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PETITION OF THE ASSOCIATION OF AMERICAN RAILROADS
TO INSTITUTE A RULEMAKING PROCEEDING TO
REINTRODUCE INDIRECT COMPETITION AS A
FACTOR CONSIDERED IN MARKET DOMINANCE DETERMINATIONS FOR
COAL TRANSPORTED TO UTILITY GENERATION FACILITIES

REPLY IN OPPOSITION OF AMERICAN PUBLIC POWER ASSOCIATION,
EDISON ELECTRIC INSTITUTE, AND
NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

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Summary of Position

American Public Power Association (“APPA”), Edison Electric Institute (“EEI”), and National Rural Electric Cooperative Association (“NRECA”) hereby jointly reply in opposition to the “Petition of the Association of American Railroads to Institute a Rulemaking Proceeding to Reintroduce Indirect Competition as a Factor Considered in Market Dominance Determinations for Coal Transported to Utility Generation Facilities” (“Petition”) filed herein on November 19, 2012.

The Board should not institute a rulemaking proceeding in response to the Petition. The facts do not support AAR’s theory. Indeed, AAR has not provided specific evidence of effective, indirect competition that has reduced even a single existing rail rate, and APPA, EEI, and NRECA are not aware of a reduction in an existing rail rate due to indirect competition. Without such evidence, AAR’s assertion that competition between generation fuels in wholesale electricity markets constitutes indirect competition that limits rail rates is just a theory that is not supported by any factual confirmation. This theory is not a sufficient basis for the Board to grant AAR’s request to open a proceeding that could result in permanent changes to the market dominance analysis. Competition between generation fuels does exist on the margin from time to time in certain electricity markets. Despite numerous pages and charts discussing the functioning of power markets, however, AAR has not shown how any such competition in electricity markets has translated into decreased railroad rates for coal.

Although AAR claims its witness has created a simple methodology for determining if indirect competition exists for electricity generated from coal, he has not done so. While the approach AAR's witness recommends may appear "simple," it is incomplete and, if adopted, again would plunge the Board into long and protracted battles over indirect competition, with discovery disputes alone costing \$1 million or more, without any benefit to anyone except railroads who are attempting to avoid having to defend their rail rates for coal transportation before the Board.

Moreover, as the Board has found in the past, there is no reason for a rail shipper of coal who has the benefit of effective direct or indirect competition for the transportation of its coal to resort to the Board to establish a reasonable rate for that transportation in the first instance, instead of simply relying on that competition to produce a reasonable rate. Therefore, there is no reason for the Board to choose to consider indirect competition in STB market-dominance determinations.

The Board has reviewed the issue of "indirect competition" several times since the enactment of the "4-R Act" and Staggers Rail Act of 1980. Its current policy (a) properly interprets the applicable statute; (b) has been upheld on judicial review; and (c) balances the concerns of shippers and railroads. The Board has many matters pending before it at the present time. It is a burden on the Board and the shipping community to open additional, general proceedings of widespread interest unless there is a public interest in doing so and then only if the proposed approach is practical.

For example, in 2008, in Ex Parte No. 679, the Board denied a separate AAR Petition for Rulemaking with respect to use of replacement costs in revenue adequacy determinations because it had been over that subject before, there was no need to go over it again, and the approach recommended was not practical. For similar reasons, the Board should deny the Petition filed herein.

Interests of APPA, EEI, NRECA and Their Members

APPA is the national service organization representing the interest of over 2,000 municipal and other state- and locally-owned electric utilities in 49 States (all but Hawaii). Collectively, public power utilities deliver electricity to one of every seven electric consumers (approximately 46 million people), serving some of the nation's largest cities, but also many of its smallest towns. Approximately 45 percent of the electricity generated by public power utilities is from coal.

EEI is the association of U.S. shareholder-owned electric utility companies. EEI's members serve 95 percent of the ultimate customers in the shareholder-owned segment of the industry and they represent approximately 70 percent of the U.S. electric power industry. EEI's diverse membership includes utilities operating in all regions, including in regions with Regional Transmission Organizations ("RTOs") and Independent System Operators ("ISOs"), and companies supplying electricity at wholesale in all regions.

NRECA is the national service organization for more than 900 not-for-profit rural electric utilities that provide electric energy to approximately 42 million consumers in 47 states or 12 percent of the nation's population. Kilowatt-hour sales by rural cooperatives account for approximately 11 percent of all electric

energy sold in the United States. NRECA members generate approximately 50 percent of the electric energy they sell and purchase the remaining 50 percent from non-NRECA members.

NRECA members are not-for-profit, consumer-owned cooperatives. NRECA's members also include approximately 65 generation and transmission ("G&T") cooperatives, which generate and transmit power to 668 of the 841 distribution cooperatives. The G&Ts are owned by the distribution cooperative they serve. Remaining distribution cooperatives receive power directly from other generation sources in the electric utility sector. Both distribution and G&T cooperatives were formed to provide reliable electric service to their owner-members at the lowest reasonable cost.

APPA, EEI, NRECA, and their members would be affected adversely if the Board institutes a proceeding in response to AAR's Petition, or if that Petition were granted, because merely instituting such a proceeding would be costly to them, and if the Petition were granted, it would erect additional unwarranted barriers to challenging rail rates at the Board, even where there is a lack of effective transportation competition and where those rates exceed a reasonable maximum.

STB and ICC Precedent Addressing Indirect Competition Supports a Denial of AAR's Petition

Congress first required a showing of "market dominance" in order to challenge a rail rate in the "4-R Act" of 1976. "Market dominance" was (and is) defined as by statute "an absence of effective competition from other rail carriers

or modes of transportation for the transportation to which a rate applies.¹ In the 4-R Act, Congress directed the Interstate Commerce Commission (“ICC”) to “establish, by rule, standards and procedures for determining ... whether and when a carrier possesses market dominance.... Such rules shall be designed to provide a practical determination without administrative delay.”²

At first, as administered by the Interstate Commerce Commission (“ICC”), the “market dominance” test was relatively straightforward to apply. The ICC’s “Special Procedures for Making Findings of Market Dominance” only considered direct competitors who operated along routes serving the same points of origin and destination, including both other rail carriers and non-rail carriers. The ICC expressly declined to require a consideration of indirect product competition (using a different product subject to a different rate), or geographic competition (using a different origin or destination).³ In 1978, the D.C. Circuit upheld the ICC’s action, including its reading of the statute, particularly in light of the 4-R Act’s clear preference for efficient and practical proceedings.⁴

In 1980, notwithstanding its earlier determination, the ICC proposed via rulemaking to add indirect competition to its market-dominance analysis. While that rulemaking proceeding was pending, Congress, in the Staggers Rail Act of 1980, directed the ICC to determine whether to consider indirect competition in

¹ 49 U.S.C. § 10707(a); former 49 U.S.C. § 10709(a)(emphasis added).

² See *Western Coal Traffic League v. United States*, 719 F.2d 772, 780 (5th Cir. 1983) (“*Western Coal Traffic League*”), citing Section 202(b) of the 4-R Act, Pub. L. No. 94-210, 90 Stat. 31 (1976); see also, 49 U.S.C. § 10101 (15).

³ See background discussion in *Association of American Railroads v. STB*, 306 F.3d 1108, 1109 (D.C. Cir. 2002).

⁴ *Atchison, Topeka & Santa Fe Ry. v. ICC*, 580 F.2d 623, 623-34 (D.C. Cir. 1987).

rate-reasonableness determinations.⁵ It bears emphasis, however, that, in the Staggers Act, Congress did not direct the ICC to include indirect competition in those determinations.

In the Staggers Act, as noted above, Congress established the “jurisdictional threshold,” effectively deregulating rates below 180 percent of a railroad’s variable costs as determined by the ICC. Moreover, even if the rate exceeded 180 percent of variable costs, Congress directed that the ICC “still must determine if market dominance exists.” Former 49 U.S.C. § 10709(a), (b).

“Although Congress did revamp the ICC’s regulations in these respects, it did not alter the market dominance statute enacted in the 4R Act and, in fact, emphasized that it did not intend ‘in any way to restrict the ability of the Commission to apply the market dominance concept, both in its regulations and individual cases.’”⁶ So, there is nothing in the statute that requires the STB to amend its market dominance standards in the manner that AAR advocates, especially given that the United States Court of Appeals for the D.C. Circuit deferred to the Board’s decision to exclude indirect competition from market-

⁵ Pub. L. No. 96-448, §205(a)(1), 94 Stat. 1905.

⁶ *Western Coal Traffic League*, 772 F.2d at 777, *citing* H.Rep. No. 96-1430, 96th Cong., 2d Sess. 89 (1980), *US.Code Cong. & Admin. News* 1980, pp. 3978, 4120. In the Staggers Rail Act, Congress intended that the ICC take another look at its market dominance standards, including consideration of product and geographic competition, but it did not require the ICC to repeal those standards (else Congress would simply have said so).

dominance determinations.⁷ Therefore, contrary to arguments made previously by AAR, Congress did not require the STB to consider indirect competition.⁸

In 1981, the ICC nevertheless decided to consider indirect competition in its market-dominance determinations. Initially, a panel of the United States Court of Appeals for the Fifth Circuit overturned the ICC's action as contrary to the statute, but on rehearing, a majority of the Court acting *en banc* deferred to the ICC's interpretation of the statute as permitting, but not requiring, such indirect competition to be considered.⁹

Thereafter, for almost two decades, the ICC and later this Board considered such indirect competition in rail-rate challenges, but the inquiry steadily became more and more complex.¹⁰ After only the first few years of considering indirect competition, the ICC recognized the burden its market-dominance rules were imposing on shippers, and so it shifted the burden of going forward on indirect competition to the Defendant railroad(s) in a rate-challenge proceeding.¹¹

Finally, in the late 1990s, after Congress expressed concern about the cost, complexity, and delays associated with the STB's rate-reasonableness proceedings, the STB instituted another rulemaking proceeding – Ex Parte No.

⁷ *AAR v. STB*, *supra*, 306 F.3d 1108.

⁸ *Market Dominance Determinations—Product and Geographic Competition* (“*Market Dominance II*”), 4 S.T.B. 269, 272 (1999).

⁹ *Western Coal Traffic League v. United States*, 719 F.2d 772 (5th Cir. 1983).

¹⁰ *Market Dominance Determinations – Product and Geographic Competition* (“*Market Dominance Determinations I*”), Ex Parte No. 627, 3 S.T.B. 937, 946-49 (1998).

¹¹ *Id.* at 941 & n.26 (citing *Product and Geographic Competition*, 2 I.C.C.2d 1 (1985)).

627 -- to consider whether to again preclude indirect competition from such proceedings. After receiving public comment, the STB adopted the current rules, precluding consideration of indirect competition in market-dominance determinations, although the Board allowed the possibility of a showing of indirect competition by the Defendant railroad(s) in their rate-reasonableness presentations.¹²

The Board concluded that the change was permissible under the Staggers Act, because the statutory language does not require that indirect competition be considered in making market-dominance determinations. The Board also concluded that the revision was warranted because the time and resources spent on indirect competition in rate litigation were often inordinate, preventing the Board from providing expeditious handling and resolution of all proceedings pending before it, as mandated by other Staggers Act provisions. The Board believed the change would benefit shippers, because under the new rule, there would be less of a disincentive to challenge rates as a result of the reduction in litigation burdens and costs. The Board concluded it would also be fair to railroads.¹³

AAR petitioned for judicial review of the Board's determination. In its decision, the D.C. Circuit deferred to the Board's reading of the Staggers' Act that "market dominance" does not require the STB to consider indirect (product and geographic) competition, and accepted the Board's reasoning that the decision would reduce administrative delay by limiting the litigation of the innately

¹² *Market Dominance Determinations I*, *supra*, 3 S.T.B. at 948-49.

¹³ See *AAR v. STB*, *supra*, 306 F.3d at 1109-10.

complex issues of geographic and product competition.¹⁴ Accordingly, the Board concluded that its decision would advance the Staggers Act mandate to “establish procedures to ensure expeditious handling of challenges to the reasonableness of rail rates ... which shall include appropriate measures for avoiding delay in the discovery and evidentiary phases of such proceedings.”¹⁵

However, the D.C. Circuit required the Board on remand to “weigh the effect, if any,” of the language in the statute’s preamble manifesting a preference for market-based rather than regulatory rate setting, on its decision.¹⁶ Although the Court thought the Board’s decision “reasonable in isolation” – meaning as an interpretation of the key language – the Court decided it was arbitrary and capricious of the Board to construe market dominance without considering the preamble policy. On remand, the Court directed the Board to “weigh the effect, if any” of the language calling for “competition and remand for services ... to establish reasonable rates for rail transportation ... *to the maximum extent possible...*” on this determination.¹⁷

On remand, the Board concluded that the quoted language from the preamble to the statute is “not inconsistent” with its decision to exclude indirect competition from consideration in the market-dominance analysis. The Board concluded it had a responsibility to apply not one, but all 15 “separate and sometimes conflicting policy goals that together establish the framework for

¹⁴ *AAR v. STB*, 237 F.3d at 680.

¹⁵ *Id.*; 49 U.S.C. §10704(d).

¹⁶ *Association of American Railroads v. STB*, 237 F.3d 676 (D.C. Cir. 2001).

¹⁷ *Id.*; 49 U.S.C. § 10101(1).

regulatory oversight of the railroad industry.”¹⁸ The Board held that “[t]o the extent that there is tension among the different policy goals [in the Rail Transportation Policy], we must balance the competing interests in a way that gives effect to each policy.”¹⁹ It “specifically concluded excluding product and geographic competition from considerations in the market dominance analysis is not inconsistent with” the first policy of the Rail Transportation Policy.²⁰ “However, experience has shown that consideration of product and geographic competition has a demonstrable negative effect on other relevant R[ail] T[ransportation] P[olicy] goals.”²¹ Accordingly, the Board again determined that indirect competition should not be considered.

AAR again sought judicial review, but this time, the D.C. Circuit rather summarily upheld the Board’s determination on remand not to allow indirect competition to be considered, concluding that there was “not much left to this case.”²² The D.C. Circuit deferred to the Board’s reading of the statute, as it had before.

The Board should be aware, in evaluating AAR’s Petition, that coal-transportation rates, especially from the Powder River Basin in Wyoming and Montana (the largest single source of coal to U.S. electricity generating stations), often exceed, by a substantial amount, the price of the coal itself. Therefore, it is within the power of the railroads, by reducing their rates if need be, to allow at

¹⁸ *Market Dominance Determinations—Product and Geographic Competition (“Market Dominance III”)*, 5.S.T.B. 492, 497 (2001).

¹⁹ *Id.* at 498.

²⁰ *Id.*

²¹ *Id.*

²² *AAR v. STB*, *supra*, 306 F.3d at 1109-10.

least some coal-fired power plants to compete on the margin with other sources of electricity, including gas-fired plants. Unfortunately, APPA, EEI, and NRECA are not aware of any evidence of railroads lowering their existing rates as a result of any such indirect competition, and AAR did not offer a single example of a railroad reducing an existing rail rate in response to such competition.

Railroads have other options for the use of their lines. For example, coal companies and railroads contend, to the financial community, that they will make large amounts of money transporting coal for export. Also, railroads are transporting ever-larger quantities of crude oil from the northern Plain States to much of the country, including the East coast. Perhaps that is why the railroads are unwilling to discount their existing rates for domestic coal users, which may explain why their theory of product and geographic competition has not proven to have reduced rates for the transportation of coal to domestic users of coal.²³

²³ For example, Union Pacific (“UP”) Chief Executive Officer Jack Koraleski recently stated that UP had no interest in reducing its rail rates – even if meant the utility plants would go out of business – because UP preferred to maximize its profits on its other lines of business:

“We have a number of customers that come to us and say ‘If you don’t lower your coal rates we will go out of business.’” Koraleski said. “Unfortunately if their business is dependent on the value of their transportation contract and not on the intrinsic product that they are producing, they will probably go out of business anyway. And we also have to be sensitive to all of our other coal customers, so we take a very pragmatic approach.”

“I can tell you we are not straying away from our strategy, which is to price to re-investable levels, and if we can’t get to re-investable levels we will walk away from the business. We have stayed strong with that, and it has paid a great benefit for us. That’s

History shows that the STB's consideration of the market-dominance issue was anything but straightforward when product and geographic competition were considered in the past. Indirect competition issues generated massive discovery requests, resulting in expenditures of as much as \$1 million (approximately 15 years ago; the amount would certainly be more today) to respond to such discovery, and delays of years,²⁴ to allow the railroads to litigate this issue and shippers to defend their claim of market dominance.

On the most practical level, there is simply no reason for a shipper to file a complaint challenging a rail rate in the first instance if the shipper is able to take advantage of effective direct or indirect competition. Similarly, there is no reason for the Board once again to dive into the swamp of indirect competition in making what is supposed to be an expedited determination "without administrative delay" of whether effective transportation competition (*i.e.*, market dominance) exists so that a rail rate may be challenged.

where our head is. We will win some, but we will lose some. . . ."

"In the event you see us lose business, you can assume from that we could not meet the criteria and we were prepared to walk away because our franchise gives us plenty of opportunities to fill the gap and take advantage of the capacity to move other freight with other customers."

"Word from UP: Don't expect rate relief designed to keep companies in business," *Coal & Energy Price Report*, Oct. 19, 2012.

²⁴ *Market Dominance I, supra*, 3.S.T.B. at 946-49 & n.61 (product and geographic competition discovery in *FMC* litigation likely cost in excess of \$1million).

AAR's Petition Contains No Evidence That Competition in the Electric Utility Has Resulted in any Reduction of Rail Rates Even Where the Rail Rates Were Higher Than the Price of the Coal Itself

Notwithstanding that the Board considered the subject of indirect competition on more than one occasion in the past, and notwithstanding the Board's decision in 1998, after a notice-and-comment rulemaking proceeding in Ex Parte No. 627, to preclude consideration of indirect competition in market-dominance determinations, and notwithstanding that the D.C. Circuit ultimately affirmed that decision over AAR's challenge, AAR's Petition would once again have the Board engage in a rulemaking proceeding to consider allowing evidence of, and arguments about, indirect competition in market-dominance determinations involving rates for the transportation of coal.

Although AAR now claims its witness Reishus has developed a simple, straightforward method of measuring such indirect competition, APPA, EEI, and NRECA have reviewed his approach in detail and do not agree that it is simple or straightforward.²⁵ Rather, APPA, EEI, and NRECA believe the methodology recommended by AAR and Dr. Reishus would be costly, complex, and controversial, and would almost certainly not prevent substantial discovery about wholesale electricity prices, the characteristics, operations, and costs of coal-fired plants, reasons why coal-fired power plants may be required to run

²⁵ In fact, APPA and NRECA would dispute the foundational notion underlying AAR's indirect competition analysis—that there is in fact effective competition in wholesale electric power markets that disciplines electric prices, and hence cost inputs to those prices. They understand, however, that this is not the STB's area of expertise, and therefore will not raise their concerns here.

regardless of cost, and a host of other matters that are not within the Board's areas of expertise.

AAR's witness Reishus identifies many sources of information about wholesale electricity markets, but actually does not propose any simple formula to determine if product and geographic competition applies.

All coal-fired power plants are not base-load facilities. And, not all base-load units are run as such at all times. These units can provide peaking service at times or could be designated temporarily as must-run units, which are used only when necessary to support reliability on the transmission grid. That can be relatively infrequent. How a coal unit is used can vary throughout the unit's life; indeed, it can vary from day-to-day and even hour-to-hour. AAR's witness does not have any way to identify the different types of plants, or purposes of such plants. This would necessarily lead to extensive litigation before the Board about whether a particular plant (which may be the subject of the rate challenge) is needed or not. This in turn will involve issues of transmission access, transmission rates, and rates for ancillary services (voltage support and the like), which are far-too-technical for an agency which is expert in rail transportation competition, but not the electricity markets and the transmission grids that support those markets.

Finally, RTOs do not exist in major regions such as the Southeast and the Rocky Mountain West, where substantial amounts of coal are used. The competitive wholesale electricity markets in those regions have numerous fundamental differences from those found in the RTO markets. AAR's attempts

to equate RTO markets with non-RTO markets in other areas of the country are unsupported by facts, thus rendering AAR's approach useless (or at best inadequate) in such regions.

Reasons the Board Should Decline to Institute a Rulemaking Proceeding

The Board should decline to institute a rulemaking proceeding, for many reasons.²⁶

First, as already explained, the determination of market dominance in a rate challenge was intended by Congress to be relatively inexpensive, efficient and not to cause inordinate delay. In the "4-R Act," in which Congress first adopted the "market-dominance" concept, and which Congress adhered to in relevant respects in the Staggers Rail Act of 1980, Congress directed the ICC to "establish, by rule, standards and procedures for determining ... whether and when a carrier possesses market dominance.... Such rules shall be designed to provide a practical determination without administrative delay."²⁷

Second, consideration of indirect competition is unnecessary. The number of coal-rate challenges filed with the Board in its 16-year existence is miniscule, compared to the docket of any other economic regulatory agency with jurisdiction to set maximum rates. The railroads admit²⁸ that there have been only 31 challenges in 16 years, less than two per year. The transaction costs of

²⁶ Lest the Board be concerned that it would be unfair or unprecedented to refuse even to institute a proceeding in response to the AAR Petition, recall that this is exactly what the Board did in 2008 in Ex Parte No. 679 when AAR petitioned for use of replacement costs in "revenue adequacy" determinations. The Board did so on grounds of practicality and because it had considered the issue previously.

²⁷ *Western Coal Traffic League v. United States*, 719 F.2d 772, 780 (5th Cir. 1983) ("*Western Coal Traffic League*"), citing Section 202(b) of the 4-R Act, Pub. L. No. 94-210, 90 Stat. 31 (1976); see also, 49 U.S.C. § 10101 (15).

²⁸ Petition at 5 n.2.

each such challenge are extraordinarily high, and the chances of success in such challenges are relatively low (which is why so few are being filed²⁹). So, there are already high barriers to filing a coal-rate challenge at the Board. The railroads' proposal would add nothing but additional complexity and cost to proceedings challenging rail rates. It also would not eliminate any coal rate challenges, because, if a coal shipper were indeed able to take advantage of effective competition for its transportation, the shipper would not file an STB rate-reasonableness challenge, and incur millions of dollars in transaction costs and years of delay. Instead it would rely on competition to determine its rate.

Third, railroads impose their rates either in contracts (which are then fixed; we are aware of none that adjust the rates during the contract's term with the prices in the electricity markets), or in tariffs. Tariffs typically cannot be changed on less than 20 days' notice, and there is no evidence of tariffs containing rail rates that change hourly or daily or over any other period to correspond with changing prices for wholesale power in the electric energy markets. Indeed, there is no mechanism, in coal transportation contracts or tariffs of which we are aware, to allow rail rates to respond to short-term changes in electricity markets. If the AAR theory that rail rates respond to short-term changes in wholesale electricity prices were correct, we should see such mechanisms, and should see specific evidence of the railroads reducing their existing rates to meet

²⁹ The fact that some coal shippers have prevailed in such challenges says nothing about whether other coal shippers would prevail if they were to challenge the rail rates applicable to their shipments. The Comments filed by APPA, EEI, and NRECA and other shipper-related entities in Ex Parte No. 715 explain why the Board's proposed changes to its rate-reasonableness standards would make the chances of success even lower.

competition from natural gas. There is no such evidence, so far as we are aware.³⁰ Instead, according to the Department of Energy's Energy Information Administration, actual domestic coal-transportation rates were up almost 50 percent from 2001 to 2010,³¹ and show no signs of declining.³² Hence, AAR's theory is inconsistent with the facts.

Fourth, AAR has offered no evidence – not a single instance – in its Petition of a railroad reducing its existing rates to meet indirect competition faced by a coal shipper. In our experience, as Mr. Schwartz's recent presentation³³ suggested, railroads generally have been unwilling to reduce their contract and tariff rates in response to competition faced by their customers. AAR's theory is not supported by the facts.

Some wholesale electric suppliers do switch from time to time to natural gas-fired electricity sources based on marginal prices. Others, however, have expended considerable sunk costs in coal-fired power plants, and therefore have substantial financial imperatives to operate these units. More to the point,

³⁰ Dr. Reishus admits (V.S. at 65) that "While publicly available data on the cost of delivered coal used in electric generation is available to some extent, the cost of railroad transportation to power generators is not." AAR should not be allowed to get away with this sort of claim; it clearly could get access to appropriate data (if not confidential contract rates) and submit it to the Board. AAR's witness Reishus instead cites a trade press article purporting to show declines from anticipated "market levels" in 2011, and it also provided specific rates supposedly agreed to by Dynegy, Inc. in August 2012 that were below "market expectations." These third-hand reports are not reliable, and are not specific evidence of a railroad or railroads reducing an existing rail rate in response to competition.

³¹ http://www.energybiz.com/article/12/11/eia-coal-transportation-costs-jump-50-last-decade&utm_medium=eNL&utm_campaign=EB_DAILY2&utm_term=Original-Member.

³² As one analyst, Mr. Seth Schwartz of Energy Ventures Analysis, put it recently, railroads are happiest with high prices and low volumes rather than low prices and high volumes.

³³ *Id.*

however, the railroads have presented no evidence to demonstrate that the railroads have actually reduced rail rates to prevent utilities from fuel-switching. Thus, while the theory has been advocated for a long time, the facts do not support the theory because there is no evidence that product or geographic competition has in fact served as a constraint on rail rates. Based on the lack of evidence cited by AAR, and the lack of publicly available evidence of railroads reducing existing rates due to lower electricity costs when generated from other fuels, we believe that the theory is wrong in the case of the railroads' shipments of coal. Moreover, the theory does not take into account the fact that the railroads can replace shipments to domestic utilities with shipments of coal for export and are now beginning to move crude oil to domestic refineries. These elements must also be considered if the STB were to evaluate the validity of the product and geographic competition hypothesis.

Fifth, analysis of potential switching is not as simple as AAR postulates. As noted, all coal-fired plants are not base-load, and not all coal-fired plants can be replaced by gas-fired generation.

The need for some plants to operate for system-reliability reasons, or to provide ancillary services, acknowledged in the AAR Petition, demonstrates the importance of looking at each plant individually. Even with the largest centrally administered wholesale power supply market, that operated by the PJM Interconnection LLC, there are so-called "load pockets" where certain generation units are from time to time designated "must run" units (or paid higher prices) to ensure grid reliability. Moreover, AAR has failed to address constraints in natural

gas pipeline capacity that may impede a unit from switching from coal to natural gas.

Sixth, electricity markets are likely to continue to change rapidly in the next few years due to the imposition of a number of new environmental regulations which will lead to the refurbishing of many coal-fired plants and the closing of others. This is particularly true because of the so-called “MACT” (*i.e.*, “Maximum Achievable Control Technology”) deadlines in 2015 and 2016, as well as other impending environmental regulations affecting the existing electric generating fleet. Many of these changes may require coal-fired plants to use specialized coals to comply with environmental requirements, thus reducing their ability to switch fuels. In this type of environment, reliance even on recent market data may be misleading.

Seventh, as the STB has acknowledged, it is not expert in analyzing wholesale electric market supply data, nor does it have the expertise to delve into all factors affecting power supply choices. It was precisely because of such complexities that the Board previously concluded that it should not become involved in these sorts of deliberations, when it decided to establish a presumption against consideration of product and geographic competition in the late 1990s.³⁴ It should come to the same conclusion again.

Eighth, despite AAR’s claim in the Petition (at 26-34) that there is now a straightforward, simple test to determine if coal-fired power plants are subject to indirect competition, the history of railroad efforts to inject indirect competition

³⁴ *Market Dominance I*, *supra*, 3 S.T.B. at 947-48.

into rail-rate challenges at the ICC and STB is not promising. Discovery on that subject, and determinations of that issue, involving an entirely different market than railroad transportation – the wholesale electricity market -- were protracted, expensive, and burdensome.³⁵ There is every reason to believe they still would be, despite AAR's assurances of a simple test.

AAR's expert recommends (Petition at 26, 29, and 34) that the Board look at "actual changes in coal-fired and natural gas-fired generation output" and "wholesale power supply and capacity factor curves," utilizing "the vast quantity of data available [which] has led to development of private data aggregation services that organize this data for regular use by market participants." Although AAR claims (*id.*) that this "would be a straight-forward, quick and inexpensive exercise for a shipper considering a rate challenge," the argument does not pass the "red face" test. There is a great deal that can be fought about in such circumstances. The discovery alone could be daunting, just as the Board has acknowledged has been the case in the past when it considered indirect competition.

The fact is that there is no standard market design for centralized wholesale electricity markets in the United States. Each such market structure has its own unique design, operations, and history. While it may be possible to perform a purely academic exercise of assuming competitive wholesale electricity markets operated in electricity the same way, the results of such an exercise would be meaningless and not represent reality. Each competitive

³⁵ *Market Dominance I, supra*, 3 S.T.B. at 946-49; *Market Dominance II, supra*, 4 S.T.B. at 273-79; *Market Dominance III, supra*, 5 S.T.B. at 493, 498-99.

wholesale electricity market has its own market parameters and business practices, requiring significant amounts of data and programming to accurately model market behavior and outcomes. The Board should be extremely reluctant to have such varied market structures, operations, and dynamics, outside the scope of the Board's expertise, brought before it.

Ninth, despite the Board's determination of market dominance without consideration of product and geographic competition, rail shippers are now expressing concern that the Board's current market-dominance determinations are too lengthy, complex, and expensive.³⁶ Market-dominance determinations by the Board in chemical rate cases are now taking two years or more. Market-dominance determinations in coal rate challenges have been more straightforward, as Congress intended, since the presumption against consideration of indirect competition was adopted. The railroads have not disputed market dominance in several recent coal-rate proceedings. Granting AAR's Petition would make it likely that the Defendant Railroad(s) again would raise market dominance in many, if not every, coal rate proceeding, arguing complexities about the wholesale electricity markets and whether rail rates are constrained by such indirect competition. It is not clear that the Board has the resources to devote to such matters, or that it should devote its scarce resources to them, with so many other matters pending before the Board and competing for its attention.

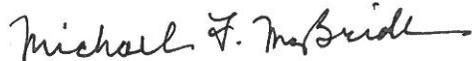
³⁶ See, e.g., *M & G Polymers USA, LLC v. CSX*, STB Docket No. NOR 42123, especially CURE's *amicus* filing of November 28, 2012, and M & G's various filings in response to the Board's September 2012 decision in that proceeding, finding that market dominance exists on most of the lanes for which M & G challenged CSX's rates.

It was for precisely these reasons that the Board rejected indirect competition as a factor in market-dominance determinations.³⁷

Conclusion

AAR has not demonstrated that competition in wholesale electricity markets has had any effect on existing railroad rates for coal. Therefore, the Petition should be denied without instituting a rulemaking proceeding, as a matter of the Board's discretion, so as not to further discourage coal shippers with potentially meritorious cases from filing a challenge to their rail rates, and so as not to complicate or delay rate-reasonableness proceedings at the Board.

Respectfully submitted,



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³⁷ *Market Dominance I*, *supra*, 3 S.T.B. at 946-49; *Market Dominance III*, *supra*, 5 S.T.B. at 498-99.

Certificate of Service

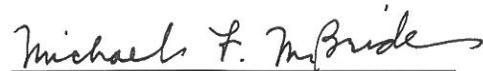
I hereby certify that I have served, this 14th day of January 2013, a copy of the foregoing Reply in Opposition of American Public Power Association, Edison Electric Institute, and National Rural Electric Cooperative Association on the following persons:

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