

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

217036

REVIEW OF RAIL ACCESS AND
COMPETITION ISSUES – RENEWED
PETITION OF THE WESTERN COAL
TRAFFIC LEAGUE

)
)
)
)
)
)

Ex Parte No. 575

**SUMMARY OF PRESENTATION BY JEFFREY G. HERNDON
ON BEHALF OF ENTERGY SERVICES, INC.,
ENTERGY ARKANSAS, INC., AND ARKANSAS ELECTRIC
COOPERATIVE CORPORATION**

July 27, 2006

Introduction

May it please the Board, my name is Jeffrey G. Herndon, and I am
Manager – Coal Supply for Entergy Services, Inc., a subsidiary of Entergy Corporation.
My job is to make sure that all of the coal-fired electric generating units operated by
Entergy’s subsidiaries receive the coal they need to meet their customers’ needs, so I am
very familiar with the rail transportation options available at each of the coal-fired units
operated by Entergy

I am here today to talk about adverse impact of “paper barriers” on the cost
and reliability of coal deliveries to one of Entergy’s plants, the Independence Station
which is operated by Entergy Arkansas, Inc. Incidentally, the Arkansas Electric

Cooperative Corporation is a co-owner of the Independence Station, but I am speaking today only on behalf of Entergy.

Entergy's prior submissions in this proceeding described in some detail the situation at Independence, which is on a rail line operated by the Missouri & Northern Arkansas Railroad under a lease from the Union Pacific Railroad. We pointed out that although the M&NA connects with the BNSF and the KCS as well as with UP, several "paper barriers to interchange" in the M&NA lease effectively prevent the M&NA from receiving coal from those carriers and delivering it to Independence. This is so, even though at one time, prior to the M&NA lease, our coal shipments to Independence were originated by BNSF and interchanged to the Missouri Pacific Railroad (MP) at Kansas City for delivery over what is now the M&NA. I should add that the Board can see for itself what those "paper barriers" are, because unlike most short line leases, the M&NA lease is public and has been submitted into the record in this proceeding.

Reading what UP has said in defense of the M&NA paper barriers, I must confess a bit of admiration for its ability to stay "on message." The paper barriers in the M&NA lease haven't reduced Entergy's transportation options at Independence, UP keeps repeating, because the plant was captive to UP before the M&NA came on the scene, and the paper barriers simply preserved that captivity. End of debate, insists UP.

Well, I respectfully disagree; if restrictions on competition embedded in short line transactions were allowed whenever they did nothing more than perpetuate the prior lack of competition, the Board wouldn't be holding this hearing. As the Western

Coal Traffic League's filings have demonstrated, though, the antitrust laws of our country, which I am told are supposed to illuminate the Board's decisionmaking, do not have such a narrow focus. Rather, when companies outside the railroad industry sell off portions of their operations to third parties, they are not allowed to impose unreasonable restraints on the ability of the buyer to compete with the seller after the spinoff, even though such competition did not exist before the transaction.¹ The same rules should apply to the railroad industry, where the growth of vibrant competition is surely no less important for the nation's economic well-being.

In our written submissions to the Board, we demonstrated that the M&NA paper barriers have significantly impeded Entergy's ability to obtain adequate coal supplies for Independence when UP has experienced operational problems and has been unable to deliver all the coal Entergy needed. In particular, we noted that the paper barriers effectively blocked our resort to BNSF service in 1997, when UP's system was so congested that it could not deliver PRB coal to Independence itself; and the same paper barriers again blocked our access to imported coal from the Gulf of Mexico in 2005 (via a KCS-M&NA connection) when both UP and BNSF were having problems in delivering PRB coal. UP replied that it had indeed offered to let BNSF deliver coal to Independence in 1997, but that BNSF refused to do so. Of course UP's "offer" was

¹ I note that the Association of American Railroads claims that restrictions on post-spinoff competition are proper without regard to whether they are reasonable, because the short line deals are essentially joint ventures and the paper barriers are at the "core" of the partnership. I'm not a lawyer, but it strikes me that while the fixing of rates and so forth for the traffic the short line interchanges with its lessor may be at the core of such a partnership, any restrictions imposed on what the short line can do with OTHER railroads are most definitely "ancillary" to that partnership, as those terms are used by the cases the AAR discusses.

designed to elicit such a refusal, since it was predicated on BNSF's willingness to serve Independence only on a temporary basis, under standard "detour" arrangements that are both costly and cumbersome. With respect to obtaining imported coal in 2005, UP at first asserted that it offered to deliver imported coal from the Gulf of Mexico to Independence in 2005, but that Entergy had not taken it up on the offer. When Entergy pointed out that the only such offer related to another plant – White Bluff – which already has two-carrier service, UP switched gears and claimed that Entergy's response "simply emphasizes that ... Entergy's issues have nothing to do with the MNA transaction..." Of course our response did no such thing. Our point was, and is, that UP at no time expressed willingness to deliver Gulf coal to Independence, and *the paper barriers prevented us from exploring KCS-M&NA service as an alternative.*

The Board should understand that when service is affected, restrictive paper barriers are not simply an economic issue – we are not just talking about how much the railroads will be able to charge for delivering the coal that keeps the public's lights on and air conditioners running. Long lasting service disruptions that limit UP's ability to transport all the coal Entergy needs to run Independence, coupled with paper barriers that prevent Entergy from obtaining coal elsewhere, have the potential to create a serious threat to the reliability of the electric grid in Arkansas and elsewhere. Last summer was a case on point. Because Entergy could not run the generating units at Independence at full capacity last summer, it had to import substantial amounts of power from other regions, in addition to generating substitute power from other, more expensive fuels such as

natural gas. The resulting transmission demands, coupled with those of our similarly-situated neighbors, put a substantial strain on the transmission grid at times last summer.

Paper barriers do have a negative economic effect on rail customers, of course, just as all restraints of trade do – they artificially increase the prices that the Class I carriers can demand from their affected customers. For Entergy, this is less of a concern than is service reliability right now, but only because our coal transportation agreement with UP still has a few years to run. Once that agreement expires, though, the customers of Entergy, AECC, and other utilities to whom Entergy sells power will be unable to reap the benefits of competition for their coal transportation business, such as the Dakota, Minnesota & Eastern Railroad (DM&E) connection to KCS to M&NA to Independence, unless the paper barriers in the M&NA lease are struck down.

Finally, I note that UP seems to be arguing that the Board lacks the power to eliminate unreasonable paper barriers in short line transactions, even if it wants to do so. Aside from its legal arguments challenging the power of the Board to redress existing paper barriers (such as those in the M&NA lease),² UP suggests that if the Board tries to block enforcement of the M&NA paper barriers it will terminate the lease, take the line back, and then abandon the portions of the line it doesn't need to serve Independence and

² UP argues that the M&NA lease is not a “pooling agreement” requiring STB approval because it and the M&NA “are not competitors with respect to traffic handled under their interchange commitments.” But I would think that this is true of all agreements between railroads to divide traffic: the parties to the agreement are not competitors with respect to the traffic in question *because the pooling agreement prevents them from competing* for it. Rather, I would think that the test has to be whether the carriers could, but for the agreement, compete with one another for the traffic. In this instance, it is obvious that if it were not for the paper barriers in the M&NA lease, the M&NA could, in cooperation with BNSF or KCS, compete effectively with UP for Entergy's coal transportation business at Independence. Accordingly, the M&NA lease is a pooling agreement subject to STB approval – or disapproval. The cases our attorneys cited in Entergy's March 8, 2006 Comments seem to make that quite clear.

another coal-fired generating plant. Of course any such ouster of the M&NA would require STB approval, and would be met with vigorous opposition from Entergy and, I am confident, other rail-dependent shippers on the M&NA line. Nor could UP abandon the “unneeded” parts of the line without going through the STB abandonment process, including the Offer of Financial Assistance procedures; and there is every reason to believe that an OFA to buy the line would be forthcoming (since the line would be worth essentially the same to a buyer as it was to the M&NA, given that M&NA did not acquire the profitable coal traffic on the line when it acquired the line in 1992).

In conclusion, I would like to express our appreciation to the Board for taking up the paper barrier problem in these proceedings. We respectfully urge the Board, upon careful consideration of the evidence and argument of all the parties, to take the next step and institute a full-fledged rulemaking proceeding to consider standards and procedures for the review and evaluation of paper barriers to interchange, both those that may be proposed in future short line transactions, and those such as the M&NA barriers that are already in effect.