

RATEPAYERS GETTING RAILROADED

**NARUC WINTER COMMITTEE MEETING
Washington Action Committee**

**Washington, D.C.
February 12, 2006**

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**COAL TRANSPORTATION TO
UTILITIES OFTEN IS SUBJECT
TO UNRESTRAINED RAILROAD
MONOPOLY POWER**

Coal/Railroads/Electricity Generation

- ❑ 52% of the nation's electricity is generated from coal.
- ❑ Most coal moves by rail to generating facilities.
- ❑ No more than two railroads serve any of the nation's coal producing regions.
- ❑ Often coal movement to utilities is “captive” to a single railroad.
- ❑ Utilities buy coal at the “minemouth,” then arrange for the transportation; utilities often supply the “train sets” for moving the coal.
- ❑ Two-thirds of the delivered price of coal at a utility generator in the south and midwest is often the railroad rate.
- ❑ The fuel cost of generating electricity from natural gas can be 7 times greater than the fuel cost of generating electricity from coal.

FEDERAL RAIL POLICY



- ❑ Railroads are exempt from nation's anti-trust laws
- ❑ The Surface Transportation Board (STB) of the U.S. Department of Transportation is responsible for protecting rail customers from railroad abuse of monopoly power
- ❑ STB has been doing nothing to protect rail customers subject to railroad monopoly power – called captive rail customers

RESULT

- ❑ **Outrageously High Rail Rates** – Passed Through to the Consumer
- ❑ **Poor service** – sometimes the utility does not even receive the amount of coal for which it has contracted
- ❑ When insufficient coal is available, the utility must either **burn expensive natural gas** as fuel, purchase electricity generated by gas at extremely high rates or fall short of its needed electricity supply.

Arkansas Example

- Arkansas coal generators receiving in 2005/first half of 2006 10 – 15% less coal than contracted amount – due to rail delivery problems.
- Arkansas utilities forced to generate electricity from natural gas or buy gas-generated electricity.
- Rural electric customers alone in Arkansas will pay \$105 million extra for electricity in winter 2005/2006

STB RESPONSE TO ARKANSAS COAL DELIVERY PROBLEM

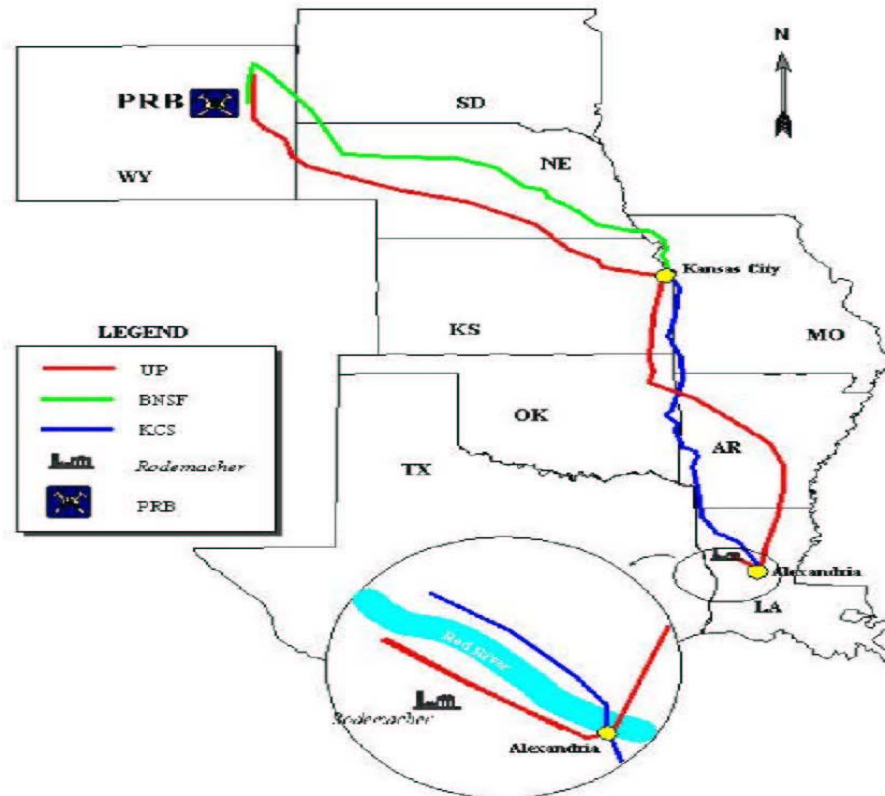
- ❑ STB conducted no hearing or public inquiry on the coal delivery problems from the Powder River Basin that occurred in 2005
- ❑ On August 12, 2005 Arkansas Electricity President & CEO Gary Voigt sent a letter to STB Chair Roger Nober regarding PRB coal delivery problems
- ❑ On November 18, 2005 Mr. Voight's letter was answered by Greg Fox, Vice President for Engineering, BNSF Railroad
- ❑ Mr. Voigt has never received a response to his letter to Chairman Nober or even an acknowledgement from Chairman Nober of the receipt of the letter!

**STB APPROVED
MECHANISMS FOR RAILROADS
TO AVOID RAIL TO RAIL COMPETITION**

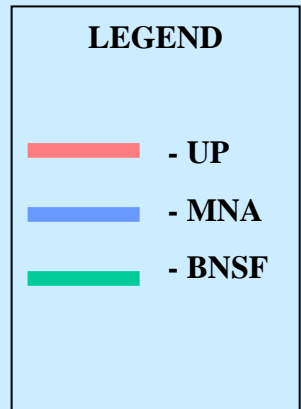
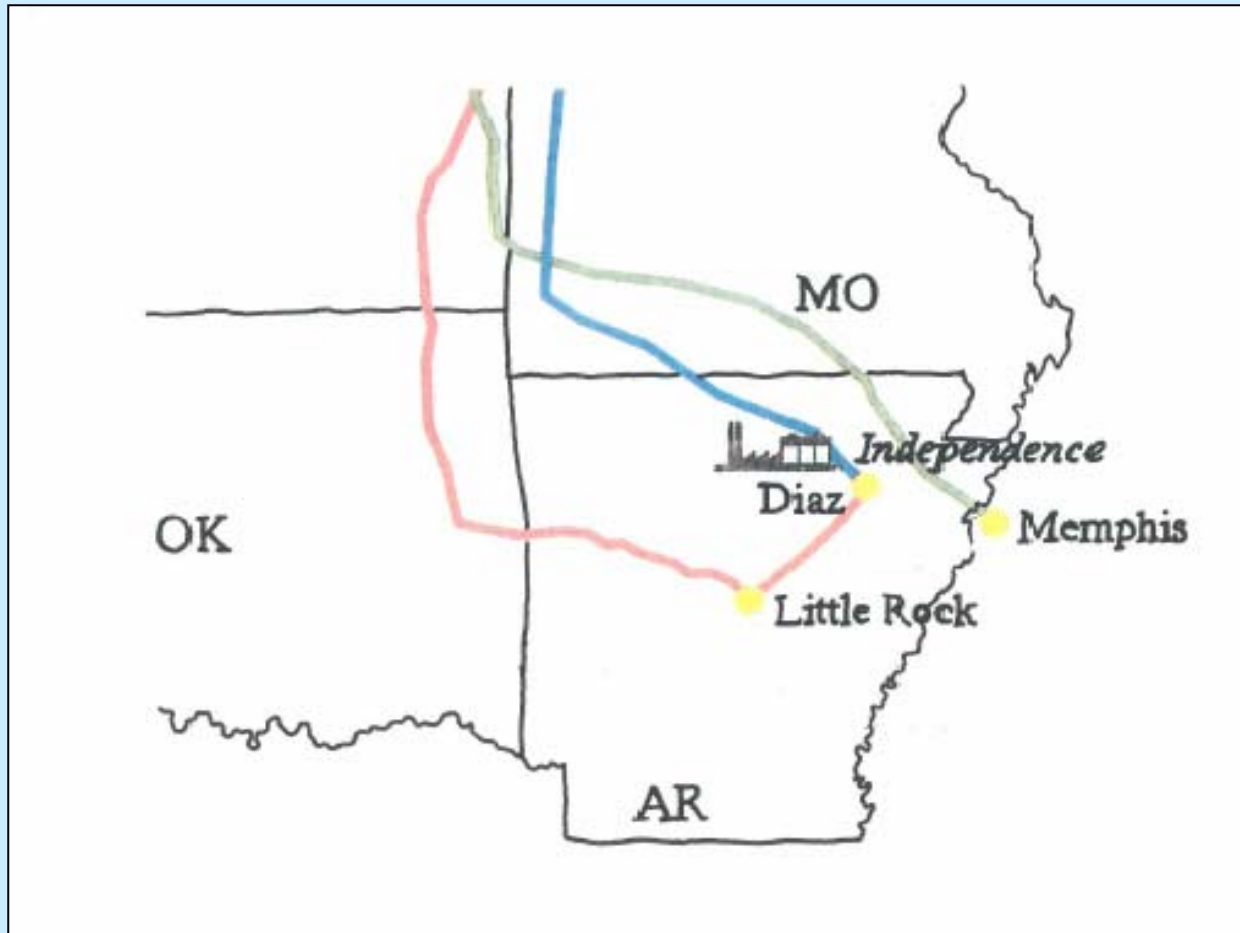


QUOTE A RATE/BOTTLENECK

Selected Routes For PRB Coal Moving to Rodemacher



PAPER BARRIERS SHORT LINE TIE IN AGREEMENTS



Result of these decisions by the ICC/STB: The Class I Railroad, through the Paper Barriers in agreements with Short Lines, can deny the customer access to railroad competition

LEASE AGREEMENT BETWEEN MISSOURI PACIFIC RAILROAD CO. (NOW UNION PACIFIC) AND MISSOURI & NORTHERN ARKANSAS RAILROAD CO. (MNA)

Section 4.01 “In consideration of this Lease, and subject to the terms and provisions set forth herein, Lessee agrees to pay Lessor rent for the Leased Premises in the amount of Ninety Million Dollars (\$90,000,000) per year payable annually in advance on the 1st day of March; PROVIDED, HOWEVER, that subject to the provisions of Section 4.02 hereof, for each lease year that 95% or more of all traffic originating or terminating on the Leased Premises is interchanged with Union Pacific Railroad Company, Missouri Pacific Railroad Company and any affiliated company, their successors and assigns, Lessor agrees that it will waive or partially waive the rent for that particular year in accordance with the schedule set forth in Section 4.03. The 95% level must be achieved separately and simultaneously on the Pleasant Hill-Bergman (including connecting branches) and Guion-Diaz Junction segments.”

Schedule in Section 4.03

**PERCENTAGE OF THE TOTAL
TRAFFIC THAT WAS INTER CHANGED
WITH LESSOR**

RENT DUE LESSOR

| | |
|-----------|--------------|
| 100 – 95% | \$-0- |
| 94 – 85% | \$10,000,000 |
| 84 – 75% | \$20,000,000 |
| 74 – 65% | \$20,000,000 |
| 64 – 55% | \$30,000,000 |
| 54 – 45% | \$40,000,000 |
| 44 – 35% | \$50,000,000 |
| 34 – 25% | \$60,000,000 |
| 24 – 15% | \$70,000,000 |
| 14 – 5% | \$80,000,000 |
| 0 – 4% | \$90,000,000 |

STB RATE REASONABLENESS PROCESS

THE STB RATE REASONABLE PROCESS

- ❑ Rail rates are not filed with the STB and are not subject to prior-approval by the STB
- ❑ Captive rail customers can petition STB to determine if a rate is “unreasonably high”
- ❑ Complainant must pay filing fee of \$102,000 to bring case (filing fee for civil cases in federal district court is \$150)
- ❑ Complainant must prove rate exceeds 180% revenue to variable cost
- ❑ Complainant must be “captive” — no effective transportation alternatives – if complainant shows it is “captive”, railroad has burden of proving other transportation alternatives exist
- ❑ Complainant must prove that the rate is “unreasonably high”
- ❑ Standard for when a rate is too high – “stand alone cost”

➤ **Stand Alone Cost (SAC):**

- ❖ *“...a railroad may not charge a shipper more than what a hypothetical new, optimally-efficient carrier would need to charge the complaining shipper if such a carrier were to design, build, and operate – with no legal or financial barriers to entry into or exit from the industry – a system to serve only that shipper and whatever group of traffic that shipper selects to be included in the traffic base.”*

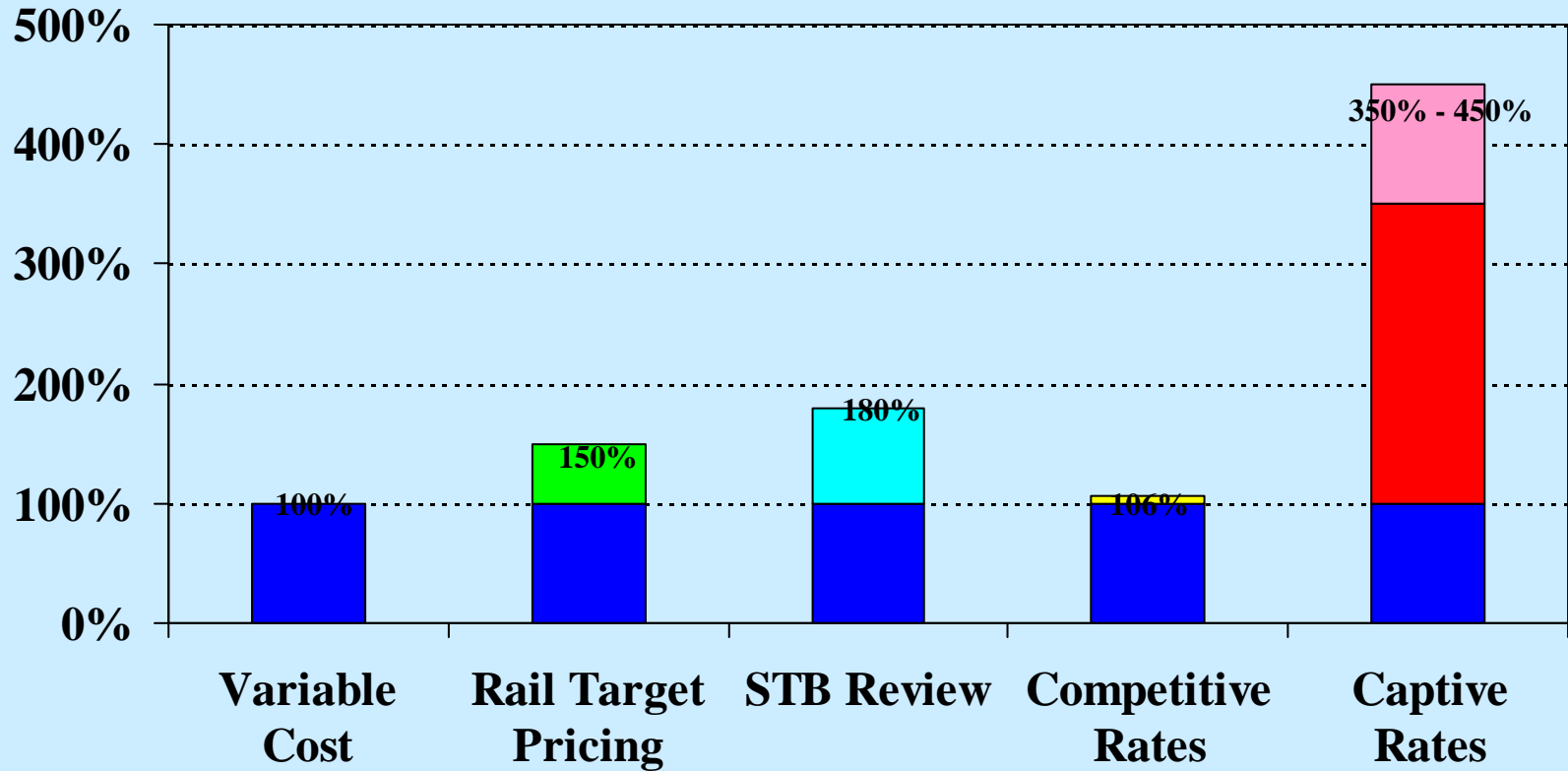
**Surface Transportation Board Chairman Roger Nober, in testimony before
the Railroad Subcommittee of the House Transportation and Infrastructure Committee,
March 31, 2004**

➤ **Stand Alone Cost (SAC):**

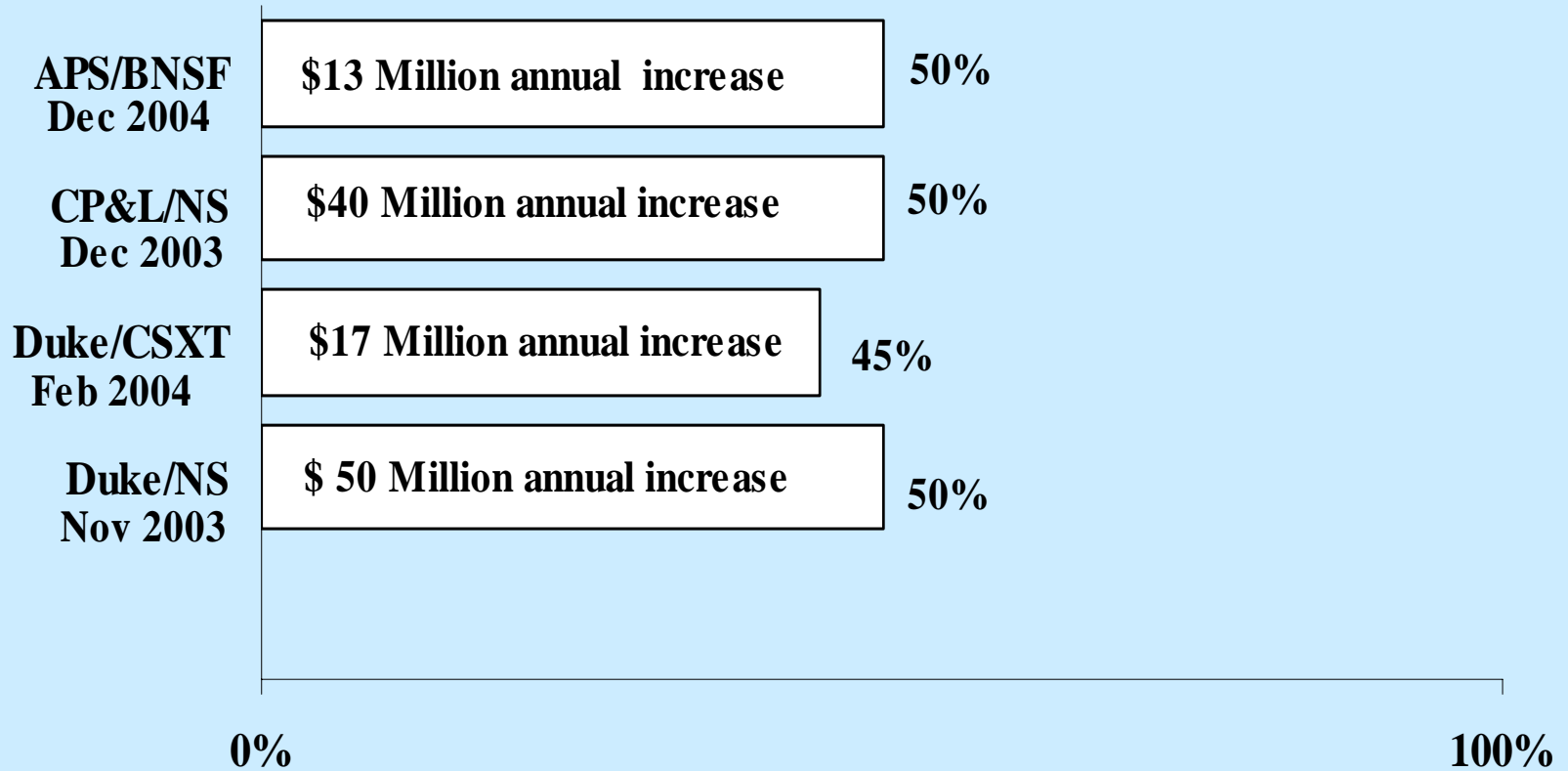
- ❖ *Stand Alone Cost used in “large rate cases” – including coal cases*
- ❖ *Stand Alone Cost rate cases “...are very expensive – parties have testified that a SAC case can cost as much as \$3 million to prosecute, \$5 million to defend, and generate more than 700,000 pages of material”*

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CAPTIVE RAIL RATES



% RATE INCREASES IN RAIL RATES PRESCRIBED BY THE STB SINCE 2002





Summary of Recent SAC Cases

| Case Name | Decision Date | Tariff Rates (per ton) | Shipper Requested Reduction | Result |
|-----------|---------------|------------------------|-----------------------------|------------------------|
| FMC | 2000 | wide range* | wide range | ~ 15% reduction |
| WPL | 2001 | \$14.66 | ~ 32% | ~ 11% reduction |
| PPL Mont. | 2002 | \$5.33 - \$7.74 | ~ 31% | dismissed |
| TMPA | 2003 | \$19.09 | ~ 30-42% | ~ 1-3% |
| Duke/NS | 2003 | \$16.00 - \$21.01 | ~ 53-62% | Not shown unreasonable |
| CP&L | 2003 | \$16.56 - \$16.86 | ~ 57% | Not shown unreasonable |
| Duke/CSXT | 2004 | \$16.66 - \$19.00 | ~ 53-63% | Not shown unreasonable |
| APS | 2004 | \$4.21 prescription | no change | prescription vacated |
| Xcel | 2004 | \$8.98 - \$9.24 | ~ 44% | ~ 16% reduction |
| AEPCO | 2005 | \$9.05 - \$10.17 | ~ 25-40% | dismissed |

* 16 origin/destination pairs involving 5 commodities



Pending SAC Cases

| Case Name | Date Filed | Tariff Rate | Statutory Deadline |
|--------------------|-----------------------------|----------------------|---------------------------------|
| Otter Tail | 2001 | \$13.49 - \$15.96 | Jan. 20, 2006 |
| AEP Texas North | 2003 | \$17.25 - \$18.04 | Mar. 9, 2006 |
| Western Fuels | 2004 | \$5.69 - \$8.13 | Record not closed |
| APS v. BNSF | 2004 | \$6.91 - \$8.75 | Complaint stayed pending appeal |
| West Texas v. BNSF | On remand from D.C. Circuit | \$13.68 prescription | None |
| KCPL v. UP | 2005 | \$15.84 - \$14.26 | Record not closed |

STB Chair Roger Nober

[Resigned 1/3/06]

**Comments in Volume 29, Number 2, p. 24, “Association Highlights”,
Association for Transportation Law, Logistics and Policy**

“Nober’s Rearview Mirror”

- ❑ “I’m sorry that the sharpness of the rail debate was not moderated...I did have shippers thank me for listening even though I did not agree.”
- ❑ Although “shipper concerns are significant,” the STB...” improved the economic health of the rail industry...”
- ❑ “The rails have found a formula for financial health for the first time in generations. Railroads today are the healthiest of all transportation systems.”

AND HOW ARE THE RAILROADS DOING FINANCIALLY?

**“Air Freight and Surface Transportation Report”, Jan 23, 2006
Published by Morgan Stanley Equity Research North America**

- ❑ “We believe [the major railroad] stocks will have 10-20% annual Earnings Per Share (EPS) growth between now and 2010”.
- ❑ “We see 50% - 100% upside in the six major railroad stocks between now and 2010”.
- ❑ “BN reported an adjusted \$1.25 Earnings Per Share compared to the Morgan Stanley estimate of \$1.20 and Street at \$1.16...we expected BNI to have a very strong quarter, given...momentum on pricing.”

Morgan Stanley, Jan 24, 2006

AND DOES MORGAN STANLEY BELIEVE WASHINGTON WILL RESTRAIN THE PRICING FREEDOM OF THE RAILROADS?

“We’re not concerned about regulatory risk as the current environment in Washington is understanding of the railroad industry’s plight to earn its cost of capital (which hasn’t been done in the last 50 years). Roger Nober, former chair of the Surface Transportation Board, recently stepped down, but given that his replacement will be nominated by the White House, we’re not concerned as the President’s cabinet includes John Snow, former CSX Chairman and CEO as well as Dick Cheney, former UNP board member.” **Morgan Stanley, January 23, 2006**

THE SOLUTION TO THE CAPTIVE RAIL PROBLEM

- ❑ Remove railroad industry exemption from the nation's antitrust laws
 - H.R. 3318, Railroad Antitrust and Competition Act of 2005
- ❑ Improve rate reasonableness process of the STB
 - S.919/H.R.2047 Rail Competition Acts
- ❑ Confirm Pro-Customer person as the new member of the STB for the current open seat

S. 919 / H.R. 2047

RAILROAD COMPETITION ACTS

- ❑ Requires railroads to quote rates to points of competition
- ❑ Removes “paper barriers” to competition
- ❑ Caps STB rate reasonableness filing fees at the level of filing fees in federal district court
- ❑ Requires STB to improve rate reasonableness process
- ❑ S.919 – lead sponsors Senators Burns (R-MT), Rockefeller (D-WV) and Dorgan (D-ND) - 12 total Senate sponsors
- ❑ H.R.2047 – lead sponsors Congressman Richard Baker (R-LA) and Congressman Jim Oberstar (D-MN) – 25 total House sponsors

H.R.3318, RAILROAD ANTITRUST AND COMPETITION IMPROVEMENT ACT OF 2005

- Puts railroads back under the nation's antitrust laws
- Lead sponsors – Congressman Mark Green (R-WI) and Congressman Earl Pomeroy (D-ND) – three House cosponsors

REQUEST

- ❑ Please help us find a good candidate for the open STB seat
- ❑ Please adopt a Resolution of Support on the Captive Rail issue
- ❑ Please advocate to your Congressional delegations about this problem – they will believe you when maybe they won't believe others
- ❑ Quantify and publicize this problem
- ❑ Help us know how to refine and improve our proposed legislation and our public advocacy