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August 7, 2006

Vernon A. Williams
Secretary
Surface Transportation Board
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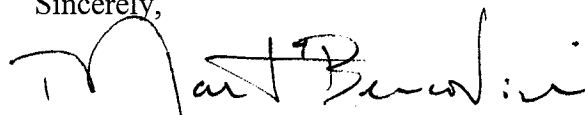
Writer's Direct Access
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Re: Review of Rail Access and Competition Issues—Renewed Petition of the Western
Coal Traffic League, STB Ex Parte No. 575

Dear Secretary Williams:

At the Board's hearing on July 27, 2006, Vice Chairman Mulvey asked Steve Sharp of Arkansas Electric Cooperative Corporation to provide any analysis AECC had of a statement in the written comments that the paper barrier limiting service to the Independence power plant results in an increased cost of at least \$3.25 per ton. Mr. Sharp stated that the figure had been developed by AECC's consultant. A report showing the basis for the statement is associated herewith.

Sincerely,



Martin W. Bercovici

Enclosure

**Estimation of “Paper Barrier” Impact on Rail Rate for Powder
River Basin Coal Movements to Independence Plant**

Prepared for Arkansas Electric Cooperative Corporation by:

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Estimation of “Paper Barrier” Impact on Rail Rate for Powder River Basin Coal Movements to Independence Plant

I. Introduction

In March 2006, Arkansas Electric Cooperative Corporation (AECC) submitted comments to the Surface Transportation Board (STB) in Ex Parte No. 575.¹ Those comments contained an estimate that “paper barriers” increase the rail rate for Powder River Basin (PRB) coal moving to the Independence plant (near Newark, AR) by at least \$3.25 per ton. This report presents the derivation of that estimate.

II. Derivation of Estimate

As discussed in the AECC Comments, a precise current rate for the movement to the Independence plant cannot be discerned from available sources.² The impact of paper barriers on the rate for the Independence movement therefore must be estimated. In this analysis, the estimate is computed as the difference between (a) the rate that reasonably could be expected for a movement with the competitive and operating characteristics of the Independence traffic with the paper barriers in place; and, (b) the analogous rate that reasonably could be expected absent the paper barriers.

A. Rate With Paper Barriers

In the presence of the paper barriers, the Independence plant has few, if any, viable transportation alternatives. Absent an effective ability to use MNA, coal moving to Independence from BNSF today would need to be trucked from a suitable point on BNSF’s main line that traverses northern Arkansas, or from a suitable point on the

¹ See STB Ex Parte No. 575, Review of Rail Access and Competition Issues - Renewed Petition of the Western Coal Traffic League, “Comments Of Arkansas Electric Cooperative Corporation” (March 8, 2006) (hereafter, “AECC Comments”).

² AECC Comments at 5, footnote 8.

trackage rights acquired by BNSF in the UP/SP merger. Regardless of the location, the volume of the movement³ and the distances involved undermine the viability of truck-based options.

Similarly, buildout options might provide a theoretical cap on rail pricing for this movement, but the distances and costs are extreme. For example, a hypothetical buildout to reach BNSF in the vicinity of Black Rock – Portia might be 35-40 miles in length, and could easily cost \$90 million or more given topographic and wetland issues. A hypothetical buildout to the former SP (SSW) line in the vicinity of Waldenburg – McDaniel might be comparatively shorter (30 miles), but would still be an expensive (\$70+ million) project facing major challenges and uncertainties.

Given the impracticality of these alternatives, as well as the absence of viable barge options or local sources of alternative coal that would not require rail transportation, the rate applicable to the Independence movement with paper barriers in place can be approximated by the rate that could be anticipated from an STB rate reasonableness proceeding. While the establishment of an exact rate in such proceedings is a complex process, the prescribed rate will never be lower than the statutory threshold of 180 percent of the incumbent carrier's variable costs. Using the variable cost determination from the TMPA/Gibbons Creek case,⁴ this suggests that the rate applicable to the Independence movement viewed in isolation is no less than $(1.80 \times 0.0057 \text{ mills})$

³ Normally in excess of 6 million tons per year.

⁴ This case involved PRB unit trains largely analogous to those used in service to Independence. Holding aside railcar ownership and operating expenses (borne by the carrier in the TMPA case but not applicable to the Independence movement, which uses shipper-owned equipment), and using data from the fourth quarter of 2001 for the Cordero movement, the Board found a "linked variable cost" of \$8.02 per ton. See STB Docket No. 42056, Texas Municipal Power Agency v. The Burlington Northern And Santa Fe Railway Company, Decision served March 21, 2003, Table A-9. Dividing by the loaded movement length of 1407.8 miles (from Table A-3) yields an estimated variable cost of \$0.0057 per revenue ton-mile.

per revenue ton-mile x 1290 miles =) \$13.24/ton.⁵ Depending upon the economic performance of the “stand-alone railroad (SARR)” in such a case, the prescribed rate could be considerably higher.

B. Rate Without Paper Barriers

Without paper barriers, the rate for this movement would be set on the basis of competitive forces. Until recently, competitive rates of 7.5-8.0 mills were readily observable for movements of this size.⁶ With a combined route length of approximately 1233 miles⁷, a BNSF-MNA route would have a competitive capability in the range of \$9.25-\$9.86. Even if MNA’s operating costs for PRB coal trains are assumed to be 1/3 higher than the costs of Class I main line operations, MNA could earn a positive contribution on a rate at or below 8.0 mills.⁸ Given that MNA currently receives a minimal contribution from this movement, it is reasonable to expect that - absent the

⁵ It should be noted that the figure of 1290 miles used in this computation, which was derived from mileage calculators, understates that actual revenue ton-miles per ton associated with this movement. As shown in the report “Rail Fuel Use and Surcharges for White Bluff and Independence Plants” (May 15, 2006), which was submitted to the Board by AECC in Ex Parte 661, segment-by-segment analysis of the route traversed by loaded PRB coal trains moving to Independence via UP shows a total route length of 1339 miles. Use of this figure in the above computation would yield an estimated rate of $(1.80 \times \$0.0057 \times 1339 =)$ \$13.74/ton.

⁶ Such rates may not currently be available in the wake of the PRB derailments of 2005 and subsequent throughput limitations. For the purposes of this analysis, impacts of such factors on competitive rates are viewed as transitory.

Competitive rates in this range also may not reflect recent fuel price increases and the application of fuel surcharges. This is consistent with the conditions (in the year 2001) underlying the variable cost estimate of \$0.0057/revenue ton-mile described above. All else equal, incorporation of higher fuel prices in this analysis would increase the rate impact ascribable to the paper barriers because of the 1.80 multiplier applied to variable costs in the estimation of the rate “with” the paper barriers.

⁷ Using the Black Thunder Mine as a point of reference, the BNSF portion of the movement (i.e., to Kansas City) would be approximately 828 miles, while the MNA portion of the movement would be approximately 405 miles.

If needed (e.g., to avoid high operating costs on the northern portion of MNA), alternative interchange points would also appear to support competitive rates of under \$10.00 per ton. For example, interchange at Lamar, MO would produce a total route length of under 1250 miles, which (at a rate of \$0.008/revenue ton-mile) equates to a competitive rate capability of under \$10.00 per ton.

⁸ Put another way, 1.33 times the assumed Class I unit variable cost of \$0.0057/revenue ton-mile is approximately \$0.0076/revenue ton-mile.

paper barriers - MNA would cooperate with BNSF at a low margin, and that a competitive rate of \$10.00 or less per ton could be achieved.

C. Estimated Impact of Paper Barriers

Based on the figures derived above, it is estimated that the "paper barrier premium" for coal moving to Independence is at least ($\$13.25 - 10.00 =$) \$3.25/ton. To the extent that a rate case would yield a prescribed rate above \$13.25 per ton,⁹ or a competitive rate of less than \$10.00 per ton could be achieved, the actual impact of the paper barriers would be higher than the \$3.25/ton estimate.

⁹ This could occur due to one or more of several possible circumstances, including (a) the economic performance of the SARR necessitates rates above 180 percent of variable costs; (b) increased fuel prices are incorporated; and/or (c) the 1339 mile route length is used.