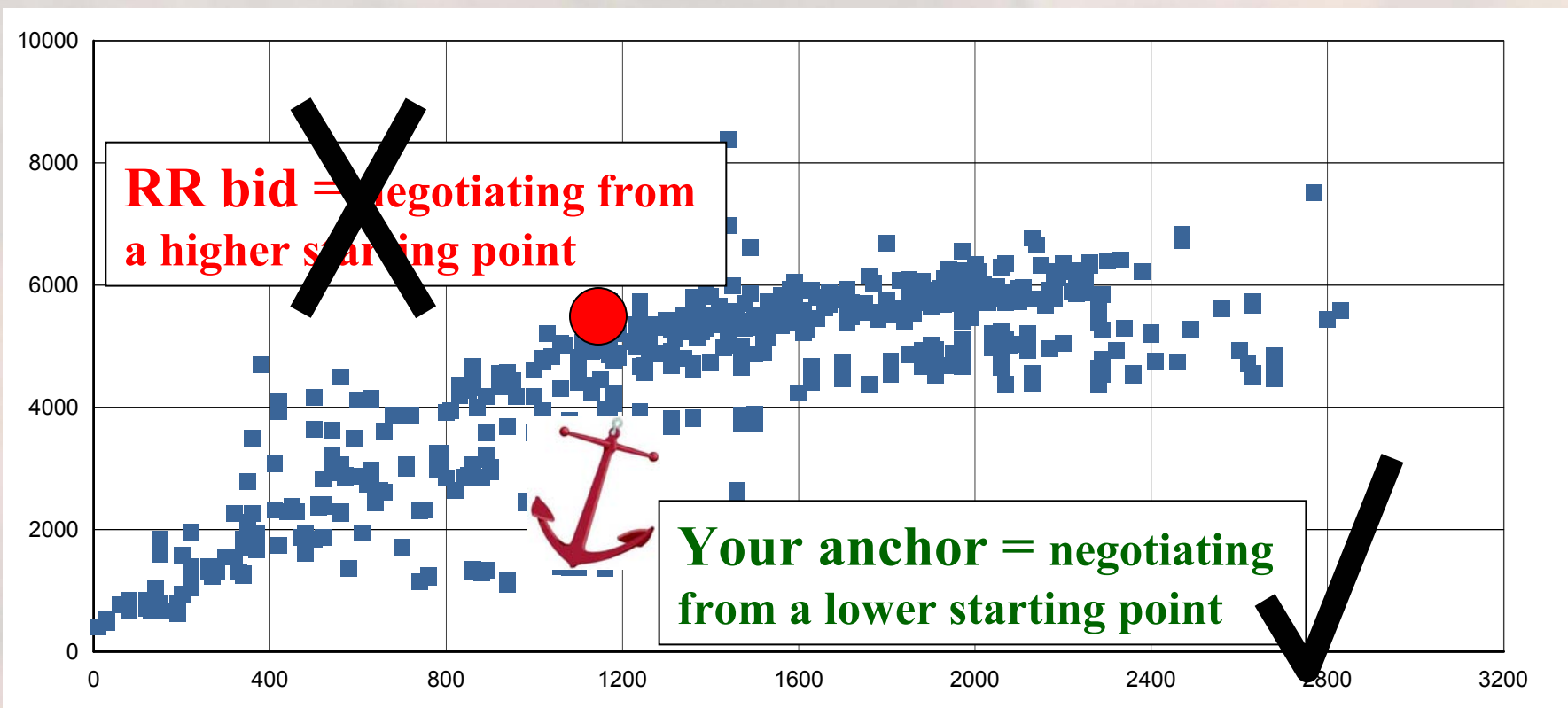


***APPENDIX***

# Typical Bid then Negotiate



# Alternative, Negotiate then Bid



**When the anchor is reasonable, the final rate tends to be lower.**