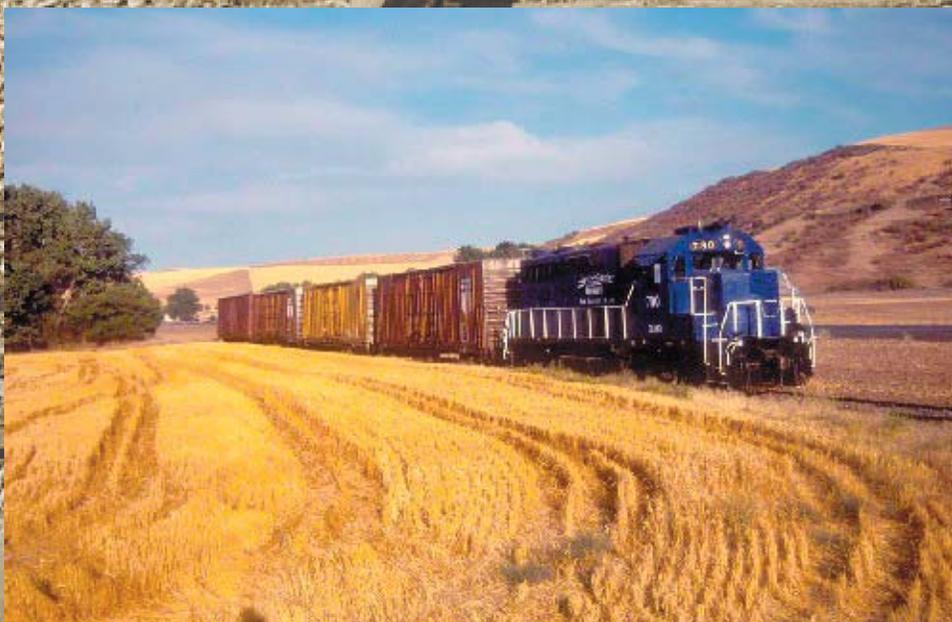


# Purchase and Rehabilitation of the Palouse River and Coulee City Railroad Track



Assessment of Economic  
and Community Benefits

May 2004





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# Purchase and Rehabilitation of the Palouse River and Coulee City Railroad Track: Assessment of Economic and Community Benefits

## Executive Summary

### Introduction and Background

This report summarizes the research, investigation, and policy analysis conducted to assess the feasibility of and options for continuing operations of the Palouse River and Coulee City Railroad (PCC) line, given the availability of state freight rail funding assistance. The PCC is the state's second longest rail system, encompassing 410 track miles: 370 miles in Washington and 40 miles in Oregon and Idaho. It provides primary freight rail service for Grant, Lincoln, southern Spokane, Whitman, Walla Walla, and Columbia Counties, and is the only rail outlet for Latah County, Idaho and northern Umatilla County, Oregon. As such, the PCC is an important commercial corridor in eastern Washington, transporting nearly a million tons of cargo each year. Approximately 80 percent of the PCC's business is agriculture-related; it provides transportation to market for 20 percent of the state's wheat crop, 67 percent of its lentil crop, as well as a mix of other products and equipment.

**PCC Management and Ownership.** The PCC is a regional rail line comprised of three separate railroads operated together by WATCO, a short-line railroad holding company based in Pittsburg, Kansas. The railroad is comprised of three lines: the "Central Washington" or CW line from Cheney to Coulee City; the Whitman County lines east of Hooper to Pullman and north to Marshall, including the "Pleasant Valley" or PV branch to Thornton; and the Blue Mountain Railroad lines east of Wallula to Dayton and Weston, Oregon via Walla Walla.

Ownership of the rail lines is likewise complex: WATCO owns the right of way for the PCC's northern lines in Grant, Lincoln,

"It is very important to keep and maintain a viable rail transportation system in eastern Washington and the state as a whole. I have seen rail service go by the wayside when the Burlington Northern pulled up the tracks that serviced Waverly and south. Since then our grain has had to be hauled over the highway system to either the Snake River terminals or to Fairfield Grain Growers unit train facility."

- *Whitman County farmer*

Spokane, and Whitman Counties, comprising the CW, Whitman County, and PV lines; portions of the PCC's southern lines in Walla Walla and Columbia Counties, known as the Blue Mountain Railroad, are owned by the Port of Columbia County; other portions of the Blue Mountain line are leased from the Union Pacific Railroad (UP) and UP and the Port began negotiations in 2003 for UP to donate these leased portions to the Port; and a smaller segment of the Blue Mountain line is owned by the UP and the Oregon Department of Transportation. The UP portion in Washington may also be donated to the Port.

**The Current Situation: Deferred Maintenance Needs, Unfavorable Economics, and WATCO's Business Decision.**

In the years since the PCC has been operating as a regional rail system, the deferred track maintenance situation which was inherited from the mainline railroads—the BNSF and UP—has worsened. Not only had the inherited maintenance backlog not been addressed, the financial performance of the line led WATCO to fund at best half the level of annual maintenance considered necessary within the industry: \$3,100 per track-mile expended versus industry standards of \$6,000 to \$8,000. There are also other disincentives and alternatives to investing in the railroad's infrastructure: the economics of the current scrap market for steel make abandonment and scrapping of rail tracks a more attractive business proposition than continuing to operate a marginally profitable rail line.

Given this situation, in March 2004 WATCO submitted a letter to the Governor stating its intention to begin operational embargoes and the filing of a formal abandonment plan for some PCC segments, effective June 1, 2004, unless agreement is reached with WSDOT to proceed with acquisition and rehabilitation. WATCO proposed to abandon key portions of the rail line under its ownership. Assuming that all of the proposed abandonments were granted, the PCC system would be halved, shrinking from 410 miles to about 200 miles, with an estimated 45 percent reduction in loads carried, or about 4,000 carloads per year.

## Economic Impacts and Community Perspectives

The PCC is an important contributor to eastern Washington's economy, and is a potential catalyst for future economic development in the regions it serves. Loss of the rail line would have direct and indirect impacts including:

- Economic impacts on the approximately 70 shippers that use the PCC, shipping goods worth more than \$160 million per year;
- Loss of approximately 30 PCC employee jobs;
- Potential closure of the Green Giant asparagus canning facility in Dayton, which employs 60 people year round and 1,100 seasonally;
- Potential closure of the new feed mill in Creston, which employs 60 people;
- Job losses at the various fuel and chemical loading/unloading facilities along the PCC;
- Closure of the grain elevator in Coulee City and with it the last major private employer in the town;
- Employment impacts on workers at the Airway Heights Industrial Park in Spokane County, whose 350 jobs will become dependent on the PCC after completion of the 2005-07 Geiger Spur project; and
- The loss of potential new investments in the area that are under discussion.

### **Community Support for the Line Is Very Strong.**

Communities served by the PCC overwhelmingly feel that the PCC is essential to the local economy and that it must be preserved. Community leaders have expressed concern that the loss of the railroad would be harmful to their economies—current and future—and there is a high level of support for WSDOT's proposed approach to the problem. Regional leaders note that the PCC is critical to getting grain to markets; its loss would mean shippers would have no way to move grain during periods when highway load restrictions are in effect. The PCC also creates a more competitive market position, generating better prices through competition, and mitigates the negative impacts of adding significant truck traffic to the highway system.

“The NW Council of Governments supports the state acquisition of the railroad track from Coulee City to Cheney. The costs of allowing the rail line to be scrapped are simply too high, as are the risks to our area's economic base.”

- *Northwest Council of Governments, Soap Lake*

## **Legislative Funding and WSDOT's Proposal to Acquire and Rehabilitate the Railroad Right of Way**

The legislature's 2003 Transportation Funding Package allocated \$33.5 million for PCC-related projects. WSDOT's subsequent analysis shows that PCC operations could be viable beyond the 10-year planning horizon required by RCW 47.76, provided that the PCC's maintenance backlog could be addressed through public funding. WSDOT also concluded that the legislature's funding is adequate to rehabilitate the PCC, and that the state's investment will potentially return about twice as much in public benefits as each dollar invested.

Because state law allows for rehabilitation grants when the public owns the right of way, if WSDOT were to acquire the PCC's privately-owned track and underlying land, the state could rehabilitate its own right of way, leasing out operation of the repaired lines to a private operator. Rather than taking rent from the operator, the state's proposed agreement would be tightly drawn to require the operator to provide stepped up maintenance to preserve the rehabilitated track at its new level of utility.

WSDOT's proposed plan is to purchase the PCC's private right of way (tracks plus underlying land and easements) from WATCO for \$7.998 million. The acquisition would include the PCC's right of way in Grant, Lincoln, Spokane, and Whitman Counties. WSDOT would also rehabilitate the northern and southern PCC lines at a cost of \$21.089 million and \$5.313 million, respectively.

An advisory group would be formed to provide input to WSDOT on the operating and maintenance performance of the PCC. The advisory group is proposed to consist of two representatives from each of the three major segments of the PCC, plus WSDOT. Each rail segment would have a public sector representative, either from a port district or from a county commission, as well as a representative from the shipper community.

## Benefit and Risk Assessment

RCW 47.76 requires that freight rail investments provide a net benefit to the state. Using the required planning methodology, the proposed PCC project has a benefit/cost calculation of 1.86, which meets the statutory test.

In addition to the business and employment benefits discussed earlier, the investment in the PCC is likely to generate a number of additional community benefits, including environmental and indirect economic benefits. These include annual discounted shipper savings of \$1.8 to \$2.3 million; protection against future fuel cost increases; and avoided highway wear and tear.

Potential risk factors for the project include: main line rail connection risk associated with service delivery problems that can be experienced by the major railroads; declines in agriculture and associated declines in demand for rail; operator risk associated with the competence and potential longevity of the lease operator; liability from typical railroad environmental hazards; road/rail grade crossing problems and risks; and heightened public expectations regarding WSDOT's role in making rail crossing improvements and in managing railroad land lease issues.

## Conclusion

WSDOT's investigations and analyses show that the PCC track purchase and rehabilitation project is viable, meets the requirements of the Revised Code of Washington, provides economic and community benefits, and is strongly supported by eastern Washington communities. While the project involves some risk to the state, these risks are reasonable and manageable, given counterbalancing benefits to the eastern Washington communities served by the line. Critical next steps are the development of an acceptable operating lease, establishment of a business plan for operating the railroad, and formation of a PCC advisory group to assist WSDOT in overseeing management of the PCC's assets and operations.

The position of the Secretary of Transportation is to move forward to acquire and lease back the PCC railroad track, subject to the conclusion of mutually agreeable terms for the purchase and operating lease.

“I am strongly in favor of acquiring the PR&CC Railroad. It is of utmost importance to the area. The area would be economically devastated without it. It is unique and it is a survivor of a way of life. It connects two very important regions of our state. It is the last heartbeat of a local transportation system.”

- *Whitman County citizen*



# Purchase and Rehabilitation of the Palouse River and Coulee City Railroad Track: Assessment of Economic and Community Benefits

## Introduction

This report summarizes the research, investigation, and policy analysis conducted to assess the feasibility of and options for continuing operations of the Palouse River and Coulee City Railroad (PCC) line, given the availability of state freight rail funding assistance. The report presents background information, key issues and alternatives considered, and staff recommendations in five major sections:

- PCC Management, Ownership, and Current Situation;
- Economic Impacts and Community Perspectives;
- Legislative Funding and WSDOT's Proposed Approach to the Problem;
- Benefit and Risk Assessment; and
- Conclusions and Recommendation.

## Palouse River and Coulee City Railroad Management, Ownership, and Current Situation

The PCC is the state's second longest rail system, encompassing a total of 410 track miles; 370 miles in Washington and 40 miles in Oregon and Idaho. The PCC provides primary freight rail service for Grant, Lincoln, southern Spokane, Whitman, Walla Walla, and Columbia Counties, and is the only rail outlet for Latah County, Idaho and northern Umatilla County, Oregon.

“The rail lines, PCC and Blue Mountain Railroad, are an absolute necessity for eastern Washington's infrastructure. The savings in better freight rates and the tremendous savings in highway maintenance make it a good investment project.”

- *Director, Port of  
Columbia County*

The PCC is an important commercial corridor in eastern Washington, transporting nearly a million tons of cargo each year. Carloads of grain carried in recent years range from 7,400 to 10,400. Approximately 80 percent of PCC's business is agriculture-related. It provides transportation to market for 20 percent of the state's wheat crop, 67 percent of its lentil crop, plus a large share of the fertilizer and agricultural chemicals needed to grow those grains. The balance of the freight carried by the PCC is machinery, minerals, natural gas and propane, processed and frozen food products, and forest products.

### ***PCC Management and Ownership***

The PCC is a regional rail line comprised of three separate railroads operated together by WATCO, a short-line railroad holding company based in Pittsburg, Kansas. In the early 1990s, the Webb brothers (the 'W' in WATCO) became the first company in the nation to transform a Union Pacific (UP) branch into a viable short-line railroad. Subsequently, WATCO has purchased and begun operating short lines across the country, growing to a company with \$100 million per year in revenue.

The PCC came into being through two purchases made by WATCO from the mainline railroads. In 1992 WATCO purchased three segments from the Union Pacific Railroad: Hooper to Colfax; Winona to Thornton; and Colfax to Moscow, Idaho. In 1996 WATCO purchased three more segments from the Burlington Northern Santa Fe: Cheney to Coulee City; Marshall to Pullman; and Palouse to Harvard, Idaho.

The three railroads that comprise the PCC are:

- The "Central Washington" or CW line from Cheney to Coulee City;
- The Whitman County lines east of Hooper to Pullman and north to Marshall, including the "Pleasant Valley" or PV branch to Thornton; and
- The Blue Mountain lines east of Wallula to Dayton and Weston, Oregon via Walla Walla.

Ownership of the rail lines is likewise complex:

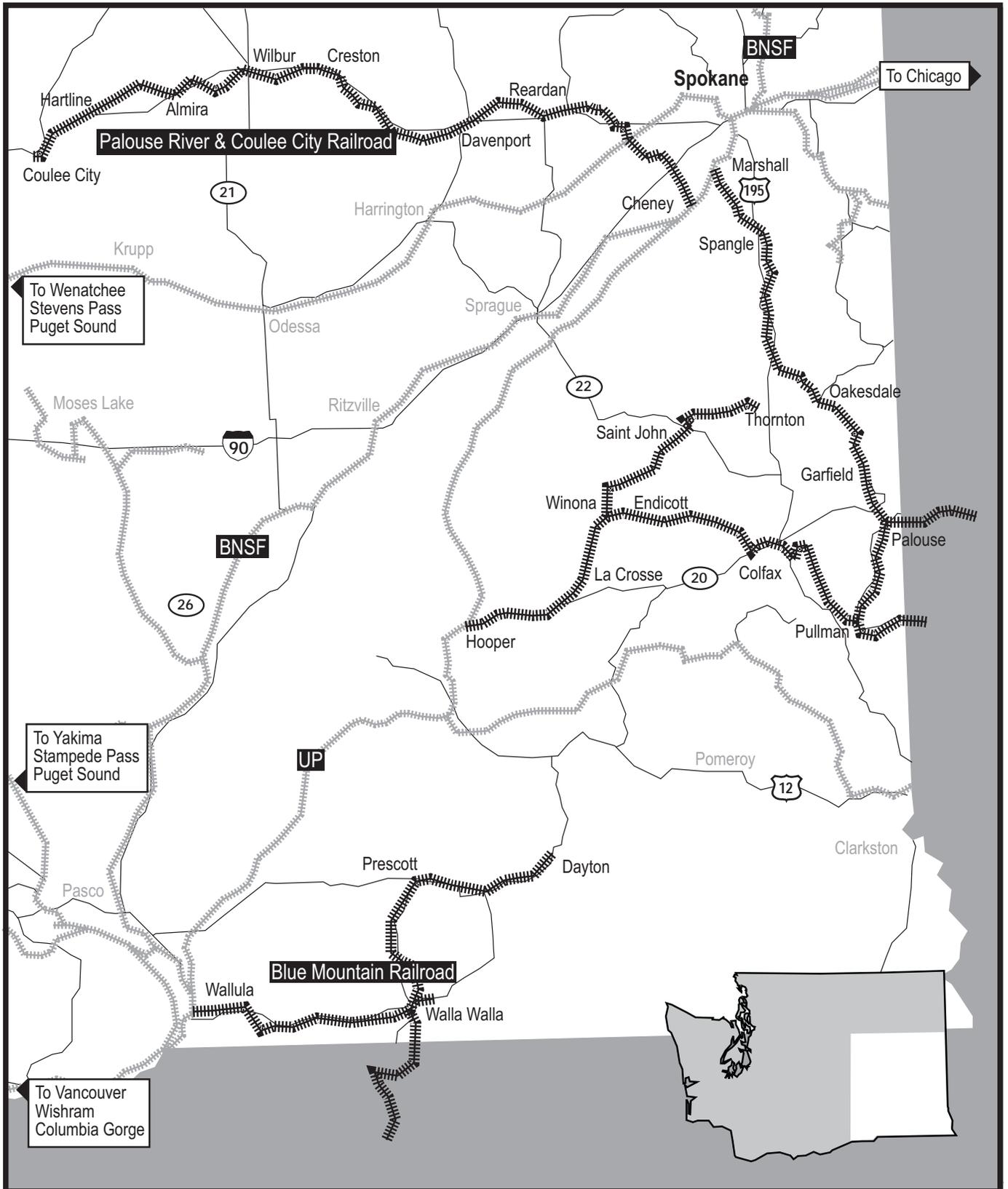
- WATCO owns the right of way (track plus fee land) for the PCC’s northern lines in Grant, Lincoln, Spokane, and Whitman Counties, comprising the Central Washington, Whitman County, and Pleasant Valley lines (315.3 miles of track).
- Portions of the PCC’s southern lines in Walla Walla and Columbia Counties, known as the Blue Mountain Railroad, are owned by the Port of Columbia County (Walla Walla to Dayton – 38.9 miles of track).
- Other portions of the Blue Mountain line are leased from the Union Pacific (UP) (Wallula MP 1.1 to Walla Walla MP 30.8 – 29.4 miles of track). UP and the Port began negotiations in 2003 for UP to donate these leased portions to the Port.
- A somewhat smaller segment of the Blue Mountain line (Walla Walla to Weston, Oregon – 20.7 miles of track) is owned by UP and the Oregon Department of Transportation. The UP portion in Washington is part of the current negotiations between the UP and the Port of Columbia County, and may also be donated to the Port.

A map of the PCC rail lines is shown in Exhibit 1 on the following page.

| Segment  | WA Track Miles to Be Rehabilitated | Out-of-State Track Miles | Total Route-Miles Operated |
|--|------------------------------------|--------------------------|----------------------------|
| PCC Railroad<br>(north of Hooper & west of Cheney) | 296.1                              | 19.2                     | 315.3                      |
| Blue Mountain<br>(east of Wallula)                 | 73.6                               | 20.7                     | 94.3                       |
| <b>PCC System Totals</b>                           | <b>369.7</b>                       | <b>39.9</b>              | <b>409.6</b>               |

# Exhibit 1

## Location of the Palouse River & Coulee City Railroad Systems



## ***Background: Origins of the Current Problem***

In the 1980s, the two mainline railroads serving Washington, the Burlington Northern & Santa Fe Railway (BNSF) and Union Pacific Railroad (UP), recognized that their cost structures would not allow continued operations of the many branch lines built a century ago. In anticipation of planned sales, the two railroads began reducing maintenance on their branch lines. When the lines were eventually sold to short-line operators a decade later, the lines came with considerable maintenance backlogs: crossties to be replaced; road crossings in need of repair; old lightweight rails required replacement with heavier versions; and bridges needed strengthening. Moreover, the economics of operating these lines are no more favorable for the short-line operators than they had been for the BNSF and UP Railroads. Adequate annual maintenance costs exceed available revenues, deferred maintenance grows, and eventually the situation begins to affect operations, and then safety.

One response to eroded track quality is to slow down the trains. When the initial PCC segments were sold to WATCO in the mid-1990's, the then-new short lines were primarily operated at the Class 2 track level, allowing for speeds of 25 mph. Most track segments have now been downgraded to the Class 1 level, with allowable speeds of 10 mph, and many are beginning to fall into the excepted category, which requires even slower speeds. Reduced speeds affect both the railroad's financial health and shipper service. For example, at a speed of 10 mph, the 108-mile Cheney-Coulee City line requires 11 hours each way to travel to Spokane—a two-day trip. In contrast, at 25 mph, it is a one-day trip, at half the cost (and with the potential for additional service if demand warrants).

Eventually, even slowing the trains isn't enough to overcome the problem. The track deteriorates such that a major bridge becomes dangerous or too many small derailments occur, as happened just east and west of Pullman in the spring of 2003. At that point, major rehabilitation is required if the line is to

## **Legislative Direction on the State's Role in Maintaining Regional Rail Service**

Since 1970, Washington has lost over one-third of its rail miles to abandonment and bankruptcies. The combination of rail abandonments and rail system capacity constraints may alter the delivery to market of many commodities. In addition, the resultant motor vehicle freight traffic increases the burden on state highways and county roads. In many cases, the cost of maintaining and upgrading the state highways and county roads exceeds the cost of maintaining rail freight service. Thus, the economy of the state will be best served by a policy of maintaining and encouraging a healthy rail freight system by creating mechanisms that keep rail freight lines operating if the benefits of the service outweigh the cost.

Recognizing the implications of this trend for freight mobility and the state's economic future, the legislature finds that better freight rail planning, better cooperation to preserve rail lines, and increased financial assistance from the state are necessary to maintain and improve the freight rail system within the state.

~RCW 47.76.210

continue operating.

## ***The Current Situation: Deferred Maintenance Needs, Unfavorable Economics, and WATCO's Business Decision***

In the years since the PCC has been operating as a regional rail system, the deferred track maintenance situation has worsened. Not only had the inherited maintenance backlog not been addressed, the financial performance of the line led WATCO to fund at best half the level of annual maintenance considered necessary within the industry: \$3,100 per track-mile expended versus industry standards of \$6,000 to \$8,000. For the last several years in particular, because WATCO has intended to abandon all or part of the Cheney-Coulee City line and many of the Whitman County lines, the company has only funded emergency maintenance on those tracks.

Moreover there are other disincentives and alternatives to investing in the railroad's infrastructure: the economics of the current scrap market for steel make abandonment and scrapping of rail tracks a more attractive business proposition than continuing to operate a marginally profitable rail line.

Given this situation, in March 2004 WATCO submitted a letter to the Governor stating its intention to begin operational embargoes and the filing of a formal abandonment plan for some PCC segments, effective June 1, 2004, unless agreement is reached with WSDOT to proceed with acquisition and rehabilitation. Assuming agreement from the federal Surface Transportation Board, these abandonments would be complete within 12 to 24 months. WATCO proposed to abandon key portions of the rail line under its ownership:

- Part or all of the CW line, from Cheney to Coulee City;
- The Palouse & Lewiston (P&L) line south of Rosalia, through Palouse and Pullman to Moscow, Idaho;
- The former Union Pacific line east of Mockonema to Pullman, including Colfax; and
- The Washington, Idaho, & Montana (WIM) line from Palouse to Harvard, Idaho.

The surviving sections of the line would likely be: Marshall to Oakesdale (38 miles); Hooper to Thornton (58 miles); and Winona-Mockonema (28 miles). Operations would continue on the Blue Mountain Railroad so long as they are safely operable; however given the condition of these tracks, such operation cannot be assumed beyond another decade or so.

Assuming all the currently proposed abandonments were granted, the PCC system would be halved, shrinking from 410 miles to about 200 miles, with an estimated 45 percent reduction in loads carried, or about 4,000 carloads per year. Local rail service to northern Grant and Lincoln Counties would disappear, as would service to central and eastern Whitman County.

## **Economic Impacts and Community Perspectives**

### ***The PCC as an Engine of Commerce for Eastern Washington***

The PCC is an important contributor to eastern Washington's economy, and is a potential catalyst for future economic development in the regions it serves. Loss of the rail line would have both direct and indirect economic impacts on those areas. Direct impacts associated with abandonment can be expected to include:

- Economic impacts on the approximately 70 shippers that use the PCC, shipping goods worth more than \$160 million per year.
- The PCC has a payroll of 34 people, earning an average wage of \$11.38 an hour. About 30 of these employees would likely lose their jobs.
- The Green Giant asparagus canning facility in Dayton employs 60 permanent positions and 1,100 seasonal jobs. While there are other important factors that may affect the future of the Green Giant facility, such as imports, the plant's managers have made it clear that the loss of low cost rail service would result in pricing the Dayton plant out of the market.

## **Recognizing the Direct and Indirect Benefits of Continued Rail Service**

*The state, counties, local communities, ports, railroads, labor, and shippers all benefit from continuation of rail service and should participate in its preservation. Lines that provide benefits to the state and local jurisdictions, such as avoided roadway costs, reduced traffic congestion, economic development potential, environmental protection, and safety, should be assisted through the joint efforts of the state, local jurisdictions, and the private sector.*

*-RCW 47.76.240*

- The new feed mill and feedlot in Creston, which has added 60 new jobs in a town with a population of fewer than 300 people, is not considered sustainable without lower cost rail service along the new PCC spur track funded last year by the Department of Community, Trade and Economic Development. Assuming average wages and benefits of \$25,000 per year for each job created, the new plant is worth \$1.5 million per year to the area's economy.

Exhibit 2 (on the following page) shows the location of these businesses in relation to the PCC rail line. In addition to the primary employment and economic impacts likely to result from abandonment of the line, other eastern Washington businesses and jobs can be expected to be jeopardized by the loss of service. These impacts include:

- Worker job losses at the various fuel and chemical loading/unloading facilities along the PCC.
- Closure of the grain elevator in Coulee City can be expected, and with it the last major private employer in the town would be lost.
- Employment impacts on workers at the Airway Heights Industrial Park in Spokane County, whose 350 jobs will become dependent on the PCC after completion of the 2005-07 Geiger Spur project there.

Other potential shippers have also indicated that they have additional investments pending, if only assurances can be made that PCC will continue operations.

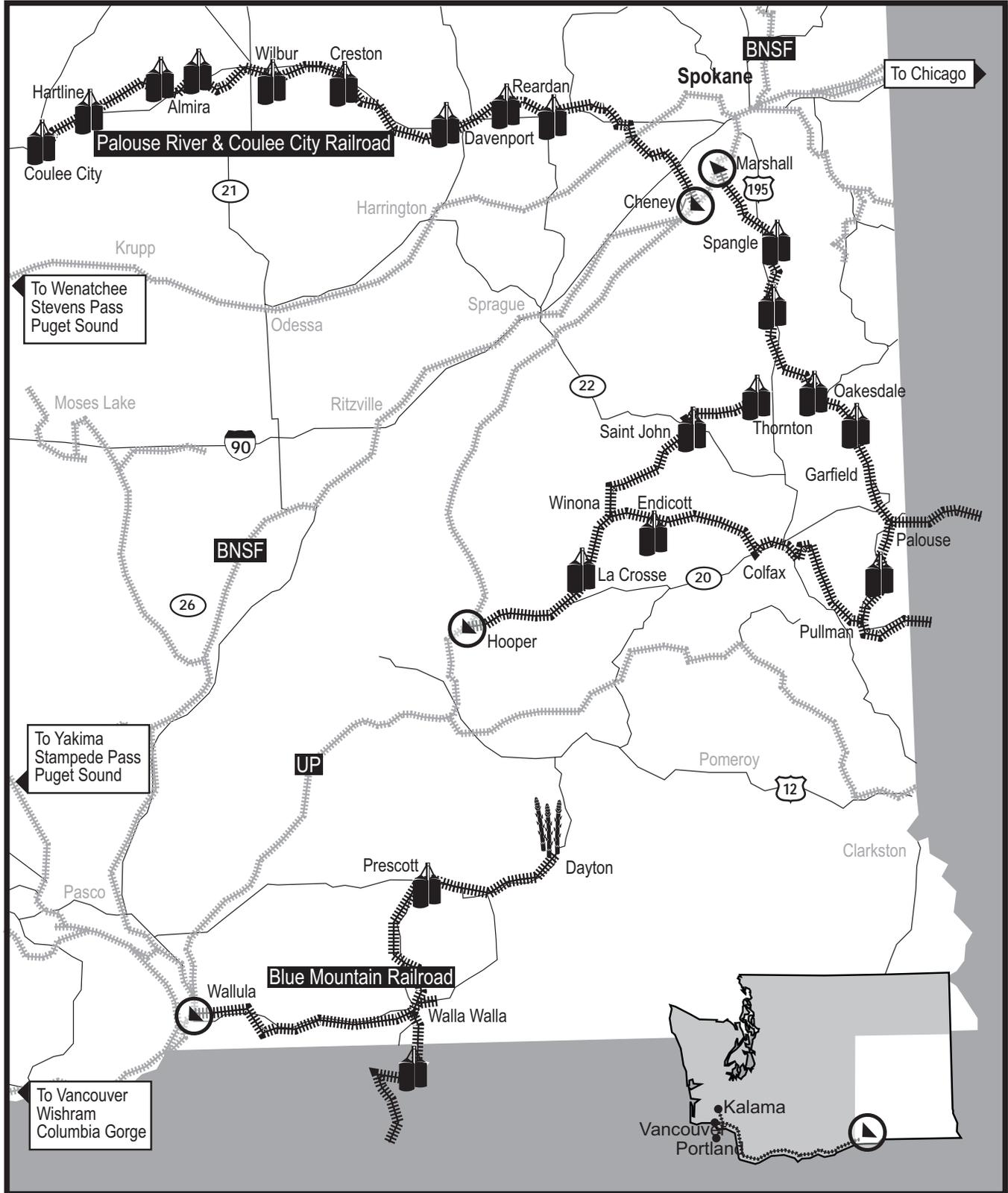
### **Community Support for the Line Is Very Strong**

In March 2004, WSDOT conducted town hall meetings in Cheney, Colfax, Davenport, and Coulee City to hear public comments on the PCC's situation and WSDOT's proposal. The community expressed strong support for PCC and its continued operations. Key points raised were:

- **There is a significant need for the PCC to continue operating.** Communities served by the PCC overwhelmingly feel that the PCC is essential to the local

## Exhibit 2

# Location of Key Shippers & Freight Flow



 Principal Grain Loading Locations on the PCC System

 Seneca-Green Giant Factory (Canned Asparagus)

 Offloading Points & Freight Flow

economy and that it must be preserved. Community leaders expressed concern that the loss of the railroad would be harmful to their economies—current and future—and there was a high level of support for WSDOT’s proposed approach.

- **The PCC is critical for getting grain to markets.** The PCC line is an all-weather freight route, and in contrast many north-south roads have winter/spring load restrictions. Loss of the PCC would mean shippers would have no way to move grain they have sold during periods when the highway load restrictions are in effect. This is very important, as often grain buyers are not willing to wait for better road conditions and can cancel the contract.
- **The PCC allows for a more competitive market position.** Several smaller shippers noted that the PCC allows them to market to several receivers, generating a better price through competition. In contrast, winter conditions and logistics force truck/barge shipments from central Washington to effectively ship products to only one river port and grain buyer.
- **The negative impacts of adding significant truck traffic to the highway system.** A number of comments were received noting the impacts of adding up to 29,000 truckloads to the state highways, including increased congestion and road damage.
- **WATCO is doing a good job of serving its customers operationally.** Shippers noted that WATCO is doing as well as it can, given the problems with operations and car supply on the Class 1 railroads. They liked WATCO’s personalized service, noting that they can speak directly to a train crew and learn what time of day their shipment will arrive, for example.
- **The need to assure that WATCO will take care of the railroad.** There were numerous comments expressing concern that WATCO had not been doing a good job maintaining the line, noting that the company was unresponsive to requests for maintenance and identifying a need for better performance in the future.

In addition to public comments received, three federal agencies also provided perspectives. The Bureau of Reclamation, Bonneville Power, and the Army Corps of Engineers noted that the PCC provides the only way to effectively move heavy electrical equipment to dam sites and switching stations. Bonneville Power moves its heavy switchgear over the PCC's territory on a continuous basis. Moving such cargo by highway is, in their words, slow, costly, and destructive to the road surface. In the event of a system failure, such as at Chief Joseph Dam several years ago, the region would be without a good option for transporting needed equipment, especially when roads are closed due to winter load limits.

## **Legislative Funding and WSDOT's Proposed Approach to the Problem**

### ***Assessment of the Long-Term Viability of PCC Operations and Legislative Direction***

The legislature's 2003 Transportation Funding Package provided a 10-year strategy for addressing large freight rail assistance projects, allocating a total of \$33.5 million for five separate PCC-related projects. Given that this funding constitutes the largest freight rail assistance project ever undertaken by the state, WSDOT undertook a significant due diligence process to assess the efficacy and impacts of funding improvements to the PCC. Key questions in the analysis focus on two issues:

- Is there a way to make the whole PCC system viable for the long term; and
- Does the public benefit justify investing in such a plan?

The results of WSDOT's assessment showed that a rehabilitated PCC system would in fact be viable in the long term, and would potentially return about twice as much in public benefits as each dollar invested. It further concluded that the revenue appropriated in 2003 for the PCC-related projects, if used across the system, was adequate to facilitate creation of a viable and sustainable network. WSDOT concluded that the PCC system would generate the greatest value if it was considered as a single, unified transportation network.

"We fully support the plans to maintain a viable freight railroad in eastern Washington."

- *Potential new  
Spokane-area shipper*

“The abandonment of the Palouse River & Coulee City Railroad will negatively impact the Bonneville Power Administration’s ability to transport equipment to the Coulee City area. Large in physical size and weighing hundreds of tons in some cases, this equipment cannot be economically transported by truck and trailer.”

- *Regional Manager,  
U.S. Department of the Interior*

Given this framework, the right of way acquisition would not work without rehabilitating the entire track system, and rehabilitating the track would not work without state acquisition of the privately-owned portion of the tracks, since PCC’s ability to repay loans was limited.

Based on this reasoning, the 2004 Legislature combined the previously funded five projects into three:

1. The private right of way acquisition: “Palouse River & Coulee City Railroad Acquisition” – \$7.028 million;
2. Rehabilitation for the northern (PCC) lines: “PR & CC Cheney-Coulee-Pullman Upgrades” – \$21.089 million; and
3. Rehabilitation for the southern (Blue Mountain) lines: “Port of Columbia Railroad Improvements” – \$5.313 million.

The rehabilitation work would achieve the following improvements:

- All of the PCC’s tracks would be at a minimum of a strong Class 1 status;
- Seventy-seven percent of the track could achieve the higher status of federal Class 2 track, good for 25 mph operations; and
- Forty-four percent of the track would be capable of sustaining modern 286,000-pound railcars, offering shippers a lower cost per ton shipped than can be achieved with the older 263,000-pound railcars the PCC was designed to carry.

WSDOT concluded that the PCC could be self-sustaining beyond the 10-year planning horizon required by RCW 47.76, provided that the maintenance backlog could be addressed through public funding. With repaired and improved track conditions, the trains could travel faster, and faster operations would translate into better service at lower cost, and consequently, increased business and revenues. In turn, increased revenues would allow the PCC to fund ongoing maintenance at a level that would keep the rehabbed track at its new, higher level of utility.

This equilibrium condition could be expected to prevail until the line’s track and bridges need major maintenance and replacement, in 15 to 20 years (2019 to 2024). Given that the same challenges are confronting communities with short-line railroads across the country, in future years the federal funding picture may change. The business situation for PCC may well also change. A new review and situation assessment should be carried out in the 2013 to 2015 timeframe, to plan for the next decade of PCC operations.

**Public Ownership of the PCC’s Tracks Makes Infrastructure Investment Feasible, and Rehabilitated Track Can Improve the Line’s Viability**

State law allows for rehabilitation grants when the public owns the right of way. Therefore, if WSDOT were to acquire the PCC’s privately-owned track and underlying land, the state could rehabilitate its own right of way, leasing out operation of the repaired lines to a private operator.

**Segments Under Consideration for WSDOT Acquisition and Rehabilitation Investment (PCC northern lines)**

| Line Segment Name            | Station and Milepost Description   | WA Track Miles to be acquired and rehabilitated | Out-of-State or Non-owned Track Miles | Total Track Miles Operated |
|------------------------------|--|---|---------------------------------------|----------------------------|
| <b>CW Subdivision</b>        | Cheney MP 1.00 to Coulee City MP 108.8   | <b>107.8</b>                                    |                                       | <b>107.8</b>               |
| <b>Hooper Jct. to Winona</b> | Hooper Junction Interchange MP 26.6 to Winona MP 52.3  | <b>25.7</b>                                     |                                       | <b>25.7</b>                |
| <b>PV Thornton to Winona</b> | Winona MP 0.00 to Thornton MP 31.7   | <b>31.7</b>                                     |                                       | <b>31.7</b>                |
| <b>Winona to Endicott</b>    | Winona MP 52.3 to Endicott MP 57.90  | <b>5.6</b>                                      |                                       | <b>5.6</b>                 |
| <b>Endicott to Colfax</b>    | Endicott to Colfax MP 57.90 to 77.70   | <b>19.7</b>                                     |                                       | <b>19.7</b>                |
| <b>Colfax to Moscow</b>      | Colfax MP 0.00 to Pullman MP 18.7 (18.7 miles) and from P&L Junction at Pullman MP 75.9 to Wash. line MP 84.05 (8.15 miles)<br>Not included: 2.8 miles to Moscow, ID MP 86.9 | <b>26.9</b>                                     | <b>2.9</b>                            | <b>29.7</b>                |
| <b>WIM Line</b>              | Palouse MP 0.00 to WA line MP 3.85. Not included: 16.3 miles to Harvard, ID MP 20.2  | <b>3.8</b>                                      | <b>16.3</b>                           | <b>20.2</b>                |
| <b>P&amp;L</b>               | From Marshall thru Oakesdale and Palouse to Pullman MP 1.00 to 75.90   | <b>74.9</b>                                     |                                       | <b>74.9</b>                |
| <b>Totals</b>                |  | <b>296.1</b>                                    | <b>19.2</b>                           | <b>315.3</b>               |

“On behalf of the Reardan Area Chamber of Commerce, I encourage WSDOT to purchase the Palouse River Coulee City Railroad. In addition to the advantages of the line serving the local farming community, it will be an important stimulant for generating local business dollars.”

*- Member of the Reardan Area Chamber of Commerce*

Such an operating lease would normally generate rentals back to the track owner, in this case, the state. However, rather than taking rent from the former owner-turned-lease-operator, the state’s proposed agreement to lease the right of way for operations would be tightly drawn to require the private lessor/operator to both provide solid shipper service and stepped up maintenance to preserve the rehabilitated track at its new level of utility. New maintenance funding of nearly \$1.2 million per year (\$6,000 per track-mile per year for 400 miles versus the current \$3,100 per mile level of investment) will be available after rehabilitation because:

1. There will be some operating savings to the private lessor/operator after rehabilitation, estimated at \$286,000 per year;
2. There is likely to be some modest traffic growth due both to better service and to the stability of the railroad, which is expected to make shippers more willing to invest in rail-related facilities; and
3. The private lessor/operator will be relieved of corporate debt payments incurred to purchase the PCC and rehab some of its tracks. WATCO has already orally agreed that it is willing to include a clause in the operating lease committing the corporation to supplement any funds needed for the stepped-up annual track work.

### ***Distinguishing Rights of Way Purchase from Operating Rights***

WSDOT’s proposed plan is to purchase the PCC’s private right of way (tracks plus underlying land and easements) from WATCO, which is a willing seller. This purchase will not affect the line’s operating rights. Operating rights are the agreements with other railroads (in this case, the Burlington Northern and Santa Fe Railway (BNSF) and Union Pacific Railroad (UP)) for the right to interchange rail traffic and be paid for it. In fact, WATCO has stated that it will not sell the PCC tracks unless it remains as the leased operator.

## ***Elements of the Proposed Acquisition: What Is and Is Not Included***

The acquisition would include the PCC's right of way in Grant, Lincoln, Spokane, and Whitman Counties. The right of way is defined as the transportation corridor, side tracks, signals, and buildings needed to operate the railroad, plus the fee real estate and transportation easements directly underneath the tracks.

The acquisition would not include:

- The lands and buildings outside the transportation corridor not needed for railroad operations (this includes most of the lands leased to trackside industries);
- The 19.3 miles of privately-owned track located in Idaho or Oregon;
- The PCC track now owned by the Port of Columbia County between Walla Walla and Dayton;
- The PCC track now leased from the Union Pacific Railroad (Wallula-Walla Walla-Oregon line);
- Locomotives, railcars, highway vehicles, maintenance-of-way vehicles;
- The fiber optic and utility easements in the transportation corridor (the BNSF and UP specifically reserved these in their deed to the PCC); and
- Most importantly, the operating agreements the PCC now has with the BNSF and UP.

## ***Net Liquidation Value Analysis***

Financially, WATCO would be better off abandoning and scrapping the lines rather than continuing current operations, unless the company receives the net scrap value of the lines being considered for abandonment. This amount is known as the Net Liquidation Value (NLV), and is calculated as the value received from the wholesale value of all the scrap from a line, less the cost of lifting and transporting it.

WSDOT conducted three NLV analyses, the results of which were relatively closely aligned, and WSDOT and WATCO have agreed to compromise on a figure of \$7.998 million. After using WATCO's outstanding freight rail assistance loans of \$1.378 million as an offset, and adding in WSDOT's evaluation and engineering costs, there is marginally more than enough funding for the acquisition from the 2003 Transportation Funding Package. The 2003 package's total amount of \$7.35 million for the PCC acquisition was therefore reduced by \$322,000 for 2005-07 in the 2004 supplemental budget.

***Alternative and Recommended Oversight Structures:  
The PCC Advisory Body***

When the public holds a significant asset in trust, such as the PCC right-of-way, it is appropriate to create a mechanism for oversight and accountability of the asset's management. WSDOT has researched various alternative oversight structures and discussed them with stakeholders and the public. One alternative is to have representatives from WSDOT and the geographic areas of the PCC system serve as advisors, including the Port of Whitman County, the Port of Columbia County, and a rotating representative from the Lincoln County Commissioners or Port of Moses Lake, since they cover the same geographic area on the line. Another suggestion is to include a representative of the wheat growing industry, due to the PCC's importance to that sector. Yet another idea is to have someone, perhaps a port employee, serve as a day-to-day liaison with the railroad for the group.

The outreach WSDOT conducted, in March 2004, resulted in many suggestions about an oversight or advisory structure. The preference of those stakeholders was to have shippers involved in the oversight.

Based on all of the feedback and input received, an advisory group is proposed to consist of two representatives from each of the three major segments of the PCC, plus WSDOT. Each rail segment would have a public sector representative, either from a port district or from a county commission, as well as a representative from the shipper community.

The primary function of the advisory body group would be to annually review operating and maintenance plans submitted by the operator (WATCO) and comment on their implementation. The Washington Utilities and Transportation Commission (WUTC) regularly inspects the PCC's tracks and that will continue. The WUTC has already indicated its willingness to provide reports of track conditions to the PCC advisory body. WSDOT will also be examining the PCC's track during and immediately after rehabilitation, providing oversight and input about that phase of work. The shippers and port districts represented on the group would no doubt be in close touch with service conditions on the PCC, providing important service quality feedback to the PCC advisory body.

### ***Operating Lease Discussions: Terms and Conditions***

The ownership and operations plan developed by WSDOT for the PCC will require a well written operating lease, and WSDOT and WATCO have been in discussions regarding the elements of the lease. WATCO's informal proposal to WSDOT involves:

- A long-term lease (15- or 20-year term) automatically renewable if WATCO continues to fulfill the terms of the agreement.
- An annual operating and detailed maintenance plan, approved each fall by whatever authority WSDOT desires. The governing body structure should not be so complex that it becomes difficult to manage the rail system properly (this has apparently happened to WATCO elsewhere), nor should the governing body have power to order service where it is not economically reasonable to provide it.
- A breach of contract mechanism whereby the PCC must respond to notice of a breach within 30 days, and cure or make a valid effort to cure the breach within 60 or 90 days (both terms are in recent WATCO contracts).
- An escalation of funding for track maintenance from the 2002 average of \$3,123 per track mile per year to a reasonably sustainable \$6,000 average, tied to completion of track rehabilitation and upgrades that will reduce operating costs.

“Our position in Coulee City is that the PCC Railroad should NOT be removed and the business plan developed with this information in mind. The loss of the railroad system poses hardship to not only the Coulee City business community but also to the citizens who must use the highways, particularly in Grant County.”

- *Coulee City  
Port Commissioner*

WSDOT's review of the WATCO proposal found that it was generally congruent with WSDOT's perspective, except that WSDOT would prefer a shorter lease term. In addition, WSDOT's informal proposal back to WATCO contains the following additional elements:

- WATCO will be responsible for all operating losses.
- WATCO can keep the gains if business grows as assumed, provided that it meets all other lease requirements, especially requirements for stepped up track maintenance.
- The disposition of additional profits if the PCC lands a major new shipper (e.g., a new coal-fired generating or biodiesel plant) that significantly increases system revenues is an unresolved issue.
- WATCO is responsible for all existing or future environmental issues.
- WATCO must maintain extensive insurance coverages and hold the state harmless for accidents or environmental damage, existing or future. In 2004, WATCO's new insurance policy must not only reflect the \$25 million per incident liability and environmental damage insurance required by BNSF when lines were sold off, but must also have catastrophic damage provisions.

**Segments Under Consideration for WSDOT  
Rehabilitation Investment for Current Owner (No Acquisition)  
(Blue Mountain lines, the southern end of the PCC system)**

| Common Name                  | Station and Milepost Description  | WA Track Miles to Be Rehabilitated | Out-of-State Track Miles |
|------------------------------|---|------------------------------------|--------------------------|
| Wallula Subdivision          | Wallula MP 1.1 to Walla Walla MP 30.8<br><i>(leased from UPRR, negotiations are underway since late 2003 for UPRR to donate this line to the Port of Columbia County)</i> | 29.4                               | 0                        |
| Wallula Subdivision          | Walla Walla to Dayton<br><i>(owned by Port of Columbia Co.)</i>   | 38.9                               | 0                        |
| Milton-Freewater Subdivision | Walla Walla to Weston, OR<br><i>(owned by UPRR and ODOT – the UP portion in WA may be part of lines donated to the Port of Columbia Co.)</i>                              | 5.3                                | 20.7                     |
|                              |   | <b>73.6</b>                        | <b>20.7</b>              |

- WATCO must maintain each line of the PCC system at the post rehabilitation level of utility unless formal arrangements are made through the annual maintenance plan.
- The PCC must employ a qualified, Washington-based marketing person for the PCC (this has already been accomplished with good initial results).
- PCC management must have a greater local presence and accountability. At least one of the top PCC officials needs to reside in the PCC's service area.

With the NLV acquisition price issue satisfactorily resolved to fit within appropriated funds and the legislature authorizing combining the project funds into northern and southern rehabilitation pools, only one key issue remains outstanding: there are parts of the PCC needing urgent repair work, mainly on the line segments that were planned to be abandoned in 2003. However, no funding is currently available for the urgent repairs, and will not be available for nearly four more years—the beginning of FY 2008. Given this situation, WATCO has indicated its willingness to assume responsibility for stopgap maintenance, until the larger rehabilitation funding begins.

## **Benefit and Risk Assessment**

### ***Satisfaction of Statutory Requirements***

Chapter 47.76 of the Revised Code of Washington authorizes the state's freight rail assistance program and lays out requirements for how proposals for assistance are to be measured. The primary requirement is that a project must provide a net benefit to the state. Under the federal planning methodology required by this RCW chapter, the proposed PCC projects generate total discounted benefits of \$62 million against total state investment of \$33.43 million. This translates into a benefit/cost calculation of 1.86, which meets the statutory test.

“The Big Bend EDC supports the acquisition of the WATCO RR track and right-of-way. This is a vital line in the farm to market process in Eastern Washington.”

- *Big Bend Economic Development Council*

### **Expected Benefits**

In addition to the business and employment benefits discussed earlier, the investment in the PCC is likely to generate a number of additional community benefits, including environmental and indirect economic benefits.

**Shipper savings and the importance of competitive transportation modes.** A 2002 study commissioned by WSDOT from North Dakota State University and WSU found that the PCC saves Washington shippers an average of \$1.8 million each year versus comparable truck/barge rates. A 2003 study for WSDOT by Wilbur Smith Associates determined the amount to be \$2.3 million per year. These savings help make Washington’s agricultural products more competitive in the very price sensitive international grain market. The \$2.3 million in savings works out to a significant cost savings of about five to seven cents per bushel.

Truck and barge rates have to respond to the existence of the PCC alternative. Without the PCC’s presence, there would be less competitive pressure on the other modes to keep their rates down, which could result in cost increases for those modes. The possibility and magnitude of such price increases, and their effect on Washington’s competitiveness in agricultural products, is an issue that seems to most worry shippers.

**Protection against future fuel cost increases.** Bulk rail freight uses only a fraction of the fuel that it takes to carry the same products by truck, and fuel costs are only one part of the rail cost equation. But fuel costs make up a very large part of truck costs. For that reason, truckers pass on any fuel price increases almost as soon as it happens, while it takes a large fuel price increase to affect rail rates. Thus, the availability of a rail freight option somewhat protects Washington shippers, and their competitive position in world markets, from the effects of the rising fuel prices. The more fuel prices rise, the greater will be the shippers’ savings from having a rail option.

**Avoided highway wear and tear.** If the PCC were not carrying 8,000 to 10,000 carloads per year, eastern Washington's secondary highways would have the annual wear and tear from approximately 29,000 additional full truckloads. In 2003 North Dakota State University's Upper Great Plains Transportation Institute estimated that the PCC's operations would avoid annual costs of \$4.2 million per year. Wilbur Smith Associates revisited avoided highway wear and tear in 2003 using a similarly detailed methodology and arrived at a similar number: estimated savings of \$4.8 million per year.

**Effect of "mega grain terminals."** Some have expressed concerns that truck/barge rates might go lower and undercut rail. This is highly unlikely in an era of rising fuel prices, since trucks are much more sensitive to fuel costs than rail. The competition from mega grain terminals, which was effectively matched by improved short-line rail service, may have left little room for further barge cost decreases. *Traffic World* magazine reported in several early fall 2003 issues that Midwestern barge operators no longer compete for grain unless they can haul coal upriver and use grain as a backfill. The economics of the Snake-Columbia system are more favorable to the barges than in the Midwest, but the barges' lack of a preemptive pricing response to inauguration of the Ritzville mega terminal in 2002 indicates they cannot seriously undercut rail rates. Any disturbance in the river system, such as a continued lack of dredging or an eventual dam breaching, would strongly favor the local railroads.

There is continual discussion in eastern Washington indicating shipper willingness to site new mega grain terminals at various PCC locations, provided that the state stabilizes its future. The likely economics of any new mega terminal on the PCC would undercut truck-barge rates by another nickel a bushel, which is probably enough to divert significantly greater amounts of grain to rail.

"On behalf of the National Wildlife Federation, thank you for this opportunity to provide comment. We have reviewed the information provided by the department and strongly support the state in going forward with the acquisition and rehabilitation plan for the PCC Railroad."

- *National Wildlife Federation*

## **Potential Risks**

**Mainline rail connection risk.** The service and pricing of the mainline rail connections are perhaps the biggest risks for any short line. Recent problems BNSF experienced moving grain immediately impacted the PCC. There is a potential that the short line will be harmed if its mainline carrier develops service issues, as happened in 2003 with grain and perishables.

**Declines in agriculture and associated declines in demand for rail service.** Roughly 80 percent of the PCC's business is agriculture-related, primarily wheat and lentils. If any of that business were lost, the PCC would be in significant danger. However, the agricultural base has been and by all accounts will continue to be stable. Moreover, there is real potential for increased demand and traffic. For example, WATCO has reacted to criticisms about its distant presence and lack of marketing by hiring a full-time marketing person residing in Washington. Subsequently, there were immediate traffic gains in the last four months of 2003 and a 13 percent increase in the first quarter of 2004 versus the previous year. WATCO is projecting a 14 percent increase in both carloads and revenues for 2004, based on agreements already signed.

### **WATCO as the operator of a publicly-owned PCC.**

WATCO's insistence that they would only sell the PCC's track structure and underlying real estate without the operating rights made its competence and staying power potential risk factors. If WATCO were to fail to perform under the terms of the operating lease proposal, it would lose its operating rights to WSDOT. A number of qualified private operators have continuously indicated their interest in taking over operations, provided that the track rehabilitation goes forward as planned. Therefore, the operator's stability does not appear to be an issue, provided WSDOT and the new advisory body adequately protect the public interest via the operating lease and annual operating and maintenance plan approval process.

Finally, the operating contract will provide that if WATCO sustains losses and wants to terminate the lease agreement, the operating rights will transfer to the state expeditiously. WSDOT has received inquiries from qualified short-line operators interested in taking over the operations of a rehabilitated PCC in such an event.

**Liability from typical railroad environmental hazards.**

Every railroad has low hazard environmental issues, such as creosote around ties in the ground and tie storage, heavy metals in mine slag ballast of the kind used on the former UP lines, and occasional oil or fuel spills, especially near former fueling facilities. Regulatory agencies allow these types of hazards to continue in their current state unless there is an obvious problem, or major construction occurs. Track maintenance is not considered major construction; however, this does not address the possibility of larger, more hazardous sites such as abandoned fuel tanks, PCB storage, and asbestos in older buildings, which must be dealt with in a prescribed way.

**Road/rail grade crossing problems and risks.** The deteriorated state of many of the 336 road/rail grade crossings on the PCC system (95 of which are on the southern Blue Mountain lines) is a major public concern, especially along those lines that are candidates for immediate abandonment. The WUTC has enforcement authority for railroad track conditions, including grade crossings. In 2001 the WUTC investigated the problem and considered the possibility of imposing severe penalties on the railroad. WATCO management reacted quickly and positively to make a good faith effort to find a satisfactory solution to the problem.

The temporary solution currently in effect is an informal agreement between WUTC staff and the railroad. The railroad completely rehabilitated 14 of its crossings and pledged to continue rehabilitation projects at the rate of five to seven per year. It must respond to and repair crossings that have such serious defects that they can be considered to be hazardous. The WUTC has also suggested that WSDOT, WUTC, and the PCC work together to close as many crossings as practicable, for safety and cost reasons.

**Heightened public expectations: rail crossing improvements.** Many in eastern Washington assume that WSDOT is going to start fixing their crossings immediately upon purchase of the right of way. These perceptions occur despite WSDOT's best efforts to emphasize that state rehabilitation funding is only available in certain future years, which dictates when crossings would be fixed as part of the track rehabilitation project. Regardless, WSDOT will need to carefully manage public expectations about when crossings can and will be repaired.

**Heightened public expectations: railroad land lease issues.** Some eastern Washington businesses lease either their rail sidings or the land their business sits on. Among these businesses, there is a perception that WATCO has been charging more than the going rate for such leases, and they are expecting more favorable lease rates once the state assumes ownership of the property. Although WSDOT staff have explained that the state's acquisition covers only the tracks and land needed for rail operations, and that it has no authority regarding such leases, nonetheless there are heightened expectations regarding the state's ability to provide lower lease rates.

**Concerns about integration with the Camas Prairie Railroad.** WATCO has recently completed its acquisition of the Camas Prairie Railroad (now renamed the Great North Western Railroad, or GNWR), covering the track from Ayer Junction southwest of Hooper along the north bank of the Snake River to just inside the Idaho line. WATCO operations began in mid-February 2004. Regardless of the future of the PCC acquisition, it appears that WATCO intends to integrate operations with the GNWR and whatever is left of the PCC, and some in eastern Washington have expressed concern. However, the operating synergies between the two lines may well provide positive options for Whitman County grain shippers going to the river. Public comments from the Colfax public outreach meeting showed a high level of interest in using both lines to move railcars of grain to river ports.

## Conclusion

WSDOT's investigations and analyses show that the PCC track purchase and rehabilitation project is viable, meets the requirements of the Revised Code of Washington, provides economic and community benefits, and is strongly supported by eastern Washington communities. While the project involves some risk to the state, these risks are reasonable and manageable, given counterbalancing benefits to the eastern Washington communities served by the line.

Critical next action steps are the development of an acceptable operating lease, establishment of a business plan for operating the railroad, and formation of a PCC advisory group to assist WSDOT in overseeing management of the PCC's assets and operations.

The position of the Secretary of Transportation is to move forward to acquire and lease back the PCC railroad track, subject to the conclusion of mutually agreeable terms for the purchase and operating lease.

“You have heard all about how we need this rail service and how valuable it is to the people it serves. Let us pray that the State and WATCO can come to a positive agreement and move forward with this purchase and lease agreement and that we can all hear the clickety-clack of the rail for many years to come.”

- *Spokane area shipper*