

In the Matter of:

STB Ex Parte No. 646
(Sub-No. 1)

Arkansas Electric Cooperative Corporation (“AECC”) respectfully submits its comments in response to the proposals advanced by this Board to revise and clarify the guidelines applicable to “small” rail rate cases.¹ AECC supports the Board’s ongoing efforts to refine its rate case procedures, and is grateful for this opportunity to comment on the proposed new standards and methods.

AECC is a membership-based generation and transmission cooperative that provides wholesale electric power to electric cooperatives, which in turn serve approximately 460,000 customers located in each of the 75 counties in Arkansas. In order to serve its member distribution cooperatives, AECC has entered into arrangements with other utilities within the state to share generation and transmission facilities. The largest of AECC's generation assets are its ownership interests in the White Bluff plant at Redfield, AR and the Independence plant at Newark, AR, each of which typically burns

¹ 71 Fed. Reg. 43703 (Aug. 2, 2006).

in excess of 6 million tons of Powder River Basin (PRB) coal annually. AECC holds a 35 percent interest in each of these plants (for which Entergy is the operator and majority owner). In addition, AECC holds a 50 percent interest (with AEP) in the Flint Creek plant, which is located in Gentry, AR. This plant normally burns in excess of 2 million tons of PRB coal annually.

As a result of the large volume of coal used by these plants and the fact that two of these plants are served by only one rail carrier,² AECC has a direct interest in the procedures applicable to large rate cases. Toward this end AECC has been an active participant in STB Ex Parte No. 657 (Sub-No. 1), *Major Issues In Rail Rate Cases* (hereafter, “*Major Issues*”).

In addition, AECC’s repeated experiences with rail delivery shortfalls and the resulting imposition of coal burn restrictions have created a need to address issues related to prospective movements of replacement coal from other sources or other alternative fuels (hereafter, “substitute coal”). Such movements generally do not reflect “optimal” patterns of fuel supply, and are undertaken – hopefully in comparatively small volumes - to avoid the need to restrict plant output. Notwithstanding the potential culpability of any particular rail carrier in the creation of the delivery shortfall, AECC needs to ensure the reasonableness of rates and service for substitute coal movements. In the course of constructing and operating its facilities, AECC also makes use of rail service for less-than-trainload shipments of commodities other than boiler fuel. AECC therefore has

² Rail service at the Flint Creek plant is provided exclusively by Kansas City Southern (KCS). Rail service at the Independence plant is controlled by Union Pacific (UP) through contractual arrangements with the Missouri & Northern Arkansas Railroad (MNA), as discussed at length in STB Ex Parte No. 575, *Review of Rail Access and Competition Issues*. See, for example, Comments of Arkansas Electric Cooperative Corporation and Entergy Arkansas, Inc. in Support of Renewed Petition of Western Coal Traffic League for Rulemaking to Eliminate Unreasonable “Paper Barriers” to Interchange (May 2, 2005), Ex Parte No. 575, at pp. 3-5.

interest in the guidelines and procedures proposed by the Board for application to smaller shipments.

II. COMMENTS

The Board's July 28 Decision describes proposals that would establish methodologies for "medium-size" and "small" rail rate disputes, and the criteria that would define eligibility for application of those methodologies. In these comments, AECC addresses the proposals that relate to the eligibility criteria and to the proposed "Simplified-SAC" methodology that would apply to "medium-size" rail rate disputes.³ Comments regarding specific proposals advanced by the Board in these areas are presented below.

A. Eligibility Criteria

The Board proposes a formulaic approach to determine the methodologies applicable to rail rate disputes of different sizes. Under this proposal, the "Maximum Value of the Case (MVC)" would be computed from the difference between the challenged rate and the jurisdictional threshold of 180% R/VC (i.e., the lowest rate the Board prospectively could prescribe) at tonnage levels over a five-year planning horizon projected by the complaining shipper. If the MVC is over \$3.5 million, the shipper would be required to utilize the "Full-SAC" methodology, which is currently being refined by the Board in *Major Issues*. If the MVC is between \$200,000 and \$3.5 million,

³ For "small" rail rate disputes, AECC defers to the opening comments of shippers more directly affected by the methodology applied to this category of traffic.

the shipper would be permitted to utilize the “Simplified-SAC” methodology proposed by the Board.⁴

An obvious problem with the MVC is the fact that the prescribed rate will often exceed, but can never be below, the jurisdictional threshold. Whenever this occurs, MVC will overstate the “actual” value of the case, prospectively denying the shipper access to the Simplified-SAC approach. While the Board contemplates that the shipper could rebut the eligibility presumptions “based on the likely actual (as opposed to maximum) value of the case”, determination of an accurate value basically requires that the case be litigated before it can begin. Absent perfect foresight, MVC systematically tends to deny shippers access to the Simplified-SAC procedure.

Even if the Board were willing and able to replace the jurisdictional threshold with an unbiased estimate of the actual value of each case, the proposed eligibility criteria appear to create further problems that run contrary to the stated purpose of the planned reforms and the public interest criteria they seek to satisfy. These problems can be illustrated with an example that reflects realistic circumstances. For the purposes of this example, assume that a plant like AECC’s White Bluff plant is experiencing a delivery shortfall that requires the acquisition of 500,000 tons⁵ of substitute coal to avoid the imposition of costly burn restrictions. Assume further that this quantity of substitute coal is available, that it could be moved to the plant by rail at a variable cost level of \$8.00 per

⁴ If the MVC is less than \$200,000, the shipper would be further permitted to use the “Modified Three Benchmark” methodology proposed by the Board.

⁵ In the case of a large plant, like White Bluff, this represents less than 10 percent of the plant’s annual burn.

ton,⁶ and that a prescribed rate set at 180 percent of variable cost (i.e., \$14.40 per ton) would enable the carrier to earn a market rate of return on the required capital.

Under these circumstances, if the railroad attempted to charge any rate between \$14.80 and \$21.40 per ton, the MVC would fall in the range between \$200,000-3,500,000⁷, and the movement would qualify for the Simplified-SAC methodology. The shipper would have the ability to spend an estimated \$200,000⁸ to constrain the rate to \$14.40 per ton. At any rate under \$14.80 per ton, it would be rational for the shipper to pay the rate rather than litigate a Simplified-SAC case.

Under the same circumstances, if the railroad attempted to charge a rate over \$21.40 per ton, the MVC would be over \$3,500,000 and the litigant would be expected to use the Full-SAC methodology. The shipper then would have the ability to spend an estimated \$3,500,000 to constrain the rate to \$14.40 per ton. At any rate under \$21.40 per ton, it would be rational for the shipper to pay the rate rather than litigate a Full-SAC case.

These outcomes are problematic in at least two significant respects. First, the railroad is able to undermine the effective relief available to the shipper simply by charging a higher initial rate. The Board has recognized the impropriety of this type of

⁶ Because the Board's proposed criteria rely on the variable cost of the movement, it is not necessary for the purposes of this example to specify the origin point of the substitute coal. For AECC's plants, substitute coal might originate from Colorado, New Mexico, North Dakota or other possible sources.

⁷ Calculated as $(\text{rate} - 14.40) \times 500,000$. To the extent that delivery of the 500,000 tons would extend over a period of longer than one year, this computation omits application of the discount rate contemplated by the Board.

⁸ For discussion purposes, AECC uses the Board's estimate of litigation costs. Such use of the Board's estimate should not be construed as constituting an endorsement of the accuracy of the estimate in the absence of experience with the Simplified-SAC methodology.

“gaming”⁹ and should not now introduce a procedure that permits and encourages this practice.

More subtle but also important is the incidence of the litigation costs. In both scenarios, the railroad is left with a negotiating position that commands rates above the level that provides a market return on the required capital. This violates the “principal objective” of the SAC constraint articulated by the Board (in the July 28 decision), which is “...to restrain a railroad from exploiting market power over a captive shipper by charging more than it needs to earn a reasonable return on the replacement cost of the infrastructure used to serve that shipper.” In establishing new criteria and procedures, the Board should take steps to ensure that a railroad is not able to rely on a shipper’s litigation costs to exploit its market power beyond the level otherwise permitted. As shown in the above examples, this practice can materially impact the degree to which the Board’s actions will achieve their stated intentions.

To address these two issues, AECC recommends that the Board adopt the following two refinements to its eligibility proposal:

1. The Board should permit shippers to utilize a reasonable variation of the Simplified-SAC procedure in larger cases. For shippers who do not wish to challenge the efficiency of existing operations, there is no discernible public interest consideration that would require such shippers to bear the expense of a Full-SAC case. Indeed, the Congressional direction cited by the Board plainly intended for the new “simplified and expedited” SAC procedure to mitigate the limitations imposed by the high cost of Full-

⁹ The Board’s decision initiating *Major Issues* (February 27, 2006) discussed in detail how the susceptibility of a methodology to manipulation “...is sufficient to warrant a change”, and how maximum reasonable rates must be determined by the evidence, and “...not by parties’ litigation tactics.” *Id.* at p. 9.

SAC, and the Board has already identified efficiency challenges as being the major cause of that high cost.

Any concerns regarding the accuracy of the simplified methodology can be addressed by permitting limited rebuttal to ensure reasonable conformity with situation-specific considerations.¹⁰ Allowing broader application of Simplified-SAC fulfills the Congressional intent for a simplified methodology, and reduces opportunities for railroads to command rates that exceed the levels contemplated in the applicable statutes and regulatory principles.

2. To further promote the simplification of maximum rate reasonableness determinations, the Board should provide for adjustment of prescribed rates or other methods that would equalize (or equitably distribute) the reasonable and actual cost of the analysis and litigation required to establish those rates. This would provide an economic incentive for parties to communicate and cooperate in the resolution of issues, and tend to limit litigation to areas that require Board direction or precedent.

With these refinements, the Board's proposal would promote the desired simplification, and the advancement of accessible, efficient and transparent processes to establish maximum rates in accordance with applicable standards.

B. Simplified-SAC

The Board advances proposals regarding numerous details of the planned Simplified-SAC methodology. Comments regarding specific proposals, including possible refinements to improve accuracy, are presented below.

¹⁰ The accuracy of the methodology would also be enhanced through adoption of the refinements presented in the following section.

Cross-Over Traffic: The Board's requirement that the SARR replicate the defendant railroad's existing facilities along the selected line is fully compatible with application of the methodology proposed by AECC for the allocation of revenue on cross-over traffic.¹¹ Absent the investment made by the SARR, the defendant railroad would realize no contribution from such traffic, except for that which would be achievable through (presumably less efficient) routing over the defendant railroad's other lines. The methodology proposed by AECC provides an accurate and computationally-feasible method to replicate the economic value of cross-over traffic associated with the defendant carrier's investment in the subject facilities.

Road Property Investment (RPI): The Board's proposed reliance on the body of knowledge amassed from Full-SAC cases represents an efficient use of available information for which the Board should be commended. The information presented in Table A-1 of the Board's July 28 decision shows how the observed variation across cases in total RPI per track mile has been quite small. Nevertheless, in several RPI categories – notably including land (Table A-2) and bridges (Table A-6) – the data presented by the Board suggest that accuracy could be improved by permitting use of stratification (generally, east vs. west) where appropriate. In cases where the prior analyses substantiate the existence of such differences, the accuracy of Simplified-SAC would be improved by permitting the use of data from the relevant stratification (e.g., use western costs in a western case) rather than compelling use of national average data.

Operating Expenses: The Board's proposal entails use of system-average operating characteristics in the development of URCS estimates of SARR operating

¹¹ See *Major Issues*, "Written Testimony of Michael A. Nelson on Behalf of Arkansas Electric Cooperative Corporation" (May 1, 2006) (hereafter, "Nelson Testimony") at pp. 9-15.

expenses. This is explicitly based on the proposition that for any given rail segment the combination of unit train, intermodal and merchandise traffic likely does not deviate materially from the system average. However, it is believed that most unit train and intermodal traffic moves in small numbers of high-density corridors,¹² while general merchandise traffic is more ubiquitous. As a result, there may be very few rail line segments for which the system average composition of traffic corresponds closely to actual operations. To the extent practical, the Simplified-SAC methodology should retain and support operating cost estimates that reflect relevant traffic type stratifications.

The Board also proposes to ignore depreciation on the defendant carrier's equipment, so that the SARR would pay the full book value of that equipment. However, this appears to be wholly inconsistent with the fact that Simplified-SAC provides no method to credit the SARR with efficiency improvements associated with purchase of new equipment. If the SARR is to be saddled with the defendant railroad's past equipment purchase decisions, it should be permitted to benefit from reliance on used equipment to the same degree as does the defendant railroad. This means the SARR should pay no more (or no less) than the depreciated values of the defendant railroad's equipment.

The Board further proposes to "run the URCS program in the 100% Flow Thru mode for Simplified-SAC cases." Given that a central purpose of the URCS program is to permit the identification and measurement of variable costs, and that URCS typically does not find variability to be 100 percent, the Board's proposal to superimpose an assumption of 100 percent variability raises larger questions than it answers. In *Major*

¹² See, for example, STB Ex Parte No. 663, *Powder River Basin Site Visit*, Tab 5 (UP Lance Fritz Presentation) at 2 of 11.

Issues, the Board indicated that limitations in the ability of URCS to produce relevant cost estimates should be addressed through URCS refinements, and not through ad hoc adjustments developed in rate cases. The same standard would require that uses of URCS to estimate total (rather than variable) costs be subjected to careful consideration, and not mandated as an expedient rate case “fix”. Given the Board’s stated wish to avoid having this proceeding degenerate into a battle of statisticians, consideration of URCS modifications to permit the reliable estimation of total costs should be undertaken in an URCS proceeding. In the meantime, the Board should not prescribe a mandatory methodology for parties to use in addressing this issue.

Internal Cross-subsidy Inquiry: AECC’s position regarding cross-subsidy issues was presented in *Major Issues*.¹³ For Simplified-SAC, the PPL and Otter Tail precedents referenced by the Board should be amended as needed to comport with the principles previously outlined by AECC.

Maximum Reasonable Rate: The methodology proposed by AECC in *Major Issues*¹⁴ can readily be used in Simplified-SAC. While this methodology was originally based on the premise that a SARR in a Full-SAC case is designed to provide only the capacity required by the traffic group, it also is consistent with the evolving environment in which minimal excess capacity is present.

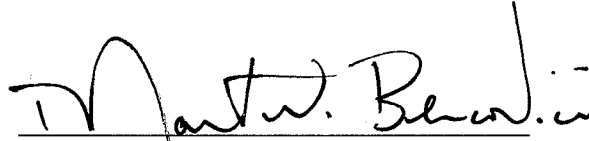
¹³ *Major Issues*, Nelson Testimony at pp. 11-15.

¹⁴ *Major Issues*, Nelson Testimony at pp. 5-8.

AECC appreciates this opportunity to respond to the Board's proposals. With the refinements suggested herein, the Board should proceed with this important effort to simplify and refine the determination of maximum rate reasonableness.

Respectfully submitted,

Arkansas Electric Cooperative Corporation

A handwritten signature in black ink, appearing to read "Martin W. Bercovici", is written over a horizontal line.

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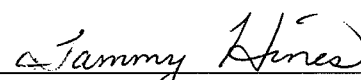
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October 24, 2006

Certificate of Service

I, Tammy Hines, a secretary in the law firm of Keller and Heckman LLP, hereby certify that a copy of the foregoing Comments of Arkansas Electric Cooperative Corporation have been sent, first class mail, postage prepaid, to all Parties of Record on this 24th day of October, 2006.


Tammy Hines