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December 22, 2008

Via Electronic Filing

The Honorable Anne K. Quinlan
Acting Secretary
Surface Transportation Board
395 E Street, S.W.
Washington, DC 20423-0001

Re: Ex Parte No. 680; Study of Competition in the Freight Rail Industry

Dear Ms. Quinlan:

Enclosed for filing in the above-referenced proceeding are the Comments of Edison Electric Institute.

Respectfully submitted,

Michael F. McBride

Michael F. McBride

Attorney for Edison Electric Institute

United States of America
Surface Transportation Board

Ex Parte No. 680

STUDY OF COMPETITION IN THE FREIGHT RAIL INDUSTRY

Comments of the Edison Electric Institute on the
November, 2008 Report of L.R. Christensen Associates, Inc.

Edison Electric Institute
701 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2696

December 22, 2008

United States of America
Surface Transportation Board

Ex Parte No. 680

STUDY OF COMPETITION IN THE FREIGHT RAIL INDUSTRY

COMMENTS OF THE EDISON ELECTRIC INSTITUTE on the November, 2008 REPORT OF L.R. CHRISTENSEN ASSOCIATES, INC.

Pursuant to the Notice issued by the Surface Transportation Board (STB or Board) on November 6, 2008 (as corrected by the Notice issued on November 7, 2008), the Edison Electric Institute (EEI) hereby submits its Comments on the November 2008 Report by L.R. Christensen Associates, Inc. ("Christensen Report"). EEI appreciates the opportunity to submit comments on the Christensen Report.

Interests of EEI

EEI is the association of U.S. investor-owned electric utilities and international affiliates and associates worldwide. EEI's U.S. members serve approximately 97 percent of all customers served by the shareholder segment of the U.S. industry and 71 percent of all electricity customers in the United States, and generate almost 60 percent of the electricity produced by U.S. electric generators. EEI frequently represents its U.S. members before state and federal agencies, courts, and legislators in matters of common concern, including before the STB.

Rates allowed to be charged by EEI members for sales of electricity to consumers (retail rates) are regulated by state utility commissions in virtually every state in the Nation. Similarly, rates for sales of electricity for resale (wholesale rates) are regulated or overseen by the Federal Energy Regulatory Commission. Such regulation often includes mechanisms for recovery of fuel costs, which are subject to extensive review, analysis, and econometric modeling and other regulatory tests for cost-effectiveness by the state utility commissions. As transportation costs are a significant portion of the cost of a ton of coal, railroad transportation charges are also subject to extensive review by electricity regulators.

EEI hereby incorporates the comments of Consumers United for Rail Equity and the Western Coal Traffic League by reference.

Christensen Report Does Not Reflect Current Market Realities

The biggest single flaw in the methodology employed in the Christensen Report, renders the report irrelevant to transportation policymakers: the failure to include 2007 and 2008 data in the analysis. The data from 2004 to 2008 timeframe would more accurately reflect the significant shift in the direction of rail rates and would reflect the pricing power held by the railroads during this time period. Not only were older, long-term coal contracts expiring in those years, but it was also a time in which the volatility of transportation fuel costs placed great stress on Railroad Fuel Surcharges, resulting in rate increases above fuel cost recovery to most rail customers. EEI believes that a report in the December, 2008, issue of Rail Price Advisor (Attachment 1) provides a more accurate state of the market: in 2008, the Average Rate Per Car for the four major Class 1 U.S. Railroads increased more than 20 percent, on top of substantial increases (approximating 15 percent) in 2007.

An additional problem with the Christensen Report data is that the authors look at average rates for entire commodity groups rather than individual rates. Shippers have not argued that all railroad rates are too high, even for a single commodity, so therefore the use of commodity group-wise averages erects a straw man and then proceeds to demolish it. If, for example, a review of rates paid by one utility, Basin Electric, during its contract term had been undertaken, the increases might have appeared modest. However, when the contract expired, the rates eventually tripled. Fuel surcharges may have accounted for much of the additional amount. Yet, if Basin Electric's rate is averaged with the other rates (many still under contract), the average annual increase would be much less.

In reviewing the Report, EEI members do not find that it represents the coal transportation market as it exists currently. EEI member companies describe the existing state of the transportation market as one dominated by monopoly providers. Even in situations where two rail carriers are capable of serving a single coal-fired electricity generation plant, they do not compete and contracts are allowed to expire. If service continues it does so under tariff rates that are 30, 50, or even 100 percent higher per ton, and most carriers typically treat customers with a "take it or leave it" attitude.

The authors also stated that, following the derailments in the Powder River Basin (PRB) in 2005 and the constraints on the railroads' ability to carry enough coal from that time until approximately 2006, it was normal for rates to increase somewhat because of the capacity constraints. However, that assertion is based entirely on speculation about the cause of the increases. It would have been possible to test the authors' theory by reviewing the rate changes that occurred for PRB coal in 2007-08 when the capacity constraints in the PRB were eliminated, to see if rates again went down in a (presumably) competitive market. Had the authors tested their theory, they would have found that rates continued to go up substantially, based on all available data. Accordingly, the authors would have been compelled to conclude that, by 2003-04, something fundamental had changed in the railroad industry, and that railroads no longer compete for business, for the most part.

Ironically some EEI members report that often having two railroads serve their plants, rather than one, can be even less advantageous. While they cannot get the non-serving railroad at a plant to compete, the presence of a potential competing rail carrier makes it more difficult to convince the STB that there is a lack of effective competition because the STB offers no help because the plant is not captive to one railroad and thus STB jurisdiction does not apply. As a result, EEI members find themselves in situations where they neither benefit from effective competition between railroads nor, have an effective rate remedy at the STB.

Had the authors more vigorously sought the guidance of the Members of the Advisory Panel, listed in Appendix 5-A of the Report, they likely would have received a more complete understanding of what is currently transpiring in the coal transportation market. Furthermore, EEI believes that given the importance of coal shipments to national energy security, especially critical electricity supply and reliability, as well the economic health of the railroad industry, additional Advisory Panel input from shareholder-owned electric companies and others in the utility sector was warranted. Nevertheless, while there is only one representative of a shareholder--owned utility listed, the coal shippers that are listed are in a position to address aspects of the Government Accountability Office's charge to the STB.

<u>Christensen Report Does Not Reflect The GAO Charge to the STB</u>

In its October 6, 2006, report, *Freight Railroads: Industry Health Has Improved, but Concerns about Competition and Capacity Should be Addressed,* the Government Accountability Office (GAO) wrote, on page 3,

> "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."

While packed with data, the Christensen Report does not examine whether "abuse of market power," is occurring, what constitutes market power, or the market reality that shippers face: duopoly or monopoly service in all regions of the nation. One important aspect of the Christensen Report is the data presented that 44 percent of shippers are paying rates above the 180 percent jurisdictional threshold limit, with the highest being over 700 percent (Christensen Report stated this was a movement of wheat at 757%) of R/VC. While not involving coal shipments, the electric industry notes with interest the recent STB case, E.I. DuPont De Nemours and Company Amended Complaint, Docket Number NOR_42112_0, (Exhibit B, page 1 of 4) which claimed a rate with an R/VC ratio of 1085% for the transport of Chlorine from Niagara Falls, New York to Edgemoor, Delaware. Other than the extensive analysis of the grain industry, it appears Christensen did not capture what is currently taking place in the market, for commodities other than grain, and for years after 2006.

Table ES-3 illustrates that in the study period, rates with a R/VC ratio greater than 300 percent had increased to 17 percent of the Waybill Sample in 2005-06, from 12 percent in 2000 and 2001. Christensen did not interpret this as an abuse of market power nor make any statement about this increase in rates with an R/VC ratio greater than 300 percent.

By not clearly addressing the potential or actual abuse of market power, the Christensen Report has not addressed a primary issue identified by the GAO for consideration in the Report. What Christensen did properly conclude was that additional factors to the R/VC threshold should be considered in the determination of market structure. Monopolists or duopolists can demonstrate market power abuse in ways that Waybill Samples can never reflect, such as inadequate service and communication with customers as well as being responsive to the variety of other needs customers may have, which for a coal shipper might include diversion of a train to a different power plant, or a reduction or an increase in coal deliveries depending upon local market conditions.

Conclusion

In short, EEI believes that the Christensen Report is flawed and incomplete, based on the fact that it did not analyze (or even include) data for 2007 and 2008. In 2007 and 2008, railroads have imposed significant rate increases, on all classes of customers. Without this data (some of which at least was available to the authors simply by requesting it from shippers or railroads, or by reviewing STB dockets in which rail rates have been challenged), it was not possible for the Christensen firm or the STB to address, let alone address adequately, the issues raised by the GAO. In particular, the Christensen Report does not address the fundamental question posed by GAO: are railroads abusing their market power? EEI believes that the answer is clearly "yes."

Respectfully submitted,

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December 22, 2008

Attachment 1

RAIL PRICE ADVISOR

The Rail Intelligence Newsletter

December 2008
Volume 17, Number 5

2008 is a Record Breaking Year for Rail Rate Increases

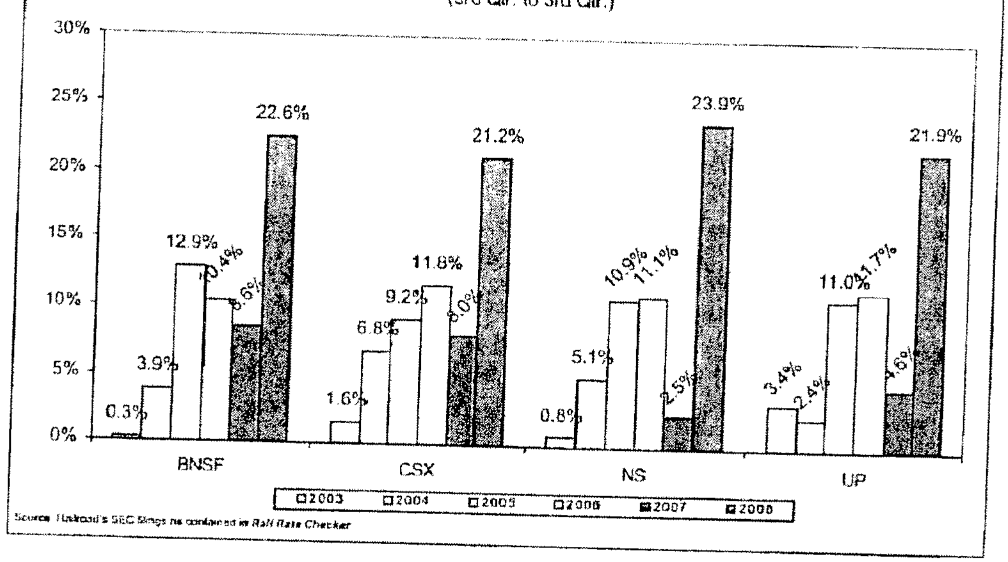
Figure 1 below tracks the annual average change in the rate per car for the major US Class I railroads over the last six years. The increases include the revenue railroads receive from rates and fuel surcharges, and are tracked from the third quarter of successive years. **The 2008 rate increases are staggering as they make even the highest change in rates over the 2002 to 2007 time period seem tame when compared to the increases in 2008.** The lowest average increase over the last four quarters was 21.2% on the CSX, followed by 21.9% for the UP and 22.6% for BNSF, the NS had the largest increase at 23.9%.

The rate increase per carload listed is a system-wide increase for all types of rail traffic: coal, intermodal and manifest business; it is developed from the railroads' Security and Exchange Commission filings. These increases represent the "Bottom Line" revenue per car increases railroads are obtaining from their customers. These increases represent a benchmark for the types of rate increases shippers can compare their increases against.

Figure 1

Annual Change in the Average Rate Per Car for the Big 4 U.S. Railroads Over the Last Six Year

(3rd Qtr. to 3rd Qtr.)



A good portion of the large 2008 increase in rates is directly related to the increase in the railroad's fuel surcharge revenue. Rail transportation, like many other commodities and services is fuel intensive. To compare how rail rates have increased in relation to other fuel intensive products and services the graph in Figure 2, on page 2, compares the average 2008 increase of the four large U.S. railroads against BLS indexes for Industrial Electric Power, Aluminum Sheet, Cement, Glass and General Freight Trucking.

Figure 2 on page 2 shows that the price of other commodities and services that are fuel intensive have increased at a lower rate than the cost of rail transportation over the last four quarters. This indicates that the pressure in the marketplace to hold down costs is much greater with other products and services than it is with rail. ☐

Inside this issue