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Submitter's Name/Association: Consumers United for Rail Equity (C.U.R.E.)
Contact: Bob Szabo
E-mail: rgs@vnf.com
Phone: (202) 298-1920

QUESTION 4: TRANSPORTATION

THE CURRENT COAL TRANSPORTATION PROBLEM

In 1980, through the Staggers Rail Act, Congress deregulated the national railroad industry. The deregulation act was unusual in that it removed the presumption of regulation, while recognizing that some rail movements would remain “captive” (subject to railroad monopoly power) and providing authority to the ICC (now STB) to prevent abuse of this monopoly power. One of the elements of the 1980 deregulation legislation was that railroads could charge their captive traffic more than their competitive traffic, a concept called “differential pricing”, but the rates charged captive traffic could not be unreasonably high. A high percentage of coal movement is “captive” and is, therefore, subject to “differential pricing”. All western coal and some eastern coal is moved on rail in highly efficient unit trains. In most cases the utilities own or lease the coal unit trains. These factors make coal transportation the single largest contributor to railroad profitability.

Since 1980, the national rail infrastructure upon which coal depends for movement to power plants has been transformed. First, the major railroads moved their less profitable segments of track into approximately 500 short line railroads that are often key segments in the movement of coal to power plants. Second, over the past twenty years, the major railroads have consolidated to only two railroads that move coal from the Powder River Basin in the west (Union Pacific and Burlington Northern) and two railroads that move coal from the mines in the east (Norfolk Southern and CSX). This consolidation has reduced the competitive transportation opportunities available to utilities that move coal.

The ICC/STB has aggravated this situation through two key rulings regarding competition, both of which must be changed by Congress.

First, through provisions contained in long-term leases of track to short line railroads, the major railroads maintain their control over the traffic movements across these short line railroads. Specifically, many of the long-term track leases to short line railroads require that, even though the short line could move traffic to several major railroads, the traffic movements must be to the major railroad that originally controlled the track. This provision, sometimes called a “paper barrier”, has had the effect of preventing access to rail transportation competition that otherwise exists. Attached to

this document is a schematic of a captive coal-fired plant in Arkansas whose captivity is caused by the restrictions in the track lease to a short line railroad. The restrictive provisions in the lease are also attached. Because each of these lease agreements was approved either by the ICC or by the STB, Congress must act to remove the anticompetitive effects of these lease agreements.

Second, in 1996, the Surface Transportation Board decided three consolidated coal utility cases called collectively the “bottleneck” case. In these cases the STB determined that a major railroad that controls a key segment of a movement of coal from a mine to a power plant may use the control of that key segment to extend its monopoly power over the entire coal movement. This ruling has had the effect of denying the utility the benefit of rail competition where it physically exists and has resulted in both unreasonably high rates and, often, poor service.

For example, the City of Lafayette, Louisiana owns a coal fired power plant that uses Powder River Basin coal. The coal can leave the Powder River Basin on either the Union Pacific or the Burlington Northern for the 1500 mile movement to the power plant. The Union Pacific can move the coal from the Powder River Basin all the way to the coal fired plant that is located on the western side of the Red River in Louisiana on a Union Pacific rail line. The Burlington Northern can move the coal to the Kansas City Southern in Kansas City, which can then move the coal to a junction point with the UP 20 miles from the power plant. Thus, competition for the coal movement is physically available for 1480 miles of the movement; the final 20 mile movement would be captive to the UP. If the City of Lafayette could have access to the 1480 miles of competitive movement, the final total coal haulage cost, when blended with the captive rate across the final 20 miles, likely would be reasonable.

Unfortunately, the Union Pacific will quote only one rate to the City of Lafayette for movement of coal from the Powder River Basin: a rate from the mine to the plant. The BN/KCS combination cannot quote a rate from the mine to the plant because they do not have access across the last 20 miles of UP track. Thus, instead of being captive for 20 miles to the UP, the City of Lafayette is captive to the UP for the entire 1500 miles of the coal movement. The UP can and does charge the City of Lafayette monopoly rates for this movement of coal.

The “rate reasonableness” process established by the ICC/STB to prevent unreasonably high rail rates is itself unreasonable and ineffective. The process does not constrain monopoly rates. The process allows a utility to seek relief when it is paying a rate roughly twice as high as the railroad’s direct cost of moving the coal; the utility must pay a \$64,000 filing fee; the utility must prove that it is captive and thus qualified for the rate relief process; the utility must bear all burdens of proof regarding the reasonableness of the rate; and the standard for whether the rate is unreasonably high is whether the utility could build its own “stand alone” railroad and provide its own transportation more cheaply than the rate it is paying. Throughout the rate proceeding, the utility must continue to pay the unreasonably high rate. The Chair of the STB has testified to Congress that this process takes at least two years and costs the complainant \$3 to \$5

million. Utilities are not winning such rate cases at the STB, which has approved as reasonable rates that are up to 350% of the railroad's direct cost of moving the coal.

RECOMMENDATION

The current rail transportation system is unacceptable to coal shippers because it is resulting in unreasonably high coal transportation costs and, often, inadequate service. Coal shippers are concerned that this inadequate rail transportation system will not be able to meet the anticipated increase in coal haulage at reasonable costs and with adequate service. In addition, the continued use of coal for electrical generation in the future is likely to require increased investments of capital by owners of electrical generating facilities. The owners of these facilities and the consumers of their electricity will not be able to pay both the unreasonably high costs of rail transportation and the anticipated increased capital costs of the use of coal for electrical generation.

Thus, C.U.R.E. encourages the Senate Energy and Natural Resources Committee to include in any energy policy legislation reported this year a provision that will remove the "paper barriers" that prevent the efficient movement of coal from the mine to the power plants and will require railroads to provide rates between any two points on their system when requested by a coal shipper.

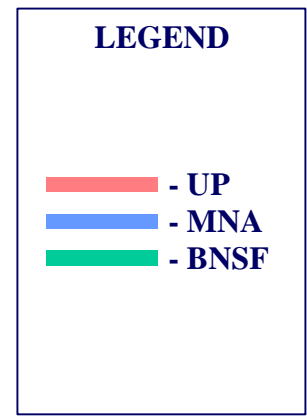
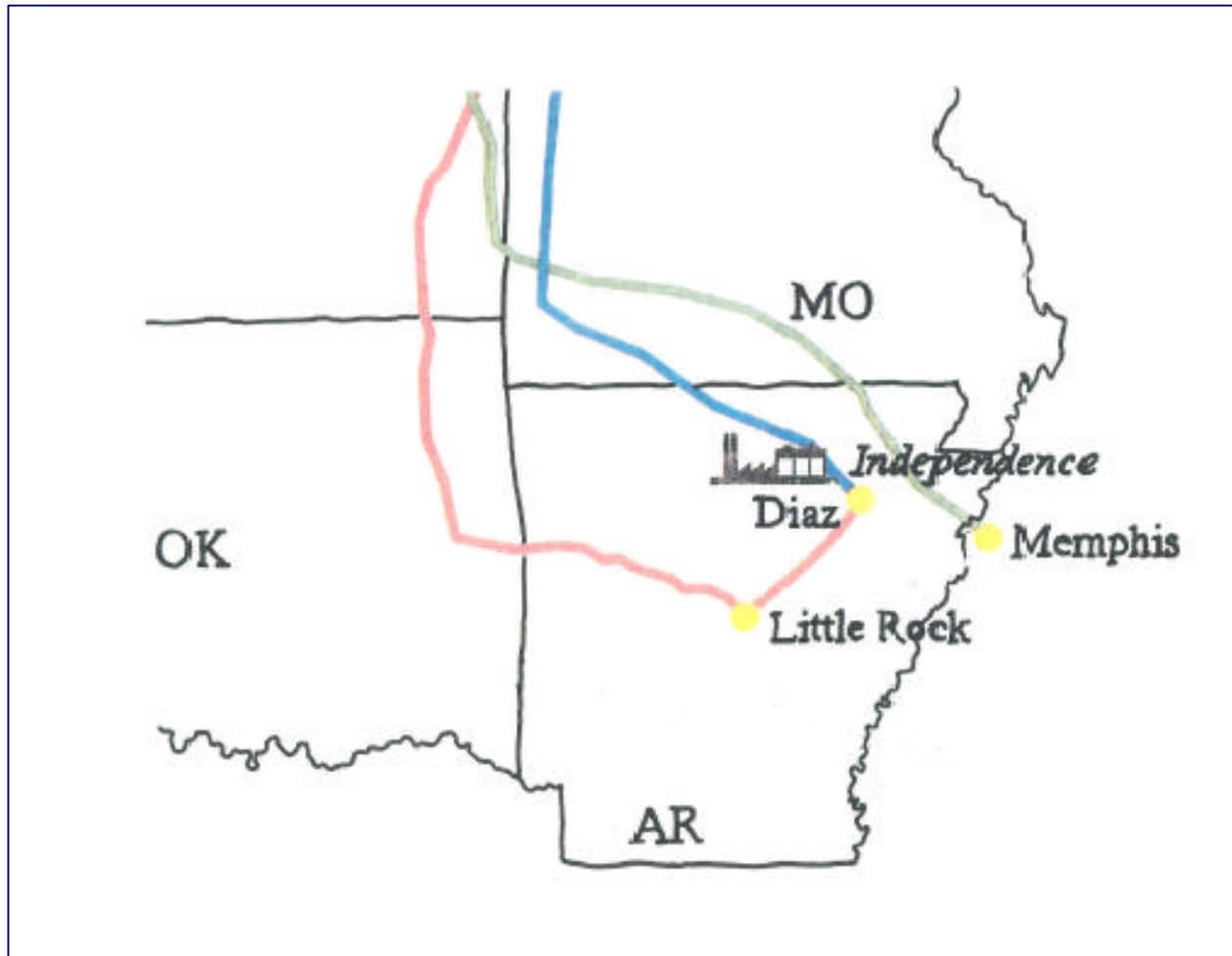
Attached is a proposed legislative provision that will make the recommended changes in current law, schematics on the coal movement situation confronting the City of Lafayette and the paper barrier being encountered by the Arkansas power plant and the paper barrier provision from the short line railroad contract involved in the Arkansas situation.

COMPETITIVE TRANSPORTATION OF COAL TO POWER PLANTS

Add a new Section _____ as follows:

“Section _____ - Competitive Transportation of Coal to Power Plants

Class I railroads, as defined by the rules of the Surface Transportation Board, that move coal from mines to power plants shall, upon request of the coal shipper, quote rates for the coal movement between any two points on its system. Non-Class I railroads shall have the authority to move coal to or from any Class I railroad regardless of any provision of a track lease agreement or other agreement with a Class I railroad that shall have the intent to restrict the movement of coal to the Class I railroad that is party to the agreement.”



Result of these decisions by the ICC/STB: The Class I Railroad, through the Paper Barriers in agreements with Short Lines, can deny the customer access to railroad competition

**LEASE AGREEMENT BETWEEN
MISSOURI PACIFIC RAILROAD CO. (NOW
UNION PACIFIC)
AND
MISSOURI & NORTHERN ARKANSAS
RAILROAD CO. (MNA)**

Section 4.01 “In consideration of this Lease, and subject to the terms and provisions set forth herein, Lessee agrees to pay Lessor rent for the Leased Premises in the amount of Ninety Million Dollars (\$90,000,000) per year payable annually in advance on the 1st day of March; PROVIDED, HOWEVER, that subject to the provisions of Section 4.02 hereof, for each lease year that 95% or more of all traffic originating or terminating on the Leased Premises is interchanged with Union Pacific Railroad Company, Missouri Pacific Railroad Company and any affiliated company, their successors and assigns, Lessor agrees that it will waive or partially waive the rent for that particular year in accordance with the schedule set forth in Section 4.03. The 95% level must be achieved separately and simultaneously on the Pleasant Hill-Bergman (including connecting branches) and Guion-Diaz Junction segments.”

Schedule in Section 4.03

<i>PERCENTAGE OF THE TOTAL TRAFFIC THAT WAS INTER CHANGED WITH LESSOR</i>	<i>RENT DUE LESSOR</i>
<i>100 - 95%</i>	<i>\$-0-</i>
<i>94 - 85%</i>	<i>\$10,000,000</i>
<i>84 - 75%</i>	<i>\$20,000,000</i>
<i>74 - 65%</i>	<i>\$20,000,000</i>
<i>64 - 55%</i>	<i>\$30,000,000</i>
<i>54 - 45%</i>	<i>\$40,000,000</i>
<i>44 - 35%</i>	<i>\$50,000,000</i>
<i>34 - 25%</i>	<i>\$60,000,000</i>
<i>24 - 15%</i>	<i>\$70,000,000</i>
<i>14 - 5%</i>	<i>\$80,000,000</i>
<i>0 - 4%</i>	<i>\$90,000,000</i>