

SLOVER & LOFTUS

ATTORNEYS AT LAW

**1224 SEVENTEENTH STREET, N. W.
WASHINGTON, D. C. 20036-3003**

**WILLIAM L. SLOVER
C. MICHAEL LOFTUS
JOHN H. LE SEUR
KELVIN J. DOWD
ROBERT D. ROSENBERG
CHRISTOPHER A. MILLS
FRANK J. PERGOLIZZI
ANDREW B. KOLESAR III
PETER A. PFOHL
DANIEL M. JAFFE
STEPHANIE M. PISANELLI

OF COUNSEL
DONALD G. AVERY**

219009

**TELEPHONE:
(202) 347-7170**

**FAX:
(202) 347-3619**

**WRITER'S E-MAIL:
cml@sloverandloftus.com**

April 4, 2007

BY HAND DELIVERY

**The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
Attn: STB Ex Parte No. 671
395 E Street, S.W.
Washington, DC 20423-0001**

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Re: Ex Parte No. 671, Rail Capacity and Infrastructure Requirements

Dear Secretary Williams:

Enclosed for filing in the referenced docket please find an original and ten copies of the Comments of the Concerned Captive Coal Shippers. We have enclosed copies of these Comments on three computer-readable disks in a Microsoft Word format.

Finally, we have enclosed an additional copy of these Comments to be date-stamped and returned to the bearer of this letter. Thank you for your attention to this matter.

Sincerely,

C. Michael Loftus

**C. Michael Loftus
An Attorney for the Concerned Captive
Coal Shippers**

Enclosures

219009

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

RAIL CAPACITY AND
INFRASTRUCTURE REQUIREMENTS

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**COMMENTS OF
THE CONCERNED CAPTIVE COAL SHIPPERS**

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Concerned Captive Coal Shippers

Of Counsel:

**Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, D.C. 20036**

Dated: April 4, 2007

**By: C. Michael Loftus
Andrew B. Kolesar III
Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, D.C. 20036
(202) 347-7170**

Attorneys & Practitioners

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

**RAIL CAPACITY AND
INFRASTRUCTURE REQUIREMENTS**

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Ex Parte No. 671

**COMMENTS OF
THE CONCERNED CAPTIVE COAL SHIPPERS**

The Concerned Captive Coal Shippers (“Concerned Coal Shippers”) hereby provide these Comments in response to the Board’s Notice of Public Hearing served March 6, 2007 (“Notice”), in which the Board expresses concerns regarding present and future rail capacity constraints and regarding possible sources of funding for railroad capacity expansion. The Concerned Coal Shippers appreciate the attention that the Board has directed to this issue through the instant proceeding and respectfully submit that questions regarding rail capacity and infrastructure are important subjects for this agency’s consideration.

Coal shippers have borne the brunt of extreme railroad rate increases during recent years. All available evidence indicates the major railroads are, under any reasonable measure, revenue adequate and are able to fund needed capacity to comply with their contractual and common carrier service responsibilities. As the agency charged with overseeing the national transportation policy and regulating the nation’s railroads, it is certainly appropriate for the Board to examine the sufficiency of the railroads’ investment in rail infrastructure in light of their obligations as common and

contract carriers. It is also appropriate for the Board to examine the extent to which the railroads may be intentionally maintaining tight capacity to advance their concerted campaign to elevate rates, especially for the transportation of coal and other rail-dependent commodities. This examination should extend to such concerns as those expressed in the Board's Notice of Proposed Rulemaking in Ex Parte No. 669, Interpretation of the Term "Contract" in 49 U.S.C. 10709 (STB served March 29, 2007), at 4, that "the increased use[] of . . . hybrid pricing mechanisms could create an environment where collusive activities in the form of anticompetitive price signaling could occur." For coal shippers, who are paying very large and constantly growing profit margins to the major railroads, it is also appropriate to consider the extent to which they are being forced to pay ever higher rates, supposedly to enable the railroads to fund infrastructure, where the infrastructure involved not only will not help, but in some cases may actually harm the interests of coal shippers.

IDENTITY AND INTEREST

A. The Concerned Coal Shippers

The Concerned Coal Shippers include the following six entities: (1) American Electric Power Service Corporation; (2) Duke Energy Corporation; (3) Intermountain Power Project; (4) Progress Energy, Inc.; (5) Seminole Electric Cooperative, Inc.; and (6) South Carolina Public Service Authority (Santee Cooper). Each entity consumes large volumes of coal to generate electricity and relies upon rail carriers to transport that coal. Each, by virtue of its circumstances, has a strong interest in the subject matter of this proceeding.

(1) American Electric Power Service Corporation. AEP Service Corporation acts as agent for its American Electric Power (“AEP”) electric generating affiliates in securing coal transportation services by rail for more than 44 million tons of coal annually. AEP, with more than 5 million American customers, is one of the country’s largest investor-owned utilities, serving parts of 11 states. The service territory covers 197,500 square miles in Arkansas, Indiana, Kentucky, Louisiana, Michigan, Ohio, Oklahoma, Tennessee, Texas, Virginia and West Virginia. AEP owns and operates about 80 generating stations in the United States, with a capacity of more than 36,000 megawatts. Coal fired plants account for 73 percent of AEP’s generating capacity.

(2) Duke Energy Corporation. Duke Energy is a diversified energy company with a portfolio of natural gas and electric businesses, both regulated and non regulated, and an affiliated real estate company. Duke Energy supplies, delivers and processes energy for customers in North America and selected international markets. Duke Energy owns two regulated electric companies which use rail transportation: Duke Power Company LLC (“Duke Power”) and PSI Energy, Inc. (“PSI”). Duke Power operates eight coal-fired electric generating stations, including one station (Marshall 2,090 MW) that is served by both Norfolk Southern Railway Corporation (“NS”) and CSX Transportation, Inc. (“CSXT”), four stations that are served solely by NS (Allen - 1,140 MW, Belews Creek- 2,240 MW, Buck - 369 MW, and Dan River - 276 MW), and three stations that are served solely by CSXT (Cliffside - 760 MW, Lee - 370 MW, and Riverbend - 454 MW). PSI operates three coal-fired electric generating stations which use rail transportation, including one served by NS (Gibson - 3,340 MW), one served by

CSXT (Cayuga - 1,062 MW), and one served by Canadian Pacific Railway (Wabash River - 860 MW). These eleven stations are capable of generating a total of 12,961 megawatts of energy.

(3) Intermountain Power Project. Intermountain Power Agency (“IPA”), a political subdivision of the State of Utah, is the owner of the Intermountain Power Project (“IPP”). IPP is located in the great basin of western Utah near Lynndyl, Millard County, Utah. The project generates more than 13 million megawatt hours of energy each year from its two coal-fired units and serves approximately 2 million customers. The units have a total capacity of 1,900 MW Gross and consume over 6 million tons of coal per year.

IPP’s generation rights are held, respectively, by the Los Angeles Department of Water and Power (44.6%), five California cities (30%), twenty-three municipal Utah purchasers (14%), six cooperative Utah purchasers (7%), and one investor-owned Utah purchaser (4%).

Rail service to IPP’s generating station is provided solely by the Union Pacific Railroad Company.

(4) Progress Energy, Inc. Progress Energy, headquartered in Raleigh, N.C., is a Fortune 250 diversified energy company with more than 24,000 megawatts of generation capacity and \$9 billion in annual revenues. The company’s holdings include two electric utilities serving approximately 2.9 million customers in North Carolina, South Carolina and Florida.

Progress Energy's coal-fired plants include: (i) the two unit, 392 MW Asheville Steam Plant at Skyland, N.C.; (ii) the two-unit, 316 MW Cape Fear Plant near Moncure, N.C.; (iii) the four unit Crystal River steam complex, located near Crystal River, Fla., which includes two units built in the 1960s (Crystal River South, totaling 865 MW) and two units built in the 1980s (Crystal River North, totaling 1,437 MW); (iv) the three unit, 407 MW H.F. Lee Plant near Goldsboro, N.C.; (v) the single unit, 745 MW Mayo Plant near Roxboro, N.C.; (vi) the single unit, 174 MW H.B. Robinson Steam Plant near Hartsville, S.C.; (vii) the four unit, 2,462 MW Roxboro Steam Plant near Roxboro, N.C.; (viii) the three unit, 613 MW L.V. Sutton Steam Plant near Wilmington, N.C.; and (ix) the three unit, 176 MW W.H. Weatherspoon Steam Plant near Lumberton, N.C. All of Progress Energy's coal-fired plants are served by rail. Three are served solely by NS, four solely by CSXT, and two jointly by NS and CSXT.

(5) Seminole Electric Cooperative, Inc. Headquartered in Tampa, Florida, Seminole Electric Cooperative, Inc. is the second largest G&T electric cooperative in the United States, based on 2006 revenues. As a G&T, Seminole generates, sells and transmits bulk supplies of wholesale electricity primarily to its ten distribution member system cooperatives. The Members, in turn, provide retail electric distribution services to residential and commercial consumers. Seminole and the Members serve more than 880,000 metered residential and business consumers in 46 of Florida's 67 counties. In 2006, Seminole generated annual revenue of \$1.2 billion. In 2006, more than 98% of Seminole's total operating revenues were generated from sales to its Members and approximately 70% of its Members' total retail sales were to

residential consumers. In 2006, Seminole sold 17 billion kilowatt hours (“kWh”) of energy, of which energy sales to its Members totaled 16.8 billion kWh. or approximately 99% of its total energy sales. Seminole’s aggregate coincident peak demand for the summer of 2006 and the winter of 2005 and 2006 were 3,518 MW and 4,098 MW, respectively.

The primary energy resource serving Seminole’s member systems is the Seminole Generating Station. This 1,300 megawatt, coal-fueled power station is located in Northeast Florida in Putnam County, on the St. Johns River, south of Jacksonville. It consumes approximately four million tons of coal and/or petroleum coke per year. The Seminole Station is served exclusively by CSXT. CSXT currently provides service to Seminole pursuant to a rail transportation contract.

(6) South Carolina Public Service Authority (Santee Cooper). Santee Cooper serves over 143,000 retail customers in Berkeley, Georgetown, and Horry Counties, South Carolina, and supplies power to the municipalities of Bamberg and Georgetown, 32 large industries, and one military installation in North Charleston. The state-owned electric and water utility generates the power distributed by the state’s 20 electric cooperatives. Santee Cooper power now flows in all 46 counties in the state serving over 625,000 customers.

Santee Cooper owns and operates four large-scale, coal-fired generating stations in South Carolina: Jefferies Station in Moncks Corner, Cross Station in Cross, Winyah Station in Georgetown, and Grainger Station in Conway. All of these plants are served exclusively by CSXT. Collectively, these four stations consume approximately

9.5 million tons of coal per year with a capacity of approximately 3,391 MW. Santee Cooper is constructing one additional unit at the Cross Station which will increase Santee Cooper's coal consumption to approximately 11 million tons per year and its capacity to approximately 3,951 MW. Rail service to these plants is currently provided by CSXT pursuant to rail transportation contract. In addition, Santee Cooper's Board has approved the construction of an additional coal-fired generating unit at Florence, South Carolina, which also will be served by CSXT.

**B. Interest of the Concerned Coal Shippers
in the Subject of Rail Capacity and Infrastructure**

The Concerned Coal Shippers have a substantial interest in the subject of this proceeding. Adequate rail capacity and infrastructure are critical to coal-burning electric utilities. Coal units are ordinarily base-load, must-run generating assets that play a vital role in meeting the nation's requirement for a reliable electric supply and transmission grid and the ever-growing demand for electric power. The coal needed to fuel these units moves over the rails in very high volumes and utilities are heavily dependent on reliable rail service to deliver the coal in a timely manner. In the absence of adequate capacity, rail service deteriorates and coal-burning utilities and their customers face the threat of substantial damages associated with the need to curtail coal-fired generation and to substitute higher-cost generation (if available) and/or purchased power. Because of its low dispatch priority on the nation's railroads, coal traffic is especially vulnerable to service failures due to capacity shortages, which can adversely impact the reliability of the nation's electric grid. In fact, coal shippers have experienced

considerable service-related problems with rail carriers in recent years. As domestic service deteriorates, coal-burning utilities are driven to alternative sources, which can increase the nation's demand for foreign energy supplies.

Another major reason that the Concerned Coal Shippers have a strong interest in this proceeding is that the railroads have focused heavily on large increases in coal transportation rates to generate additional revenues. This has been particularly true for coal traffic moving to power plants that are captive to a single railroad for delivery of coal. Theoretically, such captive shippers are protected against the imposition of unreasonable rail rates by maximum rate regulation by this agency. However, based on a variety of decisions in coal rate cases and rulemaking proceedings this Board has issued in recent years, there is widespread sentiment in the rail shipper community that the Board has set the bar extremely high for any effort to challenge rail rates as exceeding a maximum reasonable level.

Coal shippers whose coal transportation requirements can be provided by more than one railroad also have experienced alarming rate increases in recent years. As reflected in the GAO's October 2006 Report, this Board's recent notice in Ex Parte No. 669, and the Department of Justice's inquiry into railroad pricing of PRB coal traffic,¹

¹ "Railroads Face Probe Over Prices For Shipping Coal," Wall Street Journal (Feb. 17, 2005) at 1 ("The Justice Department has launched an investigation into the pricing practices of Burlington Northern Santa Fe Corp. and Union Pacific Corp., the nation's two largest railroads, on shipments from one of the largest coal-producing areas in the U.S. The probe by the Justice Department's antitrust division comes amid complaints by electric utilities that moves toward greater pricing transparency by the two railroads could lead to their coordinating prices and driving shipping costs higher.").

there are concerns about the extent to which competition is functioning to protect such “competitive” shippers from unreasonable rate increases.

A primary explanation from the railroads for rate increases on coal traffic has been the need to fund infrastructure improvements. Thus, coal shippers have a strong interest that this proceeding not simply serve as a predicate for further aggressive rate increases on coal traffic.

COMMENTS

In its Notice of Public Hearing initiating this proceeding, the Board observes that “[i]n recent years, there has been growing recognition that rail capacity in the United States has become constrained.” Notice at 1.² After reciting various predictions regarding anticipated freight volume increases, the Board adds that “[t]he convergence of increased demand with constrained capacity has highlighted the need to address what further infrastructure investment will be required to meet these demands.” Id. at 2. The Concerned Coal Shippers respectfully submit that the Board is correct to identify the need for adequate rail capacity as an issue that merits careful consideration by the agency, but also submit that there is genuine and legitimate concern that the railroads may improperly rely upon railroad infrastructure requirements as a predicate for further increasing rates on coal traffic in a manner that cross-subsidizes other, lower-

² The Board’s Notice makes reference to both rail capacity and rail infrastructure requirements. While the subject of rail infrastructure relates to track itself, the concept of rail capacity is broader and encompasses issues such as the adequacy of locomotive power and the availability of crews. Each of these additional capacity issues directly impacts the volume of traffic that a railroad can transport.

margin traffic. The Concerned Coal Shippers request that the Board be sensitive to this concern and preclude such a result.

A. The Need for Adequate Rail Capacity

The Board observes in its Notice that the rail transportation policy of the United States Government obligates the Board to “ensure the development and continuation of a sound rail transportation system with effective competition and coordination *between rail carriers and other modes.*” See Notice at 2 (emphasis added). The language of the Board’s Notice actually condenses two separate elements of the national rail transportation policy. Section 10101(4) of Title 49 addresses the “development and continuation of a sound rail transportation system,” and in that regard, emphasizes that such a “sound” system must reflect “effective competition among rail carriers [i.e., intramodal competition] and with other modes.” 49 U.S.C. § 10101(4) (emphasis added). Section 10101(5) of Title 49 states that it is the policy of the United States Government to “foster sound economic conditions in transportation and to ensure effective competition and coordination between rail carriers and other modes [i.e., intermodal competition and coordination].” 49 U.S.C. § 10101(5) (emphasis added). The Concerned Coal Shippers believe it is important to emphasize in the context of the Board’s analysis in this proceeding that the development and continuation of a sound rail transportation system requires effective intramodal competition “among rail carriers.”

It is important that the Board also focus in this proceeding on several other elements of the National Transportation Policy that go unmentioned in the Notice: “to maintain reasonable rates where there is an absence of effective competition and where

rail rates provide revenues which exceed the amount necessary to maintain the rail system and to attract capital” (49 U.S.C. § 10101(6)); “to encourage honest and efficient management of railroads” (49 U.S.C. § 10101(9)); “to prohibit predatory pricing and practices, to avoid undue concentrations of market power, and to prohibit unlawful discrimination” (49 U.S.C. § 10101(12)); and “to ensure the availability of accurate cost information in regulatory proceedings, while minimizing the burden on rail carriers of developing and maintaining the capability of providing such information” (49 U.S.C. § 10101(13)).

It is critical, of course, that the railroads maintain adequate capacity and infrastructure to transport coal to utility power plants. As explained above, coal shippers are dependent upon rail carriers to provide needed coal transportation service, and disruptions in this service due to inadequate capacity can impose substantial damages upon electric generating utilities and their customers.

Under Title 49, railroads are common carriers and are obligated, as such, to provide transportation upon reasonable request. See 49 U.S.C. § 11101(a) (“A rail carrier providing transportation or service subject to the jurisdiction of the Board under this part shall provide the transportation or service on reasonable request.”). Significantly, the obligation to provide transportation on reasonable request includes the obligation to provide adequate track facilities. In particular, Title 49 provides that a “rail carrier” is “a person providing common carrier railroad transportation for compensation” (49 U.S.C. § 10102(5)) and further provides that the term “railroad” includes “the road used by a rail carrier and owned by it or operated under an agreement.” 49 U.S.C. § 10102(6). Finally,

Title 49 states that “transportation” includes a “locomotive, car, . . . yard, property, [or] facility . . . related to the movement of passengers or property . . . by rail”

Case law confirms that the Board has jurisdiction to enforce the common carrier obligation to provide adequate service. See Winnebago Farmers Elevator Co. v. Chicago and North Western Transp. Co., 354 I.C.C. 859, 868 (1978) (“We believe that the power to enforce the duty of adequate service is imperative to our ultimate purposes and responsibilities, and thus that we have jurisdiction to enforce section 1(4).”); id. at 872 (“[T]he duty to provide ‘transportation’ under section 1(4) . . . includes not only transportation services provided and vehicles used, but also ‘all instrumentalities and facilities,’ such as tracks. Thus, section 1(4) is broad enough to encompass the entire subject matter of the complaint.”);³ see also Illinois Central Gulf R.R. – Abandonment, 363 I.C.C. 690, 695 (1980), aff’d, Bloomer Shippers Ass’n v. ICC, 679 F.2d 668 (7th Cir. 1982) (“In determining whether a railroad has violated its duty under 49 U.S.C. 11101 to provide adequate service, we will apply a balancing test . . . We will weigh the public need for service over the line at the level sought in the complaint and compare that need with the burden on the carrier and on interstate commerce of providing service at that level.”).

In keeping with these requirements, the Board should examine the adequacy of railroad capacity and infrastructure to meet the transportation needs of rail shippers at present, as well as evaluate the railroads’ plans to accommodate anticipated

³ This Board has taken note of the Winnebago decision in this context. Docket No. 41068, Valley Feed Co. v. Great Shenandoah Valley Devel. Co. d/b/a Shenandoah Valley R.R. (STB served Dec. 11, 1998) at 15 n.35 (citing Winnebago).

future volume levels. In order to do that, of course, the Board must require the railroads to submit detailed information regarding their capacity and the demand for their services. In particular, the carriers should be directed to report on requests for services that they have declined or effectively refused by demanding such high rates that the traffic was never tendered. If the Board determines that current capacity is inadequate to satisfy demand, it should direct railroads to improve their capacity as may be required, or to show cause why they should not do so.

B. Railroads are Entitled to Earn Adequate Returns

Railroads are, of course, entitled to charge rates that are adequate to enable them to finance needed capacity. The Concerned Captive Coal Shippers submit that in light of the current market for coal transportation service, there can be no serious question about whether rates on coal traffic are sufficiently profitable to cover infrastructure investment required for that traffic.

During recent years, the Class I railroads have enjoyed remarkable improvements in their finances. For example, in its October 2006 Report entitled "Freight Railroads: Industry Health Has Improved, but Concerns about Competition and Capacity Should Be Addressed" ("GAO Report"),⁴ the Government Accountability Office ("GAO") observed that the "railroad industry's financial health has improved substantially," and that "various measures indicate an increasingly strong freight railroad industry." See GAO Report at 9.

⁴ United States Government Accountability Office, Report GAO-07-94, "Freight Railroads: Industry Health Has Improved, but Concerns about Competition and Capacity Should be Addressed" (October 2006).

Similarly, the carriers themselves have reported record revenues and net income in recent months. See, e.g., Norfolk Southern Corporation's 2006 Annual Report, at 30 ("Norfolk Southern's 2006 results reflect another year of record revenues, income from railway operations and net income. . . . Railway operating revenues were a record \$9.4 billion, up \$880 million, or 10 percent, compared with 2005, a result of increased average revenue per unit, including fuel surcharges, and modestly higher traffic volume.");⁵ see also "BNSF announces record profit, capital investments," Memphis Business Journal (Jan. 23, 2007) ("Burlington Northern Santa Fe Corp. said its fourth-quarter profit rose 21 percent on higher freight revenue and fuel surcharges. The Fort Worth-based railroad operator reported earnings of \$519 million, or \$1.42 a share, compared with fourth-quarter 2005 earnings of \$430 million, or \$1.13 a share. Revenue rose 9 percent to \$3.88 billion from \$3.55 billion in the year-ago period.").⁶

These improvements have been due, in significant part, to substantial increases imposed by the railroads on their rates for coal transportation. See, e.g., "CSX Predicts Double-Digit Growth in 2007," Associated Press (Jan. 23, 2007) ("Railroad operator CSX Corp. says it's expecting a double-digit increase in earnings this year after reporting its fourth-quarter profit rose 46 percent, due in part to pricing power and

⁵ See also id. at 31 (NS's income from railway operations increased from \$1,158,000 in 2002 to \$2,557,000 in 2006); id. (NS's railway operating revenues increased from \$6,270,000 in 2002 to \$9,407,000 in 2006).

⁶ "Union Pacific CEO Received \$13M in 2006," Associated Press (March 29, 2007) ("Union Pacific . . . continued to reap robust profits. . . . Union Pacific said its 2006 net income jumped 57 percent to \$1.606 billion, or \$5.91 per share, as the railroad worked to become more efficient. And Union Pacific is still enjoying strong demand for the agricultural products, coal and other goods that it ships.").

strength in shipments of coal and agricultural freight.”); see also “CSX chugging right along, earnings signal,” The Florida-Times Union (Jan. 24, 2007) (“CSX Corp. thinks it will retain its position of strength when it comes to increasing the rates it charges its customers, company officials said Tuesday during a discussion of its 2006 financial results. . . .”); id. (“‘We’re not going to go out there and start chasing business’ by lowering prices, Chief Executive Officer Michael Ward said. ‘We don’t think we need to do that.’ For the past two years, the Jacksonville-based railroad has seen its rates grow between 5 percent and 6 percent, and rates should creep up by the same amount in 2007, Ward said. . . . Those higher rates enabled CSX to ring up \$9.56 billion in revenue from its Surface Transportation business in 2006, up 11 percent from the year before, despite an essentially flat volume of freight moved, as a whole.”); accord “Burlington Northern profits roll in,” Associated Press (Jan. 24, 2007) (“Burlington Northern Santa Fe Corp. said Tuesday its fourth-quarter profit rose 21 percent because of strong demand for shipping coal and agricultural and consumer goods. . . . The railroad said revenue from coal shipments, driven by freight out of the Powder River Basin in Wyoming, grew 22 percent to \$775 million. . . . [Chairman and CEO Matthew Rose] predicted record shipments of coal, agricultural products and intermodal freight in 2007. ‘This is still a very, very great environment,’ he said.”).

Recently, Mr. Edward Wolfe, Senior Managing Director of Bear Stearns, expressed the view during a presentation at the joint National Industrial Transportation League/Association of Transportation Law Professionals’ March 26, 2007 Spring Policy Forum that there should be no question that the Class I rail carriers are earning sufficient

revenues to permit them to invest adequately in their transportation systems.⁷ In fact, the extent of railroad investment in coal transportation capacity and the increase in coal transportation volumes over the past twenty-five years – notwithstanding claims of inadequate revenues – provide irrefutable evidence that coal transportation is a highly profitable, highly desirable segment of the railroads' businesses that provides sufficient returns to warrant the investment of substantial railroad capital. The recent, staggering increases in coal transportation rates have further inflated the profit margins on this critical commodity.

A 2003 Report by the American Association of State Highway and Transportation Officials ("AASHTO"), which principally addresses the subject of potential public investment in rail infrastructure, nevertheless provides some important insight into the question of whether railroads themselves have sufficient resources and incentive to permit them to development and maintain adequate capacity. Specifically, the AASHTO Report entitled "Transportation—Invest in America: Freight—Rail Bottom Line Report" ("AASHTO Report") addresses "concerns about the capacity of the nation's freight transportation system, especially the freight-rail system, to keep pace with the expected growth of the economy over the next 20 years." *Id.* at 1. In its Report, AASHTO considers four different possible scenarios regarding railroad infrastructure spending through 2020, and evaluates the public impact and public benefits that would be associated with each possible scenario. Specifically, AASHTO considers the following

⁷ Mr. Wolfe appeared at the conference as part of a panel addressing the subject of Transportation Funding and Infrastructure.

scenarios regarding possible railroad infrastructure investment: (1) “No Growth,” which assumes only the minimum freight-rail industry investment necessary to maintain current volumes; (2) “Constrained Investment,” which assumes that the freight-rail industry will make selected investments that allow the industry to grow, but not sufficiently to capture the expected 2020 volume levels; (3) “Base Case,” which assumes that the freight-rail industry will invest sufficiently to maintain its current share of traffic in lanes in specific rail-served communities; and (4) “Aggressive Investment,” which assumes that the freight-rail industry makes the investments necessary to meet and exceed the base-case 2020 forecast volume. Id. at 57.⁸

AASHTO then evaluates the volume of traffic that would be diverted from rail service if future railroad infrastructure is insufficient to accommodate all of the expected freight volumes, and AASHTO calculates public costs associated with these anticipated diversions in the form of greater spending on the highway system, greater costs tied to highway congestion, etc. Based upon its analysis of the four investment scenarios, AASHTO finds that “relatively small public investments in the nation’s freight

⁸ The AASHTO Report includes the observation that “[w]ary of the gap between the railroads’ capital needs and their income, investors have backed away from railroad stocks.” Id. at 2-3. Since the time of the AASHTO Report, however, railroad stocks have enjoyed a tremendous resurgence relative to the market as a whole. Specifically, the four largest U.S. carriers have seen average annual stock price increases over the past five years of 24.3% per year (BNI), 19.0% per year (NSC), 17.5% per year (CSX), and 13.2% per year (UNP), respectively. These average returns vastly exceed the average S&P 500 return for that same five-year trailing period of 4.5% per year. Morningstar Report (March 28, 2007). Consequently, to the extent that AASHTO concluded that railroad stock value constituted a reasonable measure of the railroads’ ability to meet their capital needs without supplemental public funding, recent history confirms that the railroads should not face any constraints in this regard.

railroads can be leveraged into relatively large public benefits for the nation's highway infrastructure, highway users, and freight shippers." Id. at 1.

In its detailed examination of its different future spending scenarios on specific rail corridors, the AASHTO Report confirms that outside funding is not necessary with respect to coal transportation service because the railroads have sufficient incentive to ensure that capacity is available to permit them to handle the lucrative unit train coal transportation business. Id. at 68 ("The benefits differ by corridor . . ."). The Report further states that:

The volumes of coal now flowing from the [PRB] region represent the single largest rail market in the country, and a steady stream of 13,000-ton trains flow out of Wyoming around the clock. This traffic is expected to grow as more power plants east of the Mississippi switch away from higher sulfur Appalachian coal.

– Because of the volume and profitability of [the PRB coal transportation] market, there are no significant rail capacity constraints. From the building of the Powder River line, to triple tracking where the corridor shares assets with transcontinental flows, to upgrading of lines to handle 286,000-pound and 315,000-pound cars, the railroads have made the necessary investments.

Id. at 70 (emphasis added).

Moreover, when arriving at its "bottom line" regarding the need for public infrastructure spending to enhance the rail-freight industry, the AASHTO Report further emphasizes that the railroads' financial self-interest will prompt them to make sufficient infrastructure investments to permit the continuation of highly profitable coal transportation service. Specifically, when outlining the choice between the "market-

driven evolution” and a “public-policy-driven expansion” of the freight-rail system (id. at 73-74), the Report concludes that a market-driven expansion will be adequate with respect to unit train services:

The choice among these futures depends on the desired balance between market-driven evolution of the freight-rail system and public-policy-driven expansion of the system.

Market-driven evolution of the freight-rail system would likely produce a rail industry that is stable, profitable, and competitive in some segments. . . .

. . . Market pressure would force the railroads to focus their own investments on unit train services, which generate most of today’s freight-rail revenues and profits. It is likely that the railroads would hold onto most or all of the forecast growth in bulk commodities such as coal. The railroads also would invest in and contend for intermodal freight because it is a growing market. However, it is not a highly profitable market.

. . . A policy-driven expansion would require network-level capital investment to enhance carload and intermodal service.

Id. at 74 (emphasis added).

AASHTO’s observations touch on another concern for rail-dependent coal shippers. Not only have coal shippers been obligated to finance the railroads’ construction of capacity needed for other types of traffic (and thus to cross-subsidize business segments that may not contribute at comparable levels to the railroads fixed costs), but those types of traffic may take priority over coal traffic in terms of dispatch over common rail facilities. Because intermodal traffic, for example, requires comparatively more capacity expansion than coal traffic, increasing levels of intermodal

traffic on a capacity-constrained line reduces the “share” of the capacity available for the coal traffic.

C. Coal Traffic Should Not be Forced to Cross-Subsidize Other Railroad Traffic

From the coal shippers’ perspective, there is a real concern about coal traffic being asked to fund far more than its reasonable share. The Board should be mindful of this as it conducts its analysis in this proceeding.

The Coal Rate Guidelines⁹ confirm that the purpose of the Board’s maximum rate regulation jurisdiction is to prevent improper cross-subsidization of the defendant’s other traffic by the issue traffic. Id. at 523 (“A captive shipper should not bear the costs of any facilities or services from which it derives no benefit.”); id. at 524 (“Carriers will be effectively limited in the rates they can charge on captive traffic and will have the necessary incentive to maximize the net revenue contribution from competitive traffic. Cross-subsidization of other shippers is effectively precluded.”). Through its recent decisions in maximum rate cases and in Ex Parte No. 657 (Sub-No. 1), Major Issues in Rail Rate Cases, however, the Board has rendered the stand-alone cost test largely ineffective as a means of preventing such improper cross-subsidization. Particularly due to the witheringly complex standards that the Board has developed in its stand-alone cost jurisprudence, the Board should be mindful in this proceeding of the need to prevent the cross-subsidization of other rail shippers by captive coal traffic. Those complex standards, at a minimum, have a strong chilling effect on shippers who

⁹ Coal Rate Guidelines, Nationwide, 1 I.C.C.2d 520 (1985), aff’d sub nom. Consolidated Rail Corp. v. ICC, 812 F.2d 1444 (3d Cir. 1987)

otherwise might seek relief from unreasonable rates on captive traffic. As a result, the “availability” of SAC relief should not be relied upon as the sole means to identify and prevent improper cross-subsidization between railroad traffic.

In its October 2006 Report to Congress, GAO addresses both railroad competition and railroad infrastructure in a manner that confirms the inherent relationship between the two topics. Specifically, the GAO Report first raises substantial concerns regarding the impact that the absence of both effective competition in the rail industry, and meaningful regulatory review, are having upon the rates being paid by captive rail shippers. See, e.g., GAO Report at 31 (explaining that “the tonnage traveling at rates above 300 percent R/VC [has] more than doubl[ed]—from about 53 million tons in 1985 to over 130 million tons in 2004.”).¹⁰ While the GAO goes on to acknowledge that strategies should be considered to level the playing field between transportation modes to maximize public benefits from federal investment, the principal thrust of the GAO report is to recommend that the STB analyze the state of competition and consider appropriate actions. Id. at 3-4 (“We are recommending that STB conduct a rigorous analysis of the state of competition nationwide and, where appropriate, consider the range of actions available to address problems associated with the potential abuse of market power.”).

As the GAO recounts, this Board disagreed with the recommendation to consider whether shippers are facing the abuse of market power citing a lack of

¹⁰ Id. at 43 (“The results of our analysis suggest a reasonable possibility that shippers in selected markets may be paying excessive rates related to a lack of competition in these markets. While our analysis of available measures shows that the extent of captivity appears to be dropping in the freight railroad industry, shippers that may be captive are paying substantially over the statutory threshold for initiating a rate relief case.”).

resources. Id. at 5. The Concerned Coal Shippers respectfully submit that in the Board's inquiry regarding railroad infrastructure investment, it should be attentive to the interplay between constrained capacity and the degree of competition between rail carriers. As the GAO Report observes, more is needed to ensure protection from market abuse than simply the refinement of the rate relief process:

While we commend STB for recognizing and taking action to address problems with the rate relief process, we believe action beyond improvements to the rate relief process is needed. In particular, these STB rule makings are designed to improve processes available to shippers after they have been charged a rate they consider to be unreasonable. In contrast, we believe that an analysis of the state of competition and the possible abuse of market power, along with the range of options STB has to address competition issues, could more directly further the legislatively defined goal of ensuring effective competition among rail carriers.

Id. at 6 (emphasis added).

Differential pricing is a basic principle underlying the Board's maximum ratemaking methodology. The Concerned Coal Shippers respectfully submit that the subject of differential pricing must be viewed in a different manner in a constrained capacity situation. Differential pricing holds that captive shippers receive a benefit from the existence of low-margin traffic on the railroad system that does not cover its fully allocated costs as long as that traffic makes some contribution to the costs of the system. In a constrained capacity situation, however, that same argument is no longer valid. To the contrary, where low-margin traffic interferes with the carrier's ability to provide service to high-margin coal traffic, then the fact that the low-margin traffic makes some contribution to system costs does not constitute a benefit to the coal shipper. Instead, the

coal shipper would be better off if the carrier were either to decline to move the low-margin traffic (in favor of greater volumes of higher-margin traffic) or to raise its rates on the low-margin traffic to a level such that the traffic pays its fair share of total system costs. Absent one of those two solutions, the low-margin traffic simply will occupy system resources in a manner that degrades the service available to coal shippers.

**D. **Recent History Confirms that there have been
Repeated Instances of Poor Coal Transportation Service****

The Concerned Coal Shippers are not here to present evidence that current rail capacity is inadequate, but the Board is well aware that there have been repeated periods in recent years in which rail service for coal traffic has been very poor.

Accordingly, it is certainly appropriate for the Board to require the railroads to make a detailed showing of the adequacy of their capacity to handle present coal traffic volumes and their plans to stay ahead of growing coal traffic demands in the future.

The history of coal transportation over the last fifteen years includes a number of instances in which eastern and western coal shippers have borne the effects of poor railroad service. Southern Powder River Basin coal transportation has experienced repeated and prolonged periods of inadequate rail service in recent years, including but not limited to the following events:

UP/CNW Merger	(1995)
UP/SP Service Crisis	(1997-1998)
“Perfect Storm”	(2003-2004)

**Derailments & Subsequent
Coal Dust-Related Repair/
Heavy Maintenance** (2005-2006)

There also have been periods in which rail deliveries of coal in the eastern United States have been poor. For example, railroad service to eastern coal shippers deteriorated following the break-up of Conrail.

To some extent, these events may have been caused or exacerbated by the railroads' practice of pursuing "just in time" capacity enhancements that leave coal shippers subject to significant effects from any disruptions in rail service. This pattern of just in time construction has the additional effect of facilitating the railroads' efforts to increase rates by restricting the potential supply of transportation service when demand for that service is increasing. See, e.g., GAO Report at 15 ("Several factors could have contributed to recent rate increases. . . . After years of reducing the size of its workforce and shedding track capacity, the industry is increasingly operating in a capacity-constrained environment in which the demand for its services exceeds its capacity in some areas.").

Recent statements from railroad executives confirm this GAO observation regarding the railroads' decisions to limit capacity spending. For example, UP's Executive Vice President-Marketing and Sales, Mr. Jack Koraleksi, explained in a public notice to UP's customers that UP's insufficient service was the result of an affirmative decision on UP's part to constrain its spending on crews. See Letter from Jack Koraleski to UP Customers (April 15, 2004) ("Koraleski Letter") ("Today, we find ourselves in the position of having more business in certain geographic areas that we can handle at this

time, and the resulting pressure on our resources has caused a deterioration of service. . . . The problem started with a shortage of train crews. . . . [W]e made the decision to keep our manpower tight.") (emphasis added).¹¹ Likewise, BNSF's CEO Mr. Matthew Rose commented during a January 24, 2006 Analysts' Conference Call that "we want to keep a fairly tight rein on capacity" and that "[w]e're not going to overbuild the network." Rail StockWatch, Issue No. 86 (Feb. 9, 2006), at 3.

The Concerned Coal Shippers therefore request that the Board consider whether the railroads have been engaged in a practice of lagging behind, rather than anticipating, increasing demand upon their systems. This practice would have the effect of affording the railroads greater pricing power, and therefore, a tendency may exist to allow capacity to become or to remain constrained as a means of enhancing the railroads' revenues.

**E. The Concerned Coal Shippers Support
Public-Private Financing Partnerships**

The Concerned Captive Coal Shippers are generally supportive of public-private partnerships, particularly under circumstances where – with the benefit of

¹¹ The solution that UP chose to implement in order to alleviate its capacity shortage was to ration service based on the price that customers were willing to pay, or stated differently, UP elected to maximize its revenues by limiting capacity spending and driving up the price for the limited service that it chose to provide. See Koraleski Letter at 2 ("With the current demand for transportation far outstripping the available supply, the most effective tool we have to control volume growth on our railroad is price. As such, we are taking pricing actions to bring supply and demand into balance."). In this same regard, when explaining the carriers' responses to the recent capacity problems during a presentation in 2006, then-Vice Chairman Mulvey acknowledged this situation, and observed that the carriers were engaged in "[p]rice rationing of available capacity" and that the railroads were "choosing who they will serve" STB Vice Chairman Francis P. Mulvey, "Optimal Investment in Rail Infrastructure: The Divergence of Public and Private Interests," Electric Utility Consultants, Inc., Mesa, Arizona (March 28, 2006).

appropriate governmental oversight and planning – they will improve access to competitive rail service and/or could help to ensure that coal shippers are not forced to pay unreasonable rates. As with each of the views expressed in these Comments, the Concerned Coal Shippers wish to qualify their support for such public-private partnerships with their concerns regarding improper cross-subsidization and potentially negative impacts that individual projects might have on coal transportation service.

CONCLUSION

For the foregoing reasons, the Concerned Coal Shippers request that the Board: (i) require the railroads to submit evidence sufficient to demonstrate the current and projected relationship of the demand for rail services to rail capacity, including, in particular, any rail corridors where demand exceeds or is anticipated to exceed capacity; (ii) consider the extent to which capacity constraints, where they exist, may be attributable to the railroads' failure to expand capacity in advance of increasing demand despite their financial ability to do so; (iii) consider adverse impacts on competition among railroads that may be associated with constrained rail capacity; and (iv) consider

the need to avoid cross-subsidization by coal shippers of other traffic in connection with any increased revenues the railroads may claim are required to finance rail infrastructure.

Respectfully submitted,

Concerned Captive Coal Shippers

Of Counsel:

Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, D.C. 20036

By: C. Michael Loftus 
Andrew B. Kolesar III
Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, D.C. 20036
(202) 347-7170

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Attorneys & Practitioners