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BEFORE THE  
SURFACE TRANSPORTATION BOARD

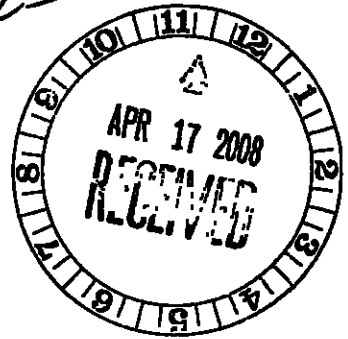
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EX PARTE NO. 677

COMMON CARRIER OBLIGATION OF RAILROADS

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WRITTEN SUBMISSION OF ARKANSAS ELECTRIC COOPERATIVE  
CORPORATION



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**Introduction and Summary**

Pursuant to the Board's notice dated February 22, 2008, this document presents the comments of Arkansas Electric Cooperative Corporation (AECC) regarding the common carrier obligation of railroads. At the public hearing scheduled for April 24-25, 2008, AECC's views will be presented by Steve Sharp. Mr. Sharp is the Principal Engineer – Fuels & Civil for AECC.

As the Board's notice states, railroads have a statutory duty under 49 U.S.C. 11101(a) to provide "transportation or service on reasonable request", even where providing such service "would be inconvenient or unprofitable". AECC understands that this obligation is not absolute, and may be limited by considerations addressed in past Board and court decisions. Nevertheless, AECC's experiences in recent years suggest that railroads have repeatedly failed to satisfy even a "loose" definition of the common carrier obligation.

In a highly regulated industry, service problems might call for increased agency oversight, inspections, investigations, fines, orders, etc. On the other hand, in a truly competitive industry, market discipline can usually be counted on to ensure that customers are provided with reasonable price/service options.

The railroad industry today is neither highly regulated nor truly competitive. As a result, to the extent that railroads are not currently meeting their common carrier obligation, the remedies will require either increased regulatory requirements, increased competitive pressure, or both.

This document presents specific examples drawn from AECC's recent experiences that highlight ways in which the common carrier obligation has not been or is not being met. It then proposes remedial actions to address such problems.

### **Description Of AECC**

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 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.

Because of the large volume of coal used by these plants, and the need for long-distance rail transportation to transport this coal, AECC has a direct interest in issues that affect rail price/service options. This interest has been heightened by AECC's

repeated experiences with rail delivery shortfalls and the resulting imposition of costly burn restrictions at our plants. 1/

**When Railroads Fail To Fulfill Their Common Carrier Obligations, It Is Typically Due To Their Own Decisions, But Industry Concentration Causes The Burden Of Their Failings To Fall On Customers**

The well-publicized infrastructure failure and throughput restrictions on the PRB Joint Line that began in May 2005 produced major operational and economic disruptions for AECC and numerous other coal users. BNSF and UP both asserted that the cause of the Joint Line problems was the “unusual” and “unprecedented” amounts of snow and rainfall acting upon accumulated coal dust. However, National Oceanic and Atmospheric Administration (NOAA) data for this portion of Wyoming establish that rainfall was at normal levels and thus completely refute the proposition that atypical weather played any role at all in this situation.

For example, the historical average amount of moisture in May (expressed in inches of water) is 2.50 inches for Douglas, WY (near the south end of the Joint Line) and 2.95 inches for Gillette (near the north end). In May 2005, Douglas received 2.55 inches, just 0.05 inches above average, and Gillette received 2.89 inches, or 0.06 inches below average. Both locations received less than average precipitation in April 2005. For the entire precipitation cycle beginning October 1, 2004, there appears to be no part of the Joint Line that received abnormally high precipitation.

Given that the weather was neither “unusual” nor “unprecedented”, the problem resulted from the failure of the railroads to maintain the ballast of the Joint Line

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1/ A description of these experiences was presented in AECC’s written submission dated July 5, 2007 in STB Ex Parte No. 672, Rail Transportation of Resources Critical to the Nation’s Energy Supply.

in stable condition. The accumulation of coal dust in the ballast was not a hidden condition, at least not from those responsible for operating and maintaining the line. Rather, the evidence indicates that the railroads chose to simply let the dust accumulate rather than take the steps needed to properly maintain the roadbed.

Part of the railroads' obligation to provide common carrier service on reasonable request is an obligation to maintain infrastructure in a condition that permits such service to be provided. It was well known to rail management that fouled ballast can prevent proper drainage of even normal precipitation, and can seriously destabilize track geometry (as happened in the Joint Line derailments). It was also plainly visible that the PRB Joint Line was potentially susceptible to at least three well-known sources of fouled ballast, including (a) deterioration of ballast particles due to high volumes of heavy-haul traffic; (b) wind-borne dust and sand from arid surrounding terrain; as well as (c) coal dust. <sup>2/</sup>

The western railroads were apparently willing to risk the reliability of the Joint Line in the hope that the drought of preceding years in eastern Wyoming would continue. As long as precipitation remained minimal or non-existent, the stability of the roadbed would not be undermined by the fouled ballast, and the railroads' short-term financial results would be inflated by the "savings" associated with not performing normal maintenance on the line.

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<sup>2/</sup> See, for example, Selig, Ernest T. and Darrell D. Cantrell, Track Substructure Maintenance – From Theory to Practice, prepared for AREMA Annual Conference (September 2001), as presented at [http://www.arcma.org/eseries/scriptcontent/custom/e\\_arema/library/2001\\_Conference\\_Proceedings/00055.pdf](http://www.arcma.org/eseries/scriptcontent/custom/e_arema/library/2001_Conference_Proceedings/00055.pdf).

This turned out to be a bad wager on the part of the western railroads that prevented them from fulfilling their common carrier obligation on a grand and unprecedented scale. However, in this highly-concentrated market, it was shippers who had to cover the railroads' poor bet.

AECC experienced (and expects to continue experiencing) substantial adverse consequences as a result of the embargo imposed by UP on July 18, 2005 in the aftermath of the Joint Line disruptions. This embargo left BNSF as a de facto monopolist for new PRB business, even to points for which UP could otherwise compete. As a result, price levels on new PRB movements increased dramatically.

UP did not lift its embargo until March 27, 2007. Because competition took a sabbatical for the better part of two years, PRB coal shippers now face a great deal of uncertainty regarding the proper level of competitive rates. With the large volumes that have moved at higher rates since 2005, individual shippers cannot reliably know what pricing is now appropriate for competitive movements. In a sense, the lengthy UP embargo has given the PRB carriers a "do-over" on the situation that existed in 1984 when competition was first introduced on PRB movements. At that time, even with aggressive competition from CNW/UP, it took several years for rates to migrate from the level established in the period of BN monopoly to a stable competitive level. <sup>3/</sup>

It is unclear why the UP embargo lasted so long. UP's declaration of force majeure was lifted in November 2005, indicating that its ability to move committed tonnage had been restored. While UP undoubtedly faced a significant deficit of delivered

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<sup>3/</sup> See, for example, See CRS (Congressional Research Service) Report for Congress, Rail Transportation of Coal to Power Plants: Reliability Issues (September 26, 2007) Order Code RL34186 at page 55, Figure 19.

tonnage, it was able to move 36.2 trains/day out of the PRB as early as January 2006, and averaged 35.2 trains/day for the entire year of 2006. As of the time the embargo was released, UP had been moving lesser volumes for the entire first quarter of 2007 (34.2 trains per day). Moreover, for at least 5 months after the embargo was lifted UP continued to move lower volumes in comparison to the capability it had demonstrated in 2006. Notwithstanding the fact that BNSF was able to rely on the redundancy of its network to restore full service after a comparatively brief period of interruption, the evidence suggests that UP may have returned to a competitive posture more slowly than its resources would have permitted.

**Railroads Possess Economies of Scale, and Cannot Legitimately Blame their Failure to Provide Service on the Volumes and Density They Historically Have Pursued**

In many venues, including the recent Board proceeding in Ex Parte 664, Methodology To Be Employed In Determining The Railroad Industry's Cost Of Capital, the railroads have advanced and cultivated the proposition that volume increases have used up or are using up excess capacity. According to the railroads, shippers and the Board should assume that capacity will be tight, and that degradations of rail price/service options are basically inevitable.

In support of this proposition, the railroads have frequently cited a study conducted by Cambridge Systematics (hereafter, "CS Study"). A detailed response to the CS Study has already been provided to the Board by AECC. 4/

As described in AECC's response, the CS Study not only does not support the railroads' argument, it actually refutes it. The CS Study highlights the way an

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4/ STB Ex Parte No. 664, Reply Comments of Arkansas Electric Cooperative Corporation (October 29, 2007), at pages 4-6, attached for convenience as Appendix A.

expanded traffic base would support increased infrastructure investment at current rates, and the way ongoing and future productivity improvements will increase the throughput capacity of the existing network without major investment. The railroad argument is further nullified by the railroads' long history of investment to expand the capacity of the PRB Joint Line in advance of volume increases.

At a more fundamental level, the railroad argument is completely inconsistent with the well-recognized fact that railroads possess economies of scale (i.e., average costs decline as volume increases). Contrary to the railroad posturing, railroads benefit from, and are well-suited to handle, volume increases

Of course, unexpected volume fluctuations or other transitory factors may affect the performance of the rail system in the short term. However, in the longer term, there is no reason to expect volume increases to cause degradations of service or increases in price. To the extent such developments occur, they are more likely to reflect a textbook increase in the exercise of rail market power than any consideration related to volume.

**Railroads Try To Conceal Their Exercise Of Market Power By Claiming That "Congestion" Causes Service Disruptions**

AECC has had specific experience with the way the exercise of rail market power can be camouflaged by assertions of "congestion" in the current rail marketplace. In response to the disruption of service on the PRB Joint Line in 2005, the co-owners of one of our generating plants attempted to arrange for the movement of imported coal to substitute for undelivered PRB coal and forestall the imposition of costly burn restrictions. Because of extensive damage to U.S. Gulf port facilities caused by the hurricanes of 2005, one of very few feasible transportation options for the imported coal

would have required participation by two Class I railroads. Despite its own involvement in the shortfall of PRB coal deliveries to the plant, one of the two railroads declined for an extended period of time to make arrangements for transporting this substitute coal to the plant. The only reason offered by the railroad for this lack of cooperation was “congestion”. This “congestion” had not previously been identified as a problem by the carrier, but materialized just in time to prevent the carrier from taking a comparatively short haul on the interline movement, while maintaining the dependency of the plant on coal sources that provide the railroad with a longer haul. In this case, the railroad relied on unsubstantiated assertions regarding congestion to duck its common carrier obligation and exercise its market power.

Similar examples may also be found in railroad practices regarding embargoes. As shown in records maintained by the AAR, <sup>5/</sup> there are major differences among the railroads in the use of embargoes. For example, as of April 10, 2008, NS and CSX had a combined total of 8 embargoes in effect. In comparison, UP and BNSF had a combined total of 34 embargoes in effect.

It is possible that differences between the eastern and western operating environments somehow contribute to the greater use of embargoes in the west. To investigate this, it is useful to compare the embargo practices of UP and BNSF. UP imposed 23 of the 34 embargoes in effect in the west. Of these, 9 (representing almost 40 percent of UP’s total) were imposed on the basis of “congestion”, including four that

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<sup>5/</sup> <https://aarembargo.railinc.com/epdb/searchEmbargoAction.do?step=searchEmbargo>.

have been in effect for between 2 months and close to a year. In comparison, BNSF only imposed 3 of its 11 active embargoes on the basis of “congestion” and none of these has been in effect for more than 3 weeks. Among the four largest Class I railroads, at least UP appears to impose embargoes on the basis of “congestion” without necessarily placing a high priority on restoration of adequate service. If an embargo premised on congestion is not resolved with reasonable urgency, it reflects either an insufficient effort to provide adequate service, or the use of the embargo to exercise market power, or perhaps both.

Of course, an embargo may be premised on any number of circumstances other than congestion. The issue in the context of the common carrier obligation is the options that the Board will provide for shippers who are unable to obtain rail service at reasonable rates on reasonable notice. In situations like the “PYCO” case, <sup>6/</sup> the Board has shown that the feeder line development process may provide a viable remedy for unsatisfactory conduct by a serving carrier.

**Service Disruptions Impose Additional Burdens On Shippers That Provide Their Own Railcars**

In the experience of most PRB coal shippers, investment in a fleet of private railcars is a necessary (but by itself not sufficient) step towards ensuring an adequate quality of rail service. Even after making a major investment of this type, many shippers have, over time, experienced progressively poorer cycle time performance and commitments, necessitating additional investments in private railcars to move a given tonnage. Moreover, when rail delivery problems arise, shipper-owned trainsets may

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<sup>6/</sup> PYCO Industries, Inc.—Feeder Line Application—Lines Of South Plains Switching, Ltd. Co., STB Finance Docket No. 34890, served Aug. 31, 2007.

simply be parked while the shippers watch their coal inventories dwindle. This has happened to the car fleets serving AECC's plants on at least three occasions.

Having virtually no ability to serve these shippers with rail-owned equipment, the railroads nonetheless are able to exercise effective control over actions the shippers might otherwise wish to take to use their own cars to mitigate delivery shortfalls. This is inequitable because shippers have been induced to supply railcars and other capital equipment on the premise that such investments would enable their transportation needs to be met, a premise that railroads seem to be comfortable in disregarding. This is also inefficient, since assets that hypothetically could be used to mitigate service problems are left sitting idle at the whim of the railroads.

**Private Railcar Owners are Also Being Burdened by Arbitrary Carrier-Imposed Requirements**

In responding to the coal dust issue on the PRB Joint Line, BNSF has properly - if belatedly - undertaken a maintenance program to restore the physical integrity of the Joint Line. However, it has also announced plans that will effectively require PRB coal shippers to either install covers on railcars or treat loaded cars with dust suppressant.

Such a requirement would represent a radical departure from industry protocols. The practice is well established for railroads to haul coal in open cars, without requiring either covers or dust treatment. Furthermore, this change would be economically unsound because roadbed maintenance and ballast cleaning would periodically be needed on the Joint Line even if coal dust were eliminated entirely. BNSF has not demonstrated that the high incremental cost for shippers associated with its requirements would be justified by cost savings in comparison with alternative mitigation

measures. In addition, above and beyond its discriminatory nature (in possible violation of 49 USC 10741), BNSF's approach suggests that BNSF intends to return to its pre-2005 practice of minimizing maintenance activity on the Joint Line. While the experience of having muted UP's competitiveness for an extended period of time may make this an appealing strategy for BNSF, its threat to the public interest is blatant.

### **Railroads' Market Power Is A Major Cause Of Their Failure To Meet Their Common Carrier Obligation**

Artificial restrictions on a shipper's ability to obtain service are textbook examples of the exercise of market power, and result from insufficient competition. To some extent, the exercise of such market power is made possible by authority that the Board (or ICC) has previously granted. For example, as discussed at length in several proceedings before the Board, paper barriers incorporated in UP's spin-off of the Missouri & Northern Arkansas Railroad (MNA) have inhibited or prevented MNA from satisfying requests for service involving AECC's Independence powerplant at Newark, AR, even during the multiple episodes when UP has been unable to fulfill its contractual or common carrier obligations. Similarly, the Board's bottleneck rule has effectively prevented this plant from making use of the efficient BNSF route via Hoxie, AR, even during UP's multiple service collapses.

### **Recommendations**

The examples presented above show many different ways in which shippers have been denied the service to which they are entitled under the common carrier obligation of railroads. While different from each other, the examples exhibit a common theme – in each case the rail carrier does not experience sufficient competitive pressure to ensure that it supplies the adequate service at reasonable rates that is

characteristic of a competitive marketplace. In the big picture, the Board should therefore be viewing these failures by the railroads to satisfy their common carrier obligations as being indicative of a need for greater competitive pressure.

Specific recommendations include the following:

1. The Board should reject railroads' attempt to blame higher rates and poorer service on increasing traffic volume – rather, it should demand that the railroads provide sufficient investment and maintenance to handle their increasing business while meeting their common carrier obligation.
2. The Board should recognize that as railroads achieve revenue adequacy, any theoretical justification for letting them exercise high levels of market power (e.g., by limiting service, capacity, or investment) is reduced or eliminated. There is no public interest rationale for railroads to achieve earnings above the level of revenue adequacy at the expense of their customers. As revenue adequacy is achieved, the Board should throw its full weight into ensuring that shippers, upon reasonable notice, are able to obtain adequate service at reasonable rates.
3. The Board should consider expanding the abilities of shippers to make use of the private cars they supply, and to protect such shippers from unreasonable deterioration in the service levels provided by railroads. To the extent that such deterioration necessitates expansions of private fleets after the time of a shipper's initial commitment to supply railcars, it reflects a type of "bait and switch" in which the shipper bears all of the

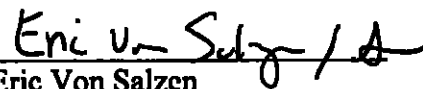
**fleet cost consequences associated with a railroad's decision to provide diminished service.**

- 4. The Board should require railroads to accept shipments tendered in accordance with industry protocols. Imposing new and costly burdens on rail customers, particularly those who have made the investment to provide their own cars, should not be tolerated. If the railroads believe an issue like coal dust imposes specific costs, they are free to establish reasonable rate incentives and/or enter transportation contracts that address the issue**
- 5. The Board should establish an expedited procedure for shippers to obtain service over multi-line routings that are more efficient than existing single-line service. At least for unit train shippers, there should be a rebuttable presumption that shorter routes are more efficient than longer routes. For captive shippers, such a demonstration should be deemed a sufficient basis for competitive access relief.**
- 6. The Board should establish meaningful accountability when railroads fail to perform due to management decisions. This could include making it easier for a shipper to obtain substitute service, especially when a carrier hasn't followed applicable maintenance guidelines or hasn't taken reasonable steps to ensure adequate capacity (e.g., contrary to the Board's mandate under 49 USC 10101(9) "to encourage honest and efficient management of railroads").**

7. The Board should devote careful attention to the legitimacy and duration of embargoes imposed on account of alleged "congestion".
8. The Board should reconsider paper barriers and the bottleneck rule in the context of the market power they convey to railroads, and the inhibitions they place on a shipper's ability to receive reasonable service under the common carrier obligation.
9. In the event of chronic or repeated problems, the Board should not hesitate to facilitate and encourage means to bring market forces to bear, such as through the feeder line development program.

Respectfully submitted,

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## APPENDIX A

Excerpt from STB Ex Parte No. 664, Reply Comments of Arkansas Electric Cooperative Corporation (October 29, 2007)

run-up of its stock price; and, (b) as of this date all 17 analysts reported by Thomson/First Call still rate UP as Hold, Buy or Strong Buy, with more now saying “buy” than did before the Board’s announcement.<sup>3</sup>

If the Board really looks at the market’s reaction to its announcement, it might reasonably conclude that Mr. Knight’s statement was ghost-written by Chicken Little. The sky will not fall on the railroads just because they are held to a cost of capital standard that is reasonably rigorous, defensible and accurate instead of ineffectual and unduly permissive. Indeed, the facts presented in Mr. Knight’s statement demonstrate how UP has been able to fund growing maintenance and expansion capital needs, as well as provide returns to its shareholders that have enabled its stock price to literally double since early 2005. Even with the Board’s proposed action, the rail industry will have every opportunity it needs to enjoy reasonable financial health.

#### IV. CS STUDY

The rail parties make numerous references to the CS Study to conjure up the image of huge capital needs associated with substantial projected volume increases. The figure of \$148 billion is repeated so often that one is tempted to accept the proposition that the rail network is facing a substantial capital deficit, and that shippers and the Board better get used to the idea of higher rates. After all, even though one might quibble with a few assumptions, the work of a reputable firm like Cambridge Systematics couldn’t be used to defend a position that’s too far removed from reality, right?

Wrong.

Even a cursory reading of the CS Study reveals the ways that the rail parties have misrepresented its results. For starters, the \$148 billion includes \$13 billion for smaller railroads – the amount applicable to the Class I’s is \$135 billion. While this number is still large, the rail

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<sup>3</sup> See <http://finance.yahoo.com/q/aq?s=LNP>

parties never mention the CS Study's conclusion that "(t)he Class I freight railroads anticipate that they will be able to meet most of this increase in investment through growth and productivity gains."<sup>4</sup> The CS Study specifically highlights the fact that even at current rates, new traffic would make a contribution to cover the costs of the facilities it uses (as does current traffic) and estimates that more than half (\$70 billion of the \$135 billion for the Class I's) likely would be funded in this manner.

Likewise, the \$135 billion figure omits any consideration of the effect of productivity improvements on capacity requirements.<sup>5</sup> It completely ignores ongoing initiatives, such as field testing of ECP brakes and increasing train lengths, as well as time-tested approaches like voluntary paired-track agreements, that could materially improve network capacity without the types of investments contemplated in the CS Study.<sup>6</sup>

The railroads must think the Board has a short memory, because it was only 6 months ago that the railroads described to the Board the essential role of productivity improvements in the provision of capacity increases. At the public hearing in Ex Parte 671, Rail Capacity and Infrastructure Requirements, conducted in April 2007, the Class I railroads described to the Board how an option like Positive Train Control ("PTC") may provide substantial increases in the effective capacity of the existing network for a small fraction of the investment cost figures the railroads now are waving around. It might be useful for the railroads to show the CS Study to the financial community to justify investment in PTC as a cost-effective way for the railroads

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<sup>4</sup> CS Study at pp. 8-2

<sup>5</sup> Ironically, the \$148 billion figure cited so prominently by the rail parties includes the cost of providing shortlines with the capability to efficiently move 286,000 lb GWR cars, but reflects none of the productivity improvements for the Class I's that would flow directly from such an investment.

<sup>6</sup> The CS Study does present a "preliminary estimate" that productivity improvements at the rate of 0.5 percent per year could offset \$26 billion of the contemplated investment requirements. However, this rate of productivity increase, which was supplied by the railroads, appears low in comparison with historical experience and expected future improvements, and is not mentioned by the rail parties in their arguments to the Board.

to increase capacity. It is not useful for the railroads to bluff the Board with scare stories based on information that omits consideration of known viable options.

There are several additional aspects of the CS Study methodology that should cause the railroads to refrain from the types of uses they have made of the \$148 billion figure. For example, for line segments with Centralized Traffic Control the only option for increasing capacity examined in the CS Study is the addition of tracks at a cost of \$3.8-4.4 million per mile. However, the railroads are well aware that many of the segments they now operate formerly contained more than the current number of tracks, and that restoration of additional tracks in such circumstances typically costs much less than assumed in the CS Study. Likewise, the railroads surely are aware of opportunities to change classification and blocking plans to permit more direct and efficient handling as volume increases.

Overall, the CS Study documents the results of an academic exercise in which current operations are simply "scaled up" to reflect projected future volumes. Indeed, the CS Study explicitly assumes ". . . that the future demand for rail freight transportation will be met by using current technology and existing rail corridors."<sup>7</sup> It does not purport to address the ways the network can be expected to evolve to efficiently handle volume increases, and certainly does not support the railroad proposition that capital needs should lead the Board to refrain from actions that ensure the validity of its procedures and the proper discharge of its statutory authority.

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<sup>7</sup> CS Study at pp 7-4