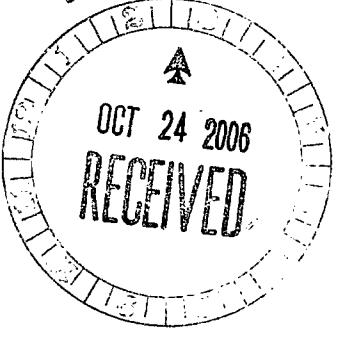


BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 646 (SUB-NO. 1)

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

SUPPLEMENTAL OPENING COMMENTS OF
THE ALLIANCE FOR RAIL COMPETITION
AND PPL ENERGYPLUS, LLC

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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

Terry C. Whiteside, Registered Practitioner
Chairman
The Alliance for Rail Competition
The Capitol Hill Office Building
412 First Street, N.W., Suite 1
Washington, DC 20003
(202) 742-4435

Representing
Alliance for Rail Competition

Dated: October 24, 2006

SUPPLEMENTAL OPENING COMMENTS OF
THE ALLIANCE FOR RAIL COMPETITION
AND PPL ENERGYPLUS, LLC

I. INTRODUCTION

The Alliance for Rail Competition (“ARC”) and PPL EnergyPlus, LLC (“PPL”) are subscribers to and supporters of the Joint Comments being filed by American Chemistry Council, et al. ARC and PPL are also filing these Supplemental Opening Comments to highlight aspects of this matter of particular concern.

The issue presented in this proceeding is of enormous importance, and action has been delayed for far too long by the STB and by the ICC before it. The vast majority of the nation’s captive shippers – those who don’t ship large volumes of coal from one or two origins to one or two destinations – have been waiting since 1980 for a methodology that will implement, for their freight, the command of Congress that rail rates on captive traffic “must be reasonable.” 49 U.S.C. § 10701(d)(1).

Under current conditions, railroads can easily make rate cases an ineffective remedy through the *in terrorem* tactics of monopoly pricing. They can say to captive shippers that if the shipper does not agree to a 35% rate increase, the railroad will publish a 50% rate increase, effectively making the shipper an offer it can’t refuse.

What captive shippers desperately need is recourse to effective regulatory remedies that force market dominant railroads to moderate their rate gouging by insuring that rates on captive traffic are reasonable. The Board’s proposals in this proceeding fall far short of meeting that need.

II. IDENTITY AND INTEREST OF ARC AND PPL

PPL EnergyPlus, LLC is part of the corporate family of PPL Corporation. For more than 30 years, PPL has participated in ICC and STB proceedings, including coal rate cases. All three of PPL's rate cases were litigated under the SAC test, including PPL Montana, LLC v. BNSF, STB Docket No. 42054 (decision served Aug. 20, 2002), aff'd, PPL Montana, LLC v. STB, 437 F.3d 1240 (D.C. Cir. 2006), in which the Board first announced and applied its segment cross-subsidy test.¹ As a result of that decision, PPL has a heightened interest in alternatives to SAC.

Even before the Board's adoption of the segment cross-subsidy test, PPL was interested in remedies for smaller rate disputes and disputes for which SAC is too costly. PPL therefore participated actively in the proceedings leading to the Board's decision in Ex Parte No. 347 (Sub-No. 2), Rate Guidelines – Non-Coal Proceedings, 1 S.T.B. 1004 (1996). Without an effective alternative remedy to SAC, even the largest captive shippers will be powerless in the face of smaller-scale abuses of railroad market power.

No responsible company can justify spending \$4 million to challenge a \$500,000 overcharge. The absence of alternatives to SAC therefore creates a glaring regulatory gap, which railroads can and do exploit through unjustified smaller rate increases, excessively high rates for shorter or lower volume shipments, and excessive ancillary charges.

ARC is an association of shippers (including PPL) that are captive to railroads for significant portions of their freight shipments. ARC members include shippers of agri-

¹ PPL Montana's Corette generating station is relatively small, which is part of the reason the issue traffic was held not to provide enough density for what the Board called the "western" part of PPL's stand-alone railroad. In addition, the Board denied PPL's request on reconsideration to be allowed to reroute traffic to satisfy the new test, which had never before been applied in any rate case.

cultural commodities, coal, chemicals, glass, and other bulk commodities, and consist of Fortune 500 companies, small businesses, shipper associations and groups.

ARC was founded in 1997 by shippers who were concerned that ICC and STB regulation under the Staggers Rail Act and subsequent legislation had fallen short of meeting the needs of captive shippers. ARC's goal continues to be to help such shippers, as well as competitive shippers and the railroads themselves, by pursuing increased rail-to-rail competition as an alternative to regulatory remedies. ARC and its members believe that the railroad industry's limited exposure to competition accounts in large part for the poor service, high rates and lack of responsiveness to customer needs that characterize rail transportation. Greater competition would discourage these characteristics, benefiting the public interest, railroad customers, and railroads.

In ARC's view, increased rail-to-rail competition was called for by Congress in the Staggers Rail Act. However, implementation of the relevant provisions by the ICC and STB has resulted in less competition. ICC and STB decisions approving Class I mergers have limited rail-to-rail competition among major railroads, the Bottleneck Decision has allowed railroads to leverage their monopoly power into market dominance over entire hauls even where competing rail service exists, and regulatory approval of paper barriers has limited the ability of smaller railroads to compete with the Class I railroads. See also Midtec Paper Corp. v. Chicago and N. W. Transp. Co., 3 I.C.C. 2d 171 (1986), in which the competitive remedies offered by (current) Section 11102 of the Act were neutralized.

ARC's main focus has been and continues to be on its legislative efforts. ARC is a leading member of a coalition of shipper groups and shippers supporting the Railroad

Competition Act of 2005, S. 919, and the Railroad Competition Improvement and Reauthorization Act of 2005, H.R. 2047. However, ARC has also followed regulatory developments, and has filed comments on several occasions with the STB.

ARC and its members, like many other shipper groups and shippers, are concerned that captive shippers today have been placed in an untenable position by the combined effects of increasing railroad monopoly and market power, ineffective rail regulation, and little or no ability to invoke the antitrust laws. We know of no other industry with the freedom that major railroads enjoy to pursue their own self-interest without fear of regulatory, legal or competitive challenges. For these reasons, the status quo is unacceptable, even if railroad financial health has improved. Unrestricted railroad monopoly power does not serve the public interest.

In addition to seeking legislative change, ARC therefore calls on the STB to revisit key aspects of current rail regulation. Unfortunately, the Board has repeatedly rejected opportunities to promote rail-to-rail competition.² In the absence of effective competitive remedies, it is axiomatic that captive shippers must have recourse to effective regulatory remedies. Without such recourse, private negotiations are simply occasions for railroads to impose their preferred outcomes, and “private sector solutions” are indistinguishable from the exercise by railroads of self-interested monopoly power.

² In Report GAO-07-94, issued in October 2006, the Government Accountability Office recommended that the Board investigate the impact on shippers of shipper captivity and the lack of competition among railroads. The GAO discussed various options available under the statute for more effective competition, including remedies provided for under Section 11102 of the Act. Unfortunately, the Board’s response was that it prefers to focus on rate and regulatory remedies rather than competitive remedies.

III. THE BOARD'S SMALL RATE CASE PROCEDURES ARE
INCONSISTENT WITH THE GOVERNING STATUTE
AND INSUFFICIENT TO SATISFY THE
PUBLIC INTEREST

As noted above, in 49 U.S.C. § 10701(d)(1), Congress mandated that rail rates on captive traffic “must be reasonable.” To date, the Board’s implementation of this mandate has relied almost exclusively on the Stand-Alone Cost (SAC) test of Coal Rate Guidelines, Nationwide, 1 I.C.C. 2d 520 (1985).

This narrow focus on a single methodology which works, if at all, only for an extremely limited number of large point-to-point shippers, has not been seen by Congress as adequate. In 49 U.S.C. § 10701(d)(3), Congress called on the Board to “establish a simplified and expedited method for determining the reasonableness of challenged rail rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case.”

The legislative history of Section 10701(d)(3) confirms that Congress wanted the Board to establish non-coal rate guidelines. See, e.g., House Report No. 104-311, at p.97, and House Conference Report No. 104-422, at pp. 169-170. See 1995 U.S.C.C.A.N. 793, at 809 and 854-55.

And yet, the Board’s July 28, 2006 Decision in this proceeding makes it clear that the Board’s goal is to implement Section 10701(d)(3) by developing modified guidelines that are as close as possible to its coal rate guidelines, i.e., as close as possible to SAC. Moreover, given the choice between denying regulatory recourse to captive shippers and deviating from SAC, the Board chooses the former every time. This is akin to assigning responsibility for all mass transit in America to NASA. Those with \$4 million may be able to get in the door, but everyone else is left out.

Instead of worrying about how closely its new small rate case standards adhere to SAC principles, the Board should worry about how many captive shippers with no remedy under the coal rate guidelines will have a remedy under the new approach. The answer is not many. The Congressional mandate in Section 10701(d)(1) will therefore remain an empty promise for the vast majority of captive rail shippers.

In testimony before the Senate Commerce Committee on October 23, 2003, former Chairman Roger Nober stated:

If no small rate cases are brought, this means that in practice, only about 75 coal shippers have a meaningful opportunity to challenge rail rates. This is unacceptable.

During the last six years, things have only gotten worse on the SAC front. The cost of SAC cases has increased significantly, and the captive shipper's chances of success have declined, along with the amount of rate relief available to the rare shipper who manages to bring a successful SAC case.

As SAC becomes a less effective means of fulfilling the Congressional mandate that rates on captive traffic must be reasonable, the need for alternative remedies increases in importance. However, by clinging to SAC as its template and by refusing to focus on the availability and effectiveness of the new remedies it proposes, the Board is guaranteeing that conditions Chairman Nober described as "unacceptable" three years ago will persist. In fact, the likelihood that a small rate case will be brought is virtually certain to decline under the Board's proposals in this proceeding, due to a number of new barriers to relief the Board plans to impose.

For example, the Board proposes to subject all but the smallest rate cases to the segment cross-subsidy test adopted in PPL Montana and expanded in Otter Tail.³ As a result, captive shippers not located on high density main lines will have no hope of rate relief. Because most captive shippers are not located on high density main lines, this single feature of the Board's new proposals will render small rate case relief unavailable to most of the captive shippers for whom SAC is prohibitively expensive. (Of course, the segment cross-subsidy test would render SAC relief unavailable even if that test were not unaffordable.)

The Board proposes to make this test an affirmative defense, with the burden of proof borne by railroad defendants in simplified cases. Decision at 13. The Board's intention is presumably to reduce the adverse impact on captive shippers of such a significant expansion of the segment cross-subsidy test, but in practical terms, shippers will be far worse off, for several reasons.

First, railroads are highly skilled at maximizing costs and minimizing revenues in SAC cases, and nothing in the Board's Decision will change this fact. Indeed, the segment cross-subsidy test may reduce railroads' litigation costs substantially, notwithstanding the proposed burden shift. The railroad defendant will merely need to identify the line segment with the lowest density, and concentrate on that segment.

Moreover, the Board has also stated that, in simplified SAC cases, no rerouting of traffic will be allowed. By eliminating the captive shipper's ability to increase density over its least dense line segment through credible reroutes of simplified SAC group traf-

³ Otter Tail Power Co. v. BNSF, STB Docket 42071 (decision served January 27, 2006), appeal pending.

fic, the Board has more than offset whatever slight mitigation might result from its proposed burden shift.

In addition, many captive shippers are the only shippers on at least one line segment – the segment terminating at the captive facility. Such shippers are plainly remediless under the Board’s new proposal unless they ship such enormous volumes as to be able to prove rate unreasonableness without grouping, and shippers who can litigate without grouping will in all likelihood be in a position to file full-scale SAC cases. All other isolated shippers, and there are thousands of them, will have no hope of relief no matter how captive they are.

The Board’s rationale for this result is derived, via SAC, from contestable market theory, which assumes non-monopolistic pricing where competition, though not actually present, is feasible because entry barriers do not exist or have been assumed away. Ironically, the same low densities that make entry unlikely, and therefore heighten the railroad’s market power, make the SAC remedy inapplicable under the segment cross-subsidy test. Thus, those most vulnerable to the abuse of market power lose all regulatory protection against such abuses.

Compounding this problem is the fact that a railroad becomes free to gouge over the entire routing of the issue traffic once it shows there is even a small segment that is not self-sustaining. The Board does not even consider the level of the challenged rate once it decides a SARR segment is not self-sustaining. This anomalous doctrine should not apply even in full SAC cases, where it reduces Chairman Nober’s universe of 75 potentially successful captive shippers to perhaps a dozen. Expanding it to small and non-

coal rate cases simply serves to foreclose relief for most of the small and non-coal shippers this proceeding should be helping.

Under the Board's new proposal, the segment cross-subsidy test would not apply to captive shippers who qualify for the three benchmark approach, as modified from the decision in Rate Guidelines – Non-Coal Proceedings, 1 S.T.B. 1004 (1996). However, the universe of shippers eligible for that approach under the Board's new proposal is so small as to be negligible.

The Board's new proposals therefore offer no improvement over the "unacceptable" status quo for most captive shippers in cases where "a full stand-alone cost presentation is too costly, given the value of the case." The only shippers who might theoretically qualify for relief under the new rule would be those with neither too much traffic, nor too little, all of which moves solely on high density main lines, but such shippers face other new barriers to relief. For example, the Board's "medium case" standards are designed to produce significantly higher maximum rail rates for shippers than the full SAC approach. This differential results from the Board's decision to disallow efficiency improvements that optimize rail service under SAC.

But recent "successful" SAC cases have produced prescribed rates with revenue to variable cost percentages exceeding 250%. If the medium case approach means that the best a smaller shipper can expect is a rate prescription exceeding 350% of variable cost, two things will have come out of this proceeding. First, captive shippers will have been penalized for being unable to afford \$4 million to litigate a SAC case, or for having too little at stake to support SAC litigation. Even major corporations cannot justify spending more on litigation than a case is worth. Second, railroads will understand that

rail rates on such shippers are effectively deregulated so long as they are below 350% of variable cost, and monopoly pricing of such shippers' freight will be lawful up to that limit.

ARC and PPL recognize that this does not mean all railroads will price all small and non-coal captive traffic up to this level. Like any self-interested monopolist, railroads may sometimes charge less than the law would permit, in order to avoid driving shippers out of business or overseas.

However, the Board should not assume railroads will never drive shippers out of business. ARC members who operated or used 26 car or 52 car grain elevators have seen those enterprises disappear as shipping origins because 100 car trains are more efficient for railroads. Similarly, if the same amount of electricity can be generated at fewer power plants, or the same number of cars can be built at fewer factories, there is no economic basis for assuming that railroads will not use their pricing power to encourage or force the shutdown of facilities they see as less efficient from a rail transportation perspective, so long as the same volume of freight moves by rail.⁴

The bottom line is that relying on the self interest of monopoly railroads to keep rates reasonable cannot be reconciled with the statute or with sound policy. The Board seems to see Section 10701(d)(3), calling for simpler and more expedited procedures than SAC for most shippers and cases, as a warrant for redefining the fundamental mandate of Section 10701(d)(1), requiring that rates on captive traffic must be reasonable. The Board has apparently concluded that it may redefine reasonableness so that most captive

⁴ If railroads are allowed to ration capacity on purely economic grounds, with no effective regulation of the rate levels used to "demarket" less desirable freight, the common carrier obligation is likely to become meaningless, with severe adverse consequences for disfavored commodities and regions.

shippers are second-class citizens, and their traffic is fair game for higher rates. However, there is no support in the statute or legislative history for such a conclusion.

Exacerbating this problem is the fact that the Board underestimates the costs of litigating small and non-coal rate cases, and overestimates the likely rate relief. This leads to an approach under which captive shippers are expected to pay hundreds of thousands of dollars to litigate rate cases which are unlikely to deliver benefits that do more, at best, than recover the cost of litigation. Even a shipper who is assured of “success” will not file such a rate case, and captive shippers under the Board’s proposals will be far from assured of success. Because the likelihood of a shipper rate case will be negligible, captive shippers will continue to have no leverage in contract negotiations.

ARC and PPL have considered what rationales might exist for the Board’s proposals. None of the reasons we have come up with is sustainable.

The Board’s new approach is not required by the statute. As noted, Congress did not mandate two alternative methodologies where SAC is prohibitively expensive. Nor did Congress instruct or permit the Board to adopt alternatives to SAC that guarantee inferior rate relief.

The Board has cited the need for railroads to achieve revenue adequacy. But enormous progress has been made on that front thanks to the “green light” the railroads perceive the Board sending for massive rate increases on all kinds of traffic, based on recent Board decisions in SAC cases. Norfolk Southern has been found revenue adequate in 2004 and 2005 even under the Board’s standards for revenue adequacy, which are indefensibly skewed in the railroads’ favor.

Nor should the Board conclude that it must restrict non-SAC access to rate relief in order to prevent a deluge of small rate cases. There has only been one such case filed in the decade since the Board adopted a version of its three benchmark test in Rate Guidelines – Non-Coal Proceedings, and that case was settled in a few weeks. This number – one small rate case per decade – could rise dramatically and still fall well short of a deluge.

In any event, most rail shippers have lost faith in the STB, and regard its policies and procedures as hopelessly pro-railroad. Even where captive shippers retain some faith in regulatory remedies (there being no other remedies, by definition, where shippers are captive), rate cases are always a last resort. Shippers routinely agree to rates they regard as in excess of reasonable levels in order to avoid the burdens, risks and costs of rate litigation. This preference for negotiation over litigation will not change if the Board approves reasonable standards for small rate cases, as called for in the Joint Comments of American Chemistry Council, et al.

IV. CONCLUSION

It is not clear why the Board is so reluctant to make recourse to effective rate regulation a reality for more captive rail shippers. However, that reluctance pervades the Board's Decision in this proceeding. Captive shippers foreclosed from relief under SAC by the segment cross-subsidy test will also be foreclosed from relief in medium cases. Most of those not eliminated by the segment cross-subsidy test will be forced to choose between filing SAC cases they can't afford or filing simplified cases that will rarely return enough to cover litigation costs. And, of course, if there are any shippers left and any file rate cases under the Board's new procedures, they will be fought every inch of

the way by the railroads, which have every incentive to make all rate litigation as costly as possible. Accordingly, ARC and PPL call on the STB to drop its proposed medium case remedy in favor of an improved version of its three benchmark approach, to revise its eligibility standards, and to make the other changes called for in the Joint Comments to which ARC and PPL have subscribed.

Respectfully submitted,



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

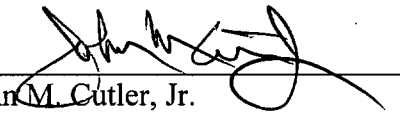
Attorney for
PPL EnergyPlus, LLC

Terry C. Whiteside, Registered Practitioner
Chairman
The Alliance for Rail Competition
The Capitol Hill Office Building
412 First Street, NW, Suite 1
Washington, DC 20003
(202) 742-4435

Representing
Alliance for Rail Competition

CERTIFICATE OF SERVICE

I hereby certify that I have, this 24th day of October, 2006, served copies of the foregoing document by first-class mail on all parties of record.



John M. Cutler, Jr.