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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 680 (Sub-No. 1)

SUPPLEMENTAL REPORT ON CAPACITY AND INFRASTRUCTURE
INVESTMENT

COMMENTS OF ARKANSAS ELECTRIC COOPERATIVE CORPORATION
REGARDING SUPPLEMENTAL REPORT ON CAPACITY AND
INFRASTRUCTURE INVESTMENT CONDUCTED BY CHRISTENSEN
ASSOCIATES

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By Notice dated April 8, 2009, the Board invited public comment on the report prepared by Christensen Associates, Inc., under contract to the Board, entitled, *Supplemental Report to the U.S. Surface Transportation Board on Capacity and Infrastructure Investment*, released on April 8, 2009 ("*Supplemental Report*"). This report supplements an earlier report by Christensen Associates, *A Study of Competition in the U.S. Freight Railroad Industry and Analysis of Proposals That Might Enhance Competition*, released in November 2008 ("*Competition Report*"). Pursuant to the Board's Notice, this document presents the comments of Arkansas Electric Cooperative Corporation (AECC)^{1/} regarding the *Supplemental Report*.

^{1/} AECC is a membership-based generation and transmission cooperative that provides wholesale electric power to electric cooperatives, which in turn serve approximately 490,000 customers located in each of the 75 counties in Arkansas. In order to serve its 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 burns in excess of 6 million tons of Powder River Basin (PRB) coal annually. In addition, AECC holds an ownership interest in the Flint Creek plant, at Gentry, AR, which normally burns in excess of 2 million tons of PRB coal annually. Because of the large volume of coal used by these plants, and the need for long-distance rail transportation to transport this coal, AECC has a direct interest in issues related to railroad capacity and infrastructure investment, particularly as such issues relate to transportation of PRB coal.

These comments do not supersede or mitigate the issues raised by AECC in its filing to the Board regarding the *Competition Report*.² As described in detail by AECC, the text of the *Competition Report* conveys an improperly benign view of the exercise of market power by the U.S. freight railroad industry in recent years. The *Competition Report* should not obscure the fact that there are serious competitive problems in the U.S. railroad industry today,³ or the importance to the public interest of reforms that would restore or enhance competition.

Notwithstanding the infirmities of the *Competition Report*, the *Supplemental Report* provides an important reality check on one of the railroad industry's central arguments for allowing the increased exercise of market power. The industry has argued in recent years that future capacity needs cannot be satisfied at current rate levels, so that higher rates are required to support needed infrastructure investments. This argument formed the central theme of the report on infrastructure needs prepared for AAR by Cambridge Systematics (*CS Report*).⁴

The *Supplemental Report* implicitly refutes this argument in several respects. For example, it shows that:

- a. the volume projections relied upon in the *CS Report* are unrealistically high, and are dramatically inconsistent with projections available from authoritative sources;

² STB Ex Parte No. 680, *Study of Competition in the Freight Railroad Industry*, "Comments Of Arkansas Electric Cooperative Corporation Regarding Study Of Competition In The U.S. Freight Railroad Industry Conducted By Christensen Associates" (December 22, 2008) ("AECC *Competition Report* Comments").

³ In a small number of instances, such as at pages ES-3, 2-19 and 2-24, the *Supplemental Report* cites the *Competition Report* for characterizations of the competitive marketplace that are undermined by the shortcomings of the *Competition Report*. These instances are tangential to the primary content of the *Supplemental Report*, and are not discussed further herein.

⁴ Cambridge Systematics, *National Rail Freight Infrastructure Capacity and Investment Study*, prepared for the Association of American Railroads, September 2007.

- b. the threshold for capacity improvement in the *CS Report* was set at an unnecessarily low volume/capacity level, particularly in light of the mandated implementation of Positive Train Control (PTC), which caused it to overstate future capacity requirements;
- c. the investments postulated in the *CS Report* would go beyond those needed to accommodate projected volume increases, and would produce an improvement in volume/capacity ratios that is unrelated to volume; and,
- d. the investments postulated in the *CS Report* have not been subjected to cost-benefit analyses or reasonableness checks, so at least some of them (presumably costly improvements that affect comparatively small volumes and/or produce small benefits) might not ever be made.

These observations complement several additional considerations identified previously by AECC⁵ that invalidate the railroads' attempted reliance on the *CS Report*. For example, AECC noted that for line segments with centralized traffic control (CTC), the only option for increasing capacity examined in the *CS Report* is the addition of tracks at a cost of \$3.8-4.4 million per mile. However, the railroads are well aware that many of the segments they now operate formerly contained more than the current number of tracks, and that restoration of additional tracks in such circumstances

⁵ STB Ex Parte No. 664, Methodology to be Employed in Determining the Railroad Industry's Cost of Capital, "Reply Comments of Arkansas Electric Cooperative Corporation" (October 29, 2007) at pages 4-6. In addition, AECC has identified adverse impacts of the Board's "bottleneck rule" on rail capacity and capacity investments. See AECC *Competition Report* Comments, "Statement of Michael A. Nelson Regarding Christensen Study of Competition in the Freight Railroad Industry", Appendix A at pages 9-11. This raises the possibility that reforms of the bottleneck rule, as contemplated by the Board in STB Ex Parte No. 688, Policy Alternatives to Increase Competition in the Railroad Industry (postponed on April 17, 2009), could enhance effective rail capacity relative to the assumptions embodied in the *CS Report*.

typically costs much less than assumed in the *CS Report*. Likewise, the railroads are surely aware of opportunities to change classification and blocking plans to permit more direct and efficient handling as volume increases.

The *Supplemental Report* also corroborates AECC's observations regarding the importance of productivity improvements in expanding the effective capacity of the rail network. Indeed, the railroads themselves have described to the Board the essential role of productivity improvements in the provision of capacity increases. At a public hearing conducted in April 2007, the Class I railroads described to the Board how an option like PTC may provide substantial increases in the effective capacity of the existing network for a small fraction of the investment cost figures generated in the *CS Report*.⁶

Data presented in the *Supplemental Report* also rebut the railroads' claim that capacity constraints they already face provide a justification for recent rail price increases. Specifically, the data in Table 2-1 on page 2-27 of the *Supplemental Report* demonstrate that the "primary measure...used...to identify network congestion" – terminal dwell times - dropped from 2006-2007 (i.e., when volumes were increasing), and stayed flat when volumes dropped from 2007-2008. These findings – which the *Supplemental Report* simply describes (on page 2-34) as "not...in the direction one would expect", refute the proposition that the railroads in recent years have been operating in a capacity-constrained environment that necessitated the use of increased differential pricing to "ration" capacity.

⁶ STB Ex Parte No. 671, Rail Capacity and Infrastructure Requirements, public hearing (April 11, 2007).

For PRB coal shippers, it is not a surprise to find that volume-driven capacity expansion does not necessitate rail price increases. For 20 years after the commencement of 2-railroad competition in 1984, PRB shippers and the railroads serving them made the investments in the infrastructure and equipment needed to accommodate strong, sustained long-term volume growth, and move that volume with increasing productivity and at lower rate levels. As long as railroads enjoy economies of density, the proposition that future volume growth will change this equation, and will inherently require higher rates, has no foundation and runs contrary to actual experience.

The *Supplemental Report* goes a step further, and clarifies that due to limited future volume growth, PRB coal traffic is unlikely to impose any significant new requirements for rail capacity expansion in the foreseeable future. As summarized on page 5-18 of the *Supplemental Report*, "...there does not appear to be an urgent need for investments to support PRB coal shipments that are not already in the railroads' plans."⁷ Instead, the *Supplemental Report* describes in detail how intermodal traffic is likely to be the primary driver of future rail capacity investment needs, and how the externalities of truck traffic support public involvement in the provision of rail infrastructure.

⁷ The discussion of PRB capacity in this portion of the Supplemental Report partially corrects the misimpression created at page 2-15 that the PRB throughput problems observed in 2005 were related to the adequacy and capacity of the infrastructure. As AECC has documented in detail for the Board, the PRB Joint Line problems of 2005 stemmed squarely from ill-advised rail management decisions pertaining to maintenance practices, and did not result from unusual weather, insufficient infrastructure or even delays associated with routine maintenance. See, for example, STB Ex Parte No. 672, Rail Transportation of Resources Critical to the Nation's Energy Supply, "Written Submission Of Arkansas Electric Cooperative Corporation" (July 5, 2007) at pages 4-6. Indeed, the design of the Joint Line infrastructure permits high-capacity double- or triple-track operations to continue even when one track is taken completely out of service for routine maintenance. See, for example, http://www.bnsf.com/employees/communications/bnsf_today/2007/11/2007-11-05-b.html. When routine maintenance is performed, the 25-foot on-center track spacings used on the Joint Line permit unrestricted operations on the tracks that remain in service without jeopardizing the safety of maintenance personnel. See, for example, <http://www.fra.dot.gov/us/content/1232> (Part 214, Subpart C).

Given these findings, the rail carrier rationale for increased differential pricing to support future capacity needs is buried even deeper. In the competitive marketplace for intermodal services, railroads are free to make whatever investments may be needed to support volume increases that are economically rational. They are also free to seek public involvement to share, support or facilitate such investments. The extent of such public involvement may well determine the degree to which rail will effectively divert future truck freight, and AECC recognizes the rationale for such involvement. However, there is absolutely no valid basis upon which the Board could or should trump decisions that are ultimately made regarding public involvement in intermodal investments by permitting cross-subsidy to intermodal from captive shippers of other commodities (including coal). The findings of the *Supplemental Report* refute conclusively the proposition that broad increases in differential pricing are required to support future infrastructure needs.

In light of these findings, the *Supplemental Report* can be seen as the last step in excising the baseless excuses for higher rail pricing in recent years that have been advanced by the rail industry, and presented in the *Competition Report*. The theory that rail price increases have been driven by factor price increases has already been nullified by the fact that recent decreases in factor prices, including fuel and track materials, have not resulted in broad declines in rail rates. Likewise, Christensen's theory that rail price increases have been driven by productivity declines has been undermined by Christensen's own acknowledgement that its methods did not account for the possible effects of changes in the traffic mix (i.e., an increase in the proportion of comparatively

high unit cost intermodal traffic) on the results it observed.⁸ The demonstration by the *Supplemental Report* that neither past nor future capacity issues justify rail price increases, combined with the fact that rail rates have generally not dropped despite the volume reductions associated with the deepest recession in 70 years, make it a clean sweep of the lame excuses floated in recent years for the increased exercise of rail market power.

If the *Competition Report* had been more effective in examining actual recent pricing patterns,⁹ the Board would have had in 2008 a foundation to begin in earnest consideration of the types of procompetitive reforms that it ultimately proposed in Ex Parte No. 688, but that now are being held in abeyance. Nevertheless, the *Supplemental Report* provides important information that debunks the industry's rhetoric and excuses for the adverse changes in rail pricing that have occurred since 2004. It demonstrates that increasing rail rates in the face of declining volumes and factor prices, and continued improvements in productivity, cannot be blamed on some capacity "bogeyman", and instead reflect the hidden hand of inadequate competition in the rail industry. While belated, this is an important contribution by the Board that further substantiates the need for careful consideration of actions to increase competitiveness in the rail marketplace.

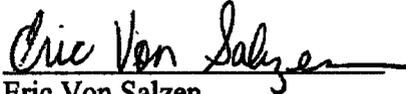
⁸ *Competition Report, Volume 2, Analysis of Competition, Capacity, and Service Quality*, pages 9-16 to 9-18, as discussed in STB Ex Parte No. 431 (Sub-No. 3), Review of the Surface Transportation Board's General Purpose Costing System, "Written Submission Of Arkansas Electric Cooperative Corporation" at page 7.

⁹ The fact that the *Supplemental Report* was able to incorporate data from 2008 despite being issued only 98 days into 2009 underscores the grievous and inexplicable nature of the omission from the *Competition Report* of data from recent time periods that were the most relevant to examination of the changing trend in rail rates that began in 2004.

Respectfully submitted,

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