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BEFORE THE
SURFACE TRANSPORTATION BOARD



EX PARTE NO. 657 (SUB-NO. 1)

MAJOR ISSUES IN RAIL RATE CASES

REBUTTAL COMMENTS OF PPL ENERGYPLUS, LLC

ENTERED
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John M. Cutler, Jr.
McCarthy, Sweeney & Harkaway, PC
2175 K Street, N.W., Suite 600
Washington, DC 20037
(202) 775-5560

Attorney for
PPL EnergyPlus, LLC

Dated: June 30, 2006

PPL EnergyPlus, LLC ("PPL") generally agrees with and supports the Rebuttal Comments being filed jointly by Western Coal Traffic League, Concerned Captive Coal Shippers, Edison Electric Institute and several other associations. Members of those associations are like PPL in that they are captive shippers of coal by rail and are concerned about high and rising rail rates and ineffective rate regulation by the STB. In supplementation of those joint rebuttal comments, PPL states as follows.

The railroads' reply comments confirm what their opening comments indicate. The railroads have no interest in improving the Board's stand-alone cost methodology for protecting captive shippers from the abuse of railroad market power. Upon adoption of the railroads' proposals, STB rail rate regulation would become even less effective, and unrestricted monopoly pricing would become even more prevalent, than they are today. As the GAO noted in recent testimony before Congress, the status quo is unacceptable; the railroads' proposals would make things worse.

Not only do the railroads' positions represent a complete rejection of the Board's goals in initiating this proceeding, but the railroads' arguments ignore or reject policy decisions made long ago by the ICC and STB. For example, the Board held in *Coal Rate Guidelines* that "a rate may be unreasonable even if the carrier is far short of revenue adequacy" (1 I.C.C. 2d at 536), and the ICC and STB have reiterated that principle on many occasions. The position of the railroads is that, on the contrary, there should be no effective constraints on differential pricing even after revenue adequacy has been achieved.

The ICC rejected the efficient component pricing (ECP) approach in *Nevada Power*, but ECP is the railroads' answer to revenue allocation on cross-over traffic. See,

e.g., the Reply V.S. of UP Witness Neels at 3-10. It is no coincidence that ECP would minimize the SARR's revenues.

BNSF argues through its Witness Kalt for the use of "full" SAC testing whenever a SARR would serve both the issue traffic and cross-over traffic. Because analyzing the stand-alone cost of every facility used for every shipper in the stand-alone group would be prohibitively expensive, Professor Kalt's approach would eliminate grouping, without which "SAC would not be a very useful test, since the captive shipper would be deprived of the benefits of any inherent production economies." *Coal Rate Guidelines*, 1 I.C.C. 2d at 544.

Coal Rate Guidelines aside, the Board has rejected arguments for "full" SAC on more than one occasion, finding that the "residual carrier would agree to move the traffic so long as the revenue division would allow it to recover its attributable costs associated with handling the traffic." See the Board's recent decision in *PPL Montana v. BNSF*, Docket No. 42054, served August 20, 2002, slip opinion at 10, n. 20, citing *Rate Guidelines – Non-Coal Proceedings*, 1 S.T.B. 1004, 1016 (1996).

Kalt rejects this reasoning. He argues that, under contestable market theory, second order SARRs would compete for the business and revenues on which the complainant captive shipper's SARR would depend for its survival, with the result that multiple SARRs would minimize revenues available from cross-over traffic. Kalt Reply V.S. at 32. UP Witness Neels' variation on this theme (Reply V.S. at 10) is that the incumbent railroad itself would join the fray by reentering the market at lower rate levels.

The problem with both railroad witnesses' reasoning is that it flies in the face of the bedrock principle of SAC (and contestable market theory) that the contestability of

the market dominant entity's position cannot be neutralized by assuming retaliation by the incumbent railroad. See the Reply V.S. of Western Coal Traffic League Witness Borts at 6-7, citing authorities. The Board's reliance on contestable market theory has in the past been limited to competition between the incumbent and the SARR. The effort by the railroads to assume away all railroad market dominance based on a presumption of pervasive contestability is contrary to fact and contrary to the conceptual underpinnings of SAC.¹

The railroads' arguments are also in conflict with the holding in *Delaware & Hudson Ry. Co. v. Consolidated Rail Corp.*, 902 F.2d 174 (2d Cir. 1990), *cert denied*, 500 U.S. 928 (1991). The court there held that Conrail was potentially in violation of the antitrust laws when it demanded a division from the D&H on a joint move that was equal to the entirety of the revenues Conrail would enjoy if it refused to interchange with the D&H. See also *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973).

It should come as no surprise to the Board that the railroads' witnesses support an allocation of revenues from cross-over traffic that minimizes any challenge to the market power of the incumbent defendant railroad in a SAC case. The railroads' goal in this proceeding is plainly to neutralize any regulatory limit on their monopoly pricing.

The question is whether a free hand to set rates in railroads' own self interest is consistent with the statute or with sound public policy. Notably, in a Draft Report filed by the Government Accountability Office at the hearing held June 21, 2006 before the Surface Transportation Committee of the Senate Commerce Committee, GAO commented as follows:

¹ Would the railroads really prefer rate regulation through mega rate cases in which multiple shippers sue jointly to expand the issue traffic to include all of the coal shipped by all of the SAC group members? Would the Board?

There is widespread agreement that the rate relief process is inaccessible to most shippers and does not provide expeditious handling and resolution of complaints.

Draft Report at 23. If anything, GAO's comments are too mild.

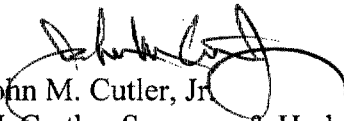
Elsewhere in the report, GAO found that the number of shippers paying rates in excess of 300% of variable cost has doubled since *Coal Rate Guidelines* was issued (*Id.* at 16). In short, there is a greater need for rate relief than ever before, STB procedures are inadequate to address this need, and the railroads' goal is to make SAC even more of a non-starter than it has proved to be in a succession of recent rate case decisions.

In its Opening Comments, PPL pointed out a number of situations in which Board action could do more to help more shippers than is possible through the tweaking of SAC that has consumed so much effort in this proceeding. GAO evidently agrees that new approaches are needed, including expanded use of simplified procedures and alternative cost approaches. Draft Report at 25.

SAC has worked for some shippers in the past, and could be a useful component of effective rail rate regulation in the future. But SAC can never be the only methodology for preventing abuses of railroad market power, and the way to make SAC more effective is emphatically not to adopt the recommendations of the railroads. PPL urges the

Board to be guided by the comments of Western Coal Traffic League and other shipper groups and shippers in reviving effective rail rate regulation.

Respectfully submitted,

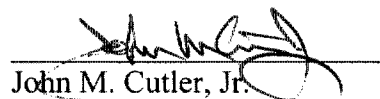

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CERTIFICATE OF SERVICE

I hereby certify that I have this 30th day of June, 2006, caused copies of the foregoing comments to be served by first class mail, postage prepaid on all parties of record.


John M. Cutler, Jr.