BEFORE THE
SURFACE TRANSPORTATION BOARD

DOCKET NO. EP 714

INFORMATION REQUIRED IN NOTICES AND PETITIONS CONTAINING INTERCHANGE COMMITMENTS

COMMENTS OF ARKANSAS ELECTRIC COOPERATIVE CORPORATION

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Dated: December 18, 2012

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Arkansas Electric Cooperative Corporation (AECC) 1/ submits these comments in accordance with the Board's Notice Of Proposed Rulemaking in its Decision served November 1, 2012.

The Notice Of Proposed Rulemaking deals with reporting requirements for transactions in which a Class I railroad seeks to impose interchange commitments when it transfers particular lines to a short line operator. However, the Board cannot decide what reporting requirements to impose on such interchange commitments in a vacuum. The Board

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1/ AECC is a membership-based generation and transmission cooperative that provides wholesale electric power to electric cooperatives, which in turn serve approximately 500,000 customers, or members, located in each of the 75 counties in Arkansas and in surrounding states. In order to serve its 17 member distribution cooperatives, AECC has entered into arrangements with other utilities within the state to share generation and transmission facilities. For example, AECC holds ownership interests in the White Bluff plant at Redfield, AR and the Independence plant at Newark, AR, each of which typically uses in excess of 6 million tons of Powder River Basin (PRB) coal each year. In addition, AECC holds an ownership interest in the Flint Creek plant at Gentry, AR, which normally uses in excess of 2 million tons of PRB coal each year. Because of the large volume of coal consumed by these plants, and the need for long-distance rail transportation to move this coal, AECC has a direct interest in measures that affect rail service and competition between rail carriers.

must first determine, as a matter of policy, the extent to which such short line transactions have the potential to create public benefits. Short line transactions could create such benefits if they alter the status quo in the railroad industry to introduce greater reliance on market forces and thereby promote improved service and productivity. The Board must then consider the extent to which interchange commitments may undermine such potential public benefits.

Thus, it is useful to start with a brief review of the status of competition in the Class I railroad industry today, and how it got this way.

The Structure Of The Railroad Industry

When the Staggers Act was passed more than 30 years ago, it sought through regulatory reform to achieve two principal and interrelated goals: (1) To maximize the role of competition and demand for services, and minimize the role of regulation, in establishing reasonable rates, a sound rail system, and sound economic conditions in transportation; and (2) To allow rail carriers to earn adequate revenues to make the rail system safe and efficient. 49 USC § 10101.

The explicit priority given to the financial health of the industry resulted from the history of failing carriers and bankruptcies that preceded the Staggers Act. Without getting too far into the history of the industry, a reasonable summary would be that a lack of competitiveness (including the innovation and productivity improvement it drives), along with comparatively poor service, had caused the railroad industry to lose volumes and market shares to other modes, and suffer declining financial health. Indeed, the reliance on competition in the Staggers Act was intended to promote revenue adequacy by increasing the extent to which market forces guide resource allocation.

For more than a decade, market forces drove a wave of consolidations. Notwithstanding the mandate it had to support revenue adequacy, and the marginal financial health of the industry, the ICC imposed meaningful conditions on several of those mergers to ensure that existing competition was preserved. For example, in the UP/MP/WP merger the ICC conditioned its approval of the merger on the grant to DRGW of trackage rights over MP between Pueblo, CO and Kansas City. Those trackage rights preserved competition in the so-called Central Corridor in the west; they also fostered the commonality of interest between DRGW and SP that eventually drove the SP/DRGW consolidation and related line acquisitions, after the ICC rejected as anti-competitive the proposed take-over of SP by ATSF. The record shows that reliance on market forces produced a lengthy period of declining rates, productivity improvements, better service, and improving carrier financial health.

By the mid-1990's, however, at least from the shipper perspective, the priority attached to preserving competition in regulatory actions declined. Mergers reduced from 3-to-2 the number of major carriers in the east and west, and the Bottleneck Decision insulated the remaining mega-carriers from competition on segments of routes where competition was possible. At the same time, the Board and its predecessor have been reluctant to use the statutory tools Congress has provided to preserve and enhance competition among railroads. The Board's own study of competition issues demonstrated how these factors caused productivity growth to slow and costs to increase relative to the trajectory they had been on. The mega-carriers also began to exhibit service instabilities, as service perturbations that in the past likely would have been dissipated by multiple carriers instead reverberated through the networks of the duopolistic mega-carriers.

If low productivity growth and service irregularities sound familiar, it is because these were the symptoms of insufficient competition that provided the motivation for the increased reliance on market forces embodied in the Staggers Act in the first place. The difference now is that the industry has made so much progress on revenue adequacy that the regulatory challenge is to protect against supracompetitive rail earnings rather than preservation of rail market power.

Interchange Commitments In The Current Railroad Environment

As a matter of good public policy, the Board should properly consider the extent to which the transfer of lines by Class I railroads to short line operators may play a role in altering the status quo in the railroad industry to introduce greater reliance on market forces to promote improved service and productivity. Decisions about the nature and extent of reporting requirements and the scrutiny of interchange commitments need to be made in light of such policy considerations.

In the context of interchange commitments, the status quo is a two-edged sword. On the one hand, as the railroads have argued, interchange commitments do not intrinsically change the extent of market power that the transferor railroad exercised over individual movements before the transfer. On the other hand, the exercise of rail market power may well be the reason why a given track segment is a candidate to be spun off as a shortline in the first place. For example, a railroad's private interests might favor the sourcing of commodities or products from other locations because movements from such locations are more profitable. If a low-density line is a low-density line due to the (lack of) competitiveness of the transferring railroad's lines for the markets in which the low-density line's traffic seeks to participate, it's hard to make out a legitimate public interest rationale for preserving that. In this light, shippers on the low-density line – and the economy as a whole – are being disadvantaged by the competitive ineffectiveness of the parent railroad, yet to date the ICC/Board has simply rubber-stamped interchange commitments intended to preserve the transferor railroad's market power.

Current Board Policy On Interchange Commitments

In EP 575, Review Of Rail Access And Competition Issues – Renewed Petition Of The Western Coal Traffic League, Served Oct. 30, 2007, at 14, the Board announced that it would "consider the propriety of interchange commitments on a case-by-case basis." The Board explained that in each case it would:

> examine the relevant facts and circumstances surrounding that agreement. We will consider whether the interchange agreement is part of a lease or a sale of a line, and we will look at the duration of the restriction. We will examine the manner in which the interchange commitment discourages interchange with other carriers and the degree to which interchange is effectively foreclosed. Parties should expect a higher level of scrutiny on agreements that contain a total ban on interchange with other carriers or go on in perpetuity.

Id. at 15. Nevertheless, in its case-by-case analysis, the Board has never met an interchange commitment it didn't like.

None of the paper barrier proposals listed in n. 17 of the November 1, 2012 Decision initiating this proceeding was disapproved by the Board on the merits, 2/ and they were initially approved, without detailed examination, under the class exemption procedures of

2/ FD 35370 was dismissed without prejudice because the applicant had failed to comply with the Board's filing requirements.

49 CFR § 1150.41. In two cases, hearings were later held in response to petitions to revoke the exemption, and the revocation petitions were denied in both cases.

Although the record on these transactions is sparse, a few intriguing facts can be gleaned about them. For example, in some cases the applicants stated that the Class I railroad that leased them the line did not initially demand an interchange restriction (FD 35529; FD 35533), or the paper barrier appeared for the first time in a renewal or extension of an earlier lease that did not have such a commitment (FD 35382; FD 35529; FD 35617), facts that undermine any notion that a paper barrier was necessary to induce the Class I carrier to transfer trackage to the short line. In some cases, the short line did not connect to another Class I (FD 35370; FD 35617; FD 35634), or handled almost nothing but inbound traffic for which it didn't control the routing or the interchange (FD 35410), so that no paper barrier would seem to be needed to protect the lessor's traffic from diversion – yet a paper barrier was nonetheless included for no articulated reason. The interchange commitments ranged in duration from 10 to 30 years (plus extensions).

Once a line transfer that includes an interchange commitment has been accomplished, there is at present no effective way for a shipper to seek to eliminate the interchange commitment in order to obtain competitive service. A petition to revoke the exemption won't work, because even if successful that would simply result in the line being returned to the transferor railroad – the very party whose revenue the paper barrier is protecting. At one time, it appeared that the Board's competitive access rules might provide a way to overcome a paper barrier in order to provide a captive shipper with a competitive alternative, but the Board has more recently construed those rules so narrowly as to render them useless for this purpose.

Entergy Arkansas, Inc. v. Union Pacific RR, NOR 42104, was a proceeding brought by the owners 3/ of the Independence power plant at Newark, AR (referenced in footnote 1) to set aside a paper barrier that was preventing the plant from obtaining competitive rail service for coal movements from the Powder River Basin. Independence was solely served by the Missouri & Northern Arkansas Railroad (MNA), which delivered to the plant PRB coal originated by UP. MNA had acquired, by lease and purchase, lines of a UP predecessor that serve the plant. Interchange commitments in the lease effectively precluded MNA from interchanging with UP's potential competitor, BNSF, to serve Independence.

In a Decision served June 26, 2009, at 2, the Board held that the "straightforward path" for Independence to seek relief from the paper barrier was an application under 49 U.S.C. 10705 4/ for the Board to prescribe a BNSF/MNA through route from the PRB to Independence. As the Board explained:

> [A] shipper's right to adequate service, reasonable rates, or any other statutory right (including access to an alternate through route) cannot be contracted away by an agreement between carriers. [citation omitted.] Thus, if a certain combination of carriers is providing inadequate service or is foreclosing the possibility of a more efficient route, the fact that they have an interchange commitment agreement does not limit the Board's ability to order alternative service over the carriers' lines or to require the carriers to open a new interchange with another carrier.

3/ AECC is a part-owner of the plant and participated in the proceedings described.

4/ This statute provides that the Board "may, and shall when it considers it desirable in the public interest, prescribe through routes, joint classifications, joint rates, the division of joint rates, and the conditions under which those routes must be operated, for a rail carrier providing transportation subject to the jurisdiction of the Board."

Id., at 3 (emphasis in original). A rail carrier has no right to "defeat legitimate competitive efforts of other rail carriers and shippers by foreclosing more efficient service." Thus:

> [I]f Entergy or AECC can demonstrate that, due to this interchange commitment, UP and MNA are providing inadequate service or foreclosing more efficient service over another carrier, [the Board] may direct that a new route be opened and order MNA to establish a common carrier rate for interchange with that other carrier.

Id., at 7.

However, the path turned out not to be as "straightforward" as the Board had said in 2009. The Board ultimately rejected the Independence Through Route application. Entergy Arkansas, Inc. v. Union Pacific RR, NOR 42104, Decision served Mar. 15, 2011, AECC Petition for Reconsideration denied, Decision served Nov. 26, 2012. The Board held that it was not enough, to obtain relief under Section 10705, to show that UP used the paper barrier to prevent Independence from receiving competitive rail service via a BNSF/MNA though route. The applicants had to show that UP and MNA had "exploited their market power to foreclose the use of a 'better' or 'more efficient' alternative." Nov. 26, 2012 Decision, at 6. Although the Board agreed (on reconsideration) that a BNSF/MNA route was considerably shorter and had lower variable costs that the UP/MNA route, the route was not enough shorter and the costs not enough lower to persuade the Board to prescribe a through route to overcome the paper barrier. Id. at 14-15. This decision demonstrates a narrow and highly restrictive view by the Board of competitive access remedies.

In a competitive marketplace, firms attract business by undercutting the price offered by competitors. All else equal, the difference need not be large, because customers have an obvious incentive to select the option with the lowest price. Through innovation, investment, or other means, firms strive to produce at the lowest possible cost to maximize their competitiveness. As long as the Board gives a higher priority to maintaining the incumbent carrier's contribution than to the possibility of increased competition, as it did in NOR 42104, the improvements in productivity and service that normally would flow from competition will not be achieved.

Conclusions And Recommendations

Requiring that Class I railroads provide additional information about proposed interchange commitments should be regarded as a means to an end, not an end in itself. The Board ought to use such reporting requirements as tools to support an effective policy related to shortline spin-offs. As part of such a policy, the Board should reconsider its current practice of allowing interchange commitments to preserve the incumbent's market power even when such market power works against specific statutory objectives. Such objectives include maximizing the role of competition and demand for services, and minimizing the role of regulation, in establishing reasonable rates, a sound rail system, and sound economic conditions in transportation. This is particularly appropriate as the revenue adequacy objective is achieved.

In particular, the Board should develop a policy to disapprove or limit an interchange commitment if it has such characteristics as:

- Foreclosing a more efficient routing via an alternative carrier, even though such foreclosure does not result from a competitive "abuse" other than the enforcement of the interchange commitment;
- Preserving control by a carrier even when it provides inadequate service;

- Preserving control by a carrier over a line serving traffic that the carrier has demarketed (for example, where the carrier has adopted policies that reduce or limit service for that traffic so that it can emphasize service for other more lucrative traffic); and/or,
- Preserving control by a carrier over a facility or resource that would be more effectively utilized if service via an alternative connecting carrier were available.

The Board should ensure that the information it requires permits it to assess the applicability of these, or any other conditions it may consider to be relevant, to the potential rejection of interchange commitments.

Not every short line has the potential to facilitate renewed competition, of course, and at best the Class I railroad industry is going to remain highly concentrated, but the proliferation of short lines does offer some hope, in some places, that a greater emphasis by the Board on competition can play a role in promoting productivity and service improvements in furtherance of the reliance on market forces envisioned in the Staggers Act.

Respectfully submitted,

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