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April 20, 2005

VIA HAND DELIVERY

The Honorable Vernon Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Room 711
Washington, DC 20423

ENTERED
Office of Proceedings
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Public Record

Re: Ex Parte No. 657, Rail Rate Challenges Under the Stand-Alone Cost Methodology

Dear Secretary Williams:

Enclosed for filing in the referenced proceeding, please find an original and 10 copies of the Statement of the Western Coal Traffic League, along with a computer disk which contains the filing.

An additional copy of the Statement also is enclosed. Kindly indicate receipt and filing by time-stamping this copy and returning it to the bearer of this letter.

Thank you for your attention to this matter.

Sincerely,

Kelvin J. Dowd
An Attorney for
The Western Coal Traffic League

KJD:jml
Enclosures

BEFORE THE
SURFACE TRANSPORTATION BOARD

RAIL RATE CHALLENGES UNDER THE STAND-ALONE COST METHODOLOGY	Ex Parte No. 657

STATEMENT OF
THE WESTERN COAL TRAFFIC LEAGUE

Of Counsel:

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Dated: April 20, 2005

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BEFORE THE
SURFACE TRANSPORTATION BOARD

RAIL RATE CHALLENGES UNDER THE STAND-ALONE COST METHODOLOGY	)))))	**Ex Parte No. 657**

STATEMENT OF
THE WESTERN COAL TRAFFIC LEAGUE

In accordance with the Orders served by the Board in the captioned proceeding on February 16, 2005 and March 14, 2005, the Western Coal Traffic League ("WCTL") submits this Statement to express its views regarding the Board's current and recent past consideration of rail rate reasonableness challenges under the stand-alone cost ("SAC") constraint of the *Coal Rate Guidelines*.[1] This Statement supports and supplements the points that will be raised by WCTL's designated representatives during the Board hearing scheduled for April 26, 2005. Additionally, WCTL subscribes to the Joint Statement of common principles being submitted this date, a copy of which is attached as Appendix A.

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[1] *Coal Rate Guidelines – Nationwide*, 1 I.C.C. 2d 520 (1985), *aff'd. sub nom.*, *Consolidated Rail Corp. v. United States*, 812 F.2d 1444 (3rd Cir. 1987).

IDENTITY AND INTEREST

WCTL is an association of shippers, receivers and consumers of coal mined from sources west of the Mississippi River. Its 21 members[2] include investor-owned electric utilities, rural electric cooperatives, state power authorities and municipalities.

The principal method of coal transportation utilized by WCTL members is rail. In 2004, WCTL members collectively shipped and paid the associated rail freight charges on over 140 million tons of western coal, the vast majority of which originated in the Powder River Basin region of Wyoming and Montana.

Since its inception in 1976, WCTL has been an active participant in every major proceeding before the Board and its predecessor concerning matters substantially related to the transportation of coal by rail. In particular, WCTL was one of the principal parties to the proceedings before the Interstate Commerce Commission ("ICC") which culminated in the adoption of the *Coal Rate Guidelines*. Additionally, individual WCTL members both have appeared as litigants before the Board and the ICC in coal rate cases brought under the *Guidelines*, and have relied upon the SAC methodology in the course of private contract negotiations, consistent with the ICC's original intent.[3] WCTL and its members have a direct and substantial interest in the matters being addressed in this proceeding.

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[2] A list of current WCTL members is attached as Appendix B.

[3] *See Coal Rate Guidelines*, 1 I.C.C. 2d at 524.

SUMMARY OF POSITION

Perhaps not since the late 1970's, when the OPEC Embargo prompted a shift toward widespread reliance on domestic coal as an electric generation source, has the need for vigilant, effective regulation of railroad rates on captive coal traffic been more acute.

Rail industry consolidations have left only four major railroads in control of virtually all U.S. utility coal transportation, and all four publicly have acknowledged drives to seek significant and sustained annual increases in coal rates on the traffic of their most dependent customers. In the West, a true duopoly has emerged, with the two participants moving in concert to adopt "public pricing" programs characterized by higher rates, unilaterally decreed service terms, an unwillingness to negotiate confidential contracts, and a reluctance or even outright refusal to compete for traffic that enjoys access to both systems. For captive shippers in particular, meaningful application of the *Guidelines*' SAC constraint represents the only available protection against aggressive, monopolistic pricing by the few remaining major coal transporters.

Unfortunately, the trend of Board decisions since 2002 has been more in the direction of sanctioning abusive rail rate practices than in protecting captive coal shippers from that abuse. Through a series of individual rulings, the Board has interpreted key components of the SAC analysis in ways that bias the results in the rail carrier's favor, and has presided over an evolution of the relative burdens of proof under the *Guidelines* which has set the bar for meaningful captive shipper relief inordinately high. At the same time, the

Board has tolerated evasive railroad discovery tactics and repeated carrier assaults on settled issues, which together have made SAC presentations ever more costly and complex, without any corresponding benefit in terms of results or record integrity.

Simply put, it is the perception of many captive coal shippers that the Board today is not receptive to complaints seeking coal rate reductions and associated reparations, and that the prevailing regulatory environment is characterized by an absence of effective regulation.

WCTL respectfully submits that there are specific elements of the SAC methodology as presently applied which are dysfunctional, and inconsistent with Congress' mandate that the Board protect captive shippers from abuse of railroad market power. These include:

- An approach to burden of proof issues under which even minor flaws in a portion of a complainant's evidence leads to rejection of that evidence in its entirety and a default to the defendant's more severely flawed evidence, while defendants are permitted to evade and frustrate legitimate discovery efforts.

- A methodology for allocating reductions in surplus SAC revenues over costs which allows a defendant to pre-determine the outcome of a case through its unilateral establishment of the level of the complainant's rate that is subject to challenge.

- An asymmetric approach to the forecasting of future changes in a hypothetical stand-alone railroad's (SARR) revenues and operating expenses under which the former is adjusted using an index which assumes a pass-through of future productivity gains, while the latter is adjusted using an index that assumes such productivity gains do not exist.

- The application of a test for improper "cross-subsidization" of light density SARR line segments that is failed by every "real world" railroad in their actual operations, and serves to artificially deprive the SARR of revenues and increase SAC.

- A *de facto* requirement that all elements of a SARR's hypothesized operations plan must correspond to proven features of "real world" railroad operations, despite the presumption in the *Guidelines* and the Board's insistence elsewhere that a SARR is a least-cost, optimally efficient railroad.

- An inequitable approach to new challenges to "settled issues" under which repeated railroad assaults on established policy and precedent are tolerated or even encouraged, while challenges by complaining shippers are summarily rejected.

None of the problems described above are the result of Congressional directives or the outcome of formal, notice-and-comment rulemaking. To the contrary, each troublesome feature of the Board's current approach to coal rate regulation under the *Guidelines* was developed and adopted in one or more individual adjudications brought under 49 U.S.C. §§ 10701 and 11704. Moreover, reasonable and effective solutions to these problems – to the extent that they are not already self-evident – currently are before the Board in the evidentiary records of pending cases. WCTL urges the Board to act expeditiously to take a more fair and balanced approach to the burden of proof, settled precedents and discovery policy issues, and to adopt (either as proposed or with appropriate modification) solutions to the methodological problems summarized above that have been offered to the Board by complainants in pending cases.

In recent decisions, the Board has suggested that some of the problems and anomalies that WCTL has identified must be addressed through formal rulemakings. WCTL respectfully disagrees. Each of the flaws in question emerged from individual adjudications, and all can and should be corrected in the same way. To initiate new and separate rulemakings would only invite delay, extraordinary and unnecessary expense, and further court litigation, all with no assurance whatsoever of a fair and effective remedial outcome.

DISCUSSION

A. Background

The final promulgation of the *Coal Rate Guidelines* in 1985 represented the culmination of a decade-long effort by the ICC to develop standards that would strike a proper balance between the promotion of railroad revenue adequacy and the Congressional mandate to protect captive coal shippers from abuse of railroad market power. *See* 1 I.C.C. 2d at 549 (Commissioner Simmons, commenting). Central to the implementation of this goal was the SAC test, the stated purpose of which was to ensure that "railroads functioning in a noncompetitive market will be required to price as if alternatives to their services were available. That is, their rates will be judged against simulated competitive prices." 1 I.C.C. 2d at 542.

The *Guidelines* explicitly sanctioned the principle that so long as a railroad is not earning an overall rate of return equal to the current cost of capital (*i.e.*, so long as it is not "revenue adequate"), it should be permitted to differentially price its service; that is, include in each rate a mark-up over the carrier's long-run marginal cost that correlates to the demand elasticity of the subject traffic. *Id.* at 526-27. The less elastic a shipper's demand (or the more dependent on the carrier that shipper is), the higher the mark-up that would be tolerated.[4] However, the ICC also determined that unconstrained so-called Ramsey Pricing was not consistent with the Congressional mandate to protect captive shippers from rail market power abuse. *Id.* at 527-28.[5] The principal constraint that the agency promulgated to afford this protection was the SAC test:

> The SAC analysis seeks to determine the lowest cost at which a hypothetical, efficient carrier could serve the traffic at issue, together with other traffic selected to share the burden of that carrier's joint and common costs. (To avoid any elements of monopoly pricing, a SAC analysis hypothesizes that this alternative service could be introduced without incurring any "barrier to entry" costs.) Under the SAC constraint, the rate at issue could be no higher than what the hypothetical carrier would have to charge to provide the needed service to the complaining shipper while fully covering all its costs, including a reasonable return.

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[4] As the basic justification for differential pricing is revenue inadequacy, the ICC also recognized that once revenue adequacy is achieved (or if it is assumed in a hypothetical context), there is no basis for continued differential pricing. *See* 1 I.C.C. 2d at 535-36.

[5] The ICC made it clear that the requirement that rail rates on captive traffic must be held to reasonable levels cannot be subordinated to the goal of revenue adequacy: "[I]t should be noted that a rate may be unreasonable even if the carrier is far short of revenue adequacy." 1 I.C.C. 2d at 536.

West Texas Utilities Co. v. Burlington Northern Railroad Co., 1 S.T.B. 638, 655 (1996) ("*WTU*"), *aff'd. sub nom.*, *Burlington Northern Railroad Co. v. STB*, 114 F. 3d 206 (D.C. Cir. 1997).

In addition to establishing a coordinated set of standards that would be used in the formal adjudication of rate disputes between regulated rail carriers and their captive coal customers,[6] the ICC viewed the *Guidelines* as a commercial tool that would facilitate negotiated solutions to potential disputes before they even reached the agency:

> ... a benefit of the guidelines is to enable both the shipper and the railroad to estimate the maximum rate we would prescribe if the matter were brought before us for adjudication. We believe that this will encourage contract solutions which . . . may often be more efficient and more beneficial to both parties than a prescribed rate.

1 I.C.C. 2d at 524.

Because the final *Guidelines* largely adopted the central components of rail rate adjudication methodologies that had been advanced by the railroad industry, many coal shippers openly voiced serious concerns that in reality there would be no meaningful protections for captive rail customers once the *Guidelines* were implemented in the context of actual rate litigation. The late Commissioner J.J. Simmons acknowledged these concerns, and in a separate concurring statement concisely framed the enduring, determinant question:

[6] The ICC took pains to point out that it had "not attempted to prescribe a hard and fast formula for developing and applying SAC. Rather, we encourage the parties in individual proceedings to develop the evidence which best presents their case." 1 I.C.C. 2d at 546.

> The real test of whether the guidelines allow for a proper balance between the legitimate interests of coal shippers and energy consumers and the revenue needs of the railroads will be their application in individual cases. The guidelines must be applied in a reasonable and even-handed manner, and captive coal shippers must be granted the reasonable discovery of railroad pricing and cost information necessary to make a case under these standards. If this is done, I believe the guidelines will provide realistic and enforceable safeguards against monopoly pricing by rail carriers.

1 I.C.C. 2d at 549.

The ICC's adoption of regulatory guidelines for the adjudication of maximum reasonable rate complaints brought by captive coal shippers came four years after another seminal ruling that would come to shape the market for western coal rail transportation service, and play a major role in determining just how many rate complaints actually made their way to the agency. In *Chicago and North Western Transportation Company – Construction and Operation Of A Line Of Railroad In Niobara and Goshen Counties, Wyoming, and in Sioux and Scotts Bluff Counties, Nebraska*, 363 I.C.C. 906 (1981) ("*CNW Construction*"), the ICC gave final approval for the entry of a second rail carrier into the coal-rich Powder River Basin, which entry actually came to pass in 1984 and ushered in a new era of competition for a large segment of the western coal transportation sector.

Rejecting arguments by the Burlington Northern Railroad Company that it should be allowed to retain a monopoly over PRB coal originations, the ICC in *CNW Construction* squarely affirmed the public interest benefits of effective intramodal coal transportation competition:

> After considering the likely effects of competition for the transportation of Powder River Basin coal, we are persuaded that the adequacy of transportation to the public will be improved by operation of this line as a joint, rather than a solely owned line. Both producers and consumers of coal have argued in this proceeding that competitive operations over the joint line will produce benefits by lowering or leveling the price of coal transportation and by increasing the quality of service available. In their testimony, shippers supporting joint use of the line stressed that without it, they would remain captive shippers of BN . . . . We are convinced that competition is crucial where a valuable natural resource exists in such quantities, where rail service is the only practical method for transporting it, and where the presence of another rail carrier would introduce a competitor into a market which is now a monopoly.

363 I.C.C. at 917. Taken together, the *CNW Construction* and *Guidelines* decisions were illustrative of the duality inherent in the Congressional policy on railroad rate regulation reflected in the Staggers Rail Act of 1980. Where effective competition prevailed or economically could be created, the dynamics of the marketplace could be relied on to place reasonable limits on a railroad's pricing aspirations. Where effective competition was lacking, however, it fell to the ICC (and now the Board) to use the *Guidelines* to craft meaningful rate protections for captive shippers.

i. **Implementation – 1985 to 2001**

While it would be an overstatement to suggest that the promulgation of the *Guidelines* and CNW's entry into the PRB combined to produce "peace in our time," the period from 1985 through 2001 was one of relative stability in terms of relations between the major coal-hauling railroads and their largest customers.

The successful initiation of origin competition for PRB shipments and a series of private and agency-assisted rail line construction projects[7] opened many previously captive coal routes to competitive rail service, and contributed to a major shift in carrier pricing practices from public pricing through tariffs and circulars, to greater and greater reliance on privately negotiated, confidential contracts. Contract arrangements between captive coal shippers and their carriers also became prevalent, as many actual or impending coal rate litigations were resolved through negotiated settlements, or avoided altogether through shippers' and carriers' use of the *Guidelines* as a commercial tool in just the manner that the ICC had intended.

While competition and effective private use of the *Guidelines* did not eliminate the need for formal agency coal rate regulation altogether, over the 1985-2001 time period only nine final decisions were rendered by the Board and its predecessor in cases brought by captive shippers seeking rate relief under the *Guidelines*. The agency's administration of the *Guidelines*, in turn, was generally stable and progressive, and consistent with the ICC's

[7] *See, e.g.*, Finance Docket No. 32607, *WFEC Railroad Company – Construction and Operation Exemption – Choctaw and MCurtain Counties, OK*, Decision served February 27, 1995.

original expectation in 1985, the ICC and the Board gradually formed the contours of a relatively predictable rate evaluation methodology on a case-by-case basis. *See Omaha Public Power District v. Burlington Northern Railroad Co.*, 3 I.C.C. 2d 123, 139 (1986).

Over the 1985-2001 timeframe, the ICC and the Board used the relative handful of individual adjudications to develop and implement many of the key methodological elements of the SAC test needed for its direct application to specific fact patterns. These included: the overall design of the Discounted Cash Flow methodology[8]; the "percentage reduction" approach to allocating reductions in excess SARR revenues over SAC[9]; the definitions of entry barriers and the grouping concept to endorse the inclusion of cross-over traffic in the SAC analysis[10]; the "guiding principles" for determining what constitutes an entry barrier for SAC purposes[11]; the modified mileage prorate methodology for allocating divisions of revenues on cross-over traffic[12]; the "time-based" method of

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[8] *See Bituminous Coal – Hiawatha, Utah to Moapa, Nevada*, 6 I.C.C. 2d 1, 18-20 (1989) (*"Nevada Power I"*).

[9] *See Coal Trading Corp., Et Al. v. B&O Railroad Co., Et Al.*, 6 I.C.C. 2d 361, 380 (1990).

[10] *Bituminous Coal – Hiawatha, Utah to Moapa, Nevada*, 10 I.C.C. 2d 259, 265-67 (1994) (*"Nevada Power II"*). In a separate concurrence, then-Chairman McDonald applauded the use of individual adjudications to solve identified problems with the SAC methodology, and called for decisions in such cases to be used as "blueprints"for the resolution of future disputes. 10 I.C.C. 2d at 279.

[11] *WTU*, 1 S.T.B. at 669-70.

[12] *McCarty Farms, Et Al. v. Burlington Northern Inc.*, 2 S.T.B. 460, 471-72 (1997). The modified mileage prorate methodology originally was advocated by the defendant railroad.

allocating capital carrying charges over the DCF period[13]; and the exclusion of premiums in calculating the SARR's cost of capital[14]. In terms of "winners" and "losers," the results in these cases were mixed[15], as would be expected when decisions ultimately turn on the specific evidentiary records of individual adjudications. In general, however, it may be said that the Board's and the ICC's administration of the *Guidelines* from their adoption through the end of 2001 was reasonably predictable and consistent, and usually yielded results that provided sound returns to the railroads while still imposing meaningful restraints on monopoly pricing.

ii. Implementation – 2002 through the Present

Over the same time period that the Board and its predecessor were developing the contours of the SAC test under the *Guidelines*, the major coal-hauling railroads engaged in a series of agency-approved consolidations and acquisitions, which by 2001 had left two carriers in the West and two carriers in the East in near-absolute control over each region's respective coal transportation markets. Over the protests of WCTL and other shippers, states, cities, and in some cases other federal departments, the Board consistently made favorable rulings on Class I merger and acquisitions proposals under 49 U.S.C. § 11323. The

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13 Docket No. 42022, *FMC Wyoming Corp. v. Union Pacific Railroad*, Decision served May 12, 2000 at 41.

14 Docket No. 42051, *Wisconsin Power & Light Company v. Union Pacific Railroad*, Decision served September 13, 2001 at 32.

15 *Compare, e.g., McCarty Farms* and *Wisconsin Power & Light, supra*.

Board responded to expressed concerns over reductions in the number of transportation competitors essentially with the finding that so long as two railroads were left in a region, continued, aggressive rate and service competition could be presumed.[16]

Beginning in 2002, the four remaining major coal-hauling railroads embarked on very public campaigns in which they claimed a need and justification for sustained, significant increases in coal revenues generally, and captive coal revenues in particular. Railroad chief executives and marketing officers openly expressed intentions to impose annual, multiple percentage increases on coal rates across-the-board,[17] even while reports of poor service quality and errant management decisions grew more prevalent. While coal shippers reacted with understandable alarm, then-Board Chairman Linda Morgan effectively endorsed the carriers' pricing aspirations, publicly declaring shortly before her scheduled retirement from the Board that:

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[16] *See Union Pacific Corp., Et Al. – Control and Merger – Southern Pacific Rail Corp., Et Al.,* 1 S.T.B. 233, 384-399 (1996); *Burlington Nothern Inc., Et Al. – Control and Merger – Santa Fe Pacific Corp., Et Al.*, 10 I.C.C. 2d 661, 743-750 (1995).

[17] *See, e.g.*, "Railroad Coal Prices on the Upswing," *Coal Transportation Report*, May 10, 2004, Page 1; "Shippers Seek Answers to UP Pricing Plan," *Coal Transportation Report*, April 12, 2004, Page 1; "Rose Details BNSF's Coal Pricing Plans," *Coal Transportation Report*, June 7, 2004, Page 1.

> The customers want lower rates ....But do they also understand that over time, over some period of time, if all these rates keep coming down, then there won't be the revenue coming into the system to sustain the network that exists today in the private sector? Then will that mean the customers will lose service that they don't want to lose, and will they be prepared for that?[18]

In 2004, the BNSF Railway and Union Pacific Railroad took their aggressive campaign for higher coal rates to another level. After nearly a quarter century of extolling the virtues of bilateral, confidential contracts as the preferred and most mutually-beneficial medium for doing business with coal shippers, BNSF and UP coincidentally announced a new commitment to "public pricing" programs, under which non-confidential rates would be set for application to western coal movements once existing contracts expired. These programs, implemented under UP Circulars 111 and 112 and BNSF Tariff 90068, also include service terms unilaterally established by the carriers, which are intended by the railroads to be adhered to by coal shippers with no opportunities for negotiation or modification. UP's 2004 Annual Report barely conceals the carrier's true agenda, and clearly links "public pricing" to higher coal rates:

> Across all business groups, we are obtaining solid price increases in the marketplace. At the same time, we are working to reduce the complexity and inflexibility of long-term contracts so that we can respond more quickly to changing market conditions.
>
> One clear example is in our coal business where we have instituted new coal pricing mechanisms for all shipments from

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[18] "Railroad Regulator Linda Morgan Resigns," *The Washington Post*, February 27, 2003, Page E04.

> the Southern Powder River Basin (SPRB) in Wyoming, as well as spot movements out of Colorado and Utah. We have simplified the way we do business with our customers by clearly communicating the revenue we need in order to reinvest in our coal business, while sharply reducing the administrative burden of dozens of separate contracts.[19]

The magnitude of individual coal rate increases resulting from BNSF and UP's new pricing policies is difficult to gauge with specificity, since the lower former contract rates usually are confidential and not subject to public disclosure. However, one representative captive BNSF customer – City Utilities of Springfield, MO – publicly reported an overnight increase of $5.00 per ton, or 34%, *before* application of an 11.5% BNSF mandatory "fuel surcharge."[20] And apart from the prospects of significant coal rate increases, the carriers' shift to non-confidential pricing on both captive and competitive movements has sparked concerns over price signaling and a *de facto* division of markets, under which competition between BNSF and UP effectively would end. The obvious implications of such a development reach well beyond the coal shipper community, and reportedly are being investigated both by Congress and the U.S. Justice Department's Antitrust Division.[21]

With the segment of the rail industry that effectively dominates volume coal shipments both in an unprecedented state of concentration *and* fully committed to sustained

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[19] 2004 Annual Report, Letter to Shareholders, at 1.

[20] "Electric Rates at CU Could Jump In March," *Springfield News-Leader*, January 2, 2005, Page 1E.

[21] *See, e.g.*, "Justice Dept. Sees Possible Antitrust Issue in Rail Pricing," *The Wall Street Journal*, October 28, 2004.

increases in coal rates to the maximum extent possible, the need for vigilant and meaningful constraints on the railroad's captive traffic pricing has never been more acute. However, the record of Board rulings under the *Guidelines* subsequent to *Wisconsin Power & Light* strongly implies that the effectiveness of captive shippers protection has rarely been more uncertain.

Between August, 2002 and March, 2005, the Board issued seven final decisions in coal rate proceedings under the *Guidelines*.[22] In each instance, extensive but unsuccessful negotiations preceded the filing of the original complaint, and in each case the shipper ultimately was burdened with a common carrier rate significantly higher than the rate it had been paying previously. Indeed, in some of these cases the challenged rates were over 50% higher than the prior rates. Yet, the outcomes bore little or no resemblance to even the mixed results seen over the 1985-2001 time period. Two of the proceedings were dismissed by the Board without even reaching a final decision on the merits, thereby permitting the railroads unfettered pricing freedom,[23] and three ended with rulings that the challenged rate increases were "not unreasonable."[24] The remaining two (2) proceedings did result in findings that the

[22] The fact that the past three years have produced almost as many coal rate disputes that could not be resolved prior to a formal Board ruling as the previous six is testament to the heightened threat of rail market power abuse that captive coal shippers face in the present environment.

[23] Docket No. 42054, *PPL Montana, LLC v. The Burlington Northern and Santa Fe Railway Co.*, Final Decision served August 20, 2003; Docket No. 42058, *Arizona Electric Power Cooperative, Inc. v. The Burlington Northern and Santa Fe Railway Co., Et Al.,* Decision served March 15, 2005.

[24] Docket No. 42069, *Duke Energy Corp. v. Norfolk Southern Railway Co.*, Decision
(continued...)

challenged rates were unlawfully high.[25] However, neither shipper received relief that approached that which its evidence demonstrated was due, and the Board's ultimate disposition of *TMPA* did not afford *any* rate relief during the second half of the DCF period.[26] Neither of these "victories," much less the Board's rulings in the other five most recent cases, realistically reflects a promise of meaningful protection for captive coal shippers in the face of the railroads' ongoing campaign for even higher revenues from this most vulnerable segment of their traffic base.

B. Key Flaws In The Board's Current Application of the *Coal Rate Guidelines*

A review of the Board's coal rate decisions over the 2002-2005 time period reveals at least six specific issue areas in which the deck is clearly stacked against captive coal shippers. While there are other flaws and inconsistencies in the Board's application of the *Guidelines*, the need for affirmative remedial action in response to the problems outlined below is of greatest immediate concern to WCTL.

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[24] (...continued)
served November 6, 2003; Docket No. 42072, *Carolina Power & Light Company v. Norfolk Southern Railway Co.*, Decision on Reconsideration served October 20, 2004; Docket No. 42070, *Duke Energy Corp. v CSX Transportation Inc.*, Decision served February 4, 2004.

[25] Docket No., 42056, *Texas Municipal Power Agency v. The Burlington Northern and Santa Fe Railway Co.*, Decision served March 4, 2003 *("TMPA")*; Docket No. 42057, *Public Service Company of Colorado v. The Burlington Northern and Santa Fe Railway Co.*, Decision served June 2, 2004.

[26] *See TMPA*, Decision served September 27, 2004 at 31.

i. **<u>The Burden of Proof</u>**

While WCTL acknowledges that complainants in coal rate proceedings bear the general burden of proof, it submits that properly applied, that concept reasonably cannot demand 100% perfection and 100% exactitude on each and every one of the myriad SAC issues which have proliferated over the years. And yet, as a practical matter, that seems to be the Board's current approach: in recent cases, virtually any defect in the complainant's evidence on an issue has been held to warrant wholesale acceptance of the defendant's counter-statement, regardless of how many or how serious the flaws in the railroad's evidence are. *See, e.g., Duke Energy Corp. v. Norfolk Southern Railway Co.* at 13-14.

Historically, the Board and its predecessor applied a reasonable, "better evidence of record" approach to burden of poof issues. *See, e.g., WTU,* 1 S.T.B. at 663-664, 678. In many cases, this approach did not result in a complete acceptance or rejection of either party's evidence. Rather, the agency would modify one party's evidence, or combine the parties' data in some fashion. *See Wisconsin Power & Light* at 17-18, 28, 53-54. Beginning with *TMPA*, however, the Board's approach shifted to one in which close scrutiny was given only to the complainant's evidence. If any flaws were detected, that evidence was rejected and the defendant's was accepted, virtually without criticism. *See TMPA* at 68, 69-70, 74. This unbalanced approach persists today.

In *Public Service Company of Colorado*, the Board was faced with a circumstance in which perceived flaws in the shipper's SARR operating plan resulted in acceptance of the defendant's own plan, again without any meaningful critique. However, that plan did not include certain traffic which the Board found could be handled by the SARR. The Board's solution was to correct the railroad's evidence, *sua sponte*:

> The Board is not simply an adjudicator; rather it is charged with carrying out the rail transportation policy set forth in 49 U.S.C. 10101, and more specifically with investigating the reasonableness of a challenged rate, making findings as to its reasonableness, and then taking appropriate action to compel compliance with the statute. . . .[W]hen the Board finds that traffic such as the JEC movement is properly included in a SAC analysis, the Board, consistent with its regulatory responsibilities outlined above, must devise another method to account for that traffic."

Id. at 23. The Board's affirmative action to correct defects in a *railroad's* evidentiary presentation so that it otherwise could be used, stands in stark contrast to the hands-off, up-or-down approach that the agency now routinely takes in evaluating a *shipper's* compliance with its burden of persuasion. *See, e.g., Duke Energy Corp. v. CSX Transportation Inc.* at 28.

Hand in hand with the problem currently afflicting the Board's handling of burden of proof issues is the need for reform of certain elements of the discovery process. In particular, these include the railroads' successful evasion-and-delay tactics to deny complainants access to important data which only the railroads possess, and the *Guidelines* acknowledge must be produced. *See* 1 I.C.C.2d at 548.

Even though complainants routinely serve their discovery requests at the outset of a proceeding, it is not uncommon for defendants to wait until just before or even well after the close of the discovery period to actually produce data and documents. Production often is incomplete, and invariably the defendant presses objections to discovery that must be resolved on motions to the Board. Often, the objections are to requests for data that historically had been produced in coal rate proceedings, but which are no longer retained by the railroad in the precise form as that described in the request. In effect, a simple modification of a carrier's filing or reporting system is used to frustrate legitimate discovery.[27]

The delays inherent in this scenario collide squarely with a complainant's effort to comply with the Board's edict to "present its full case-in-chief in its opening evidence,"[28] with the attendant limitations on the scope of later rebuttal.[29] Quite properly, the Board has acknowledged that maximum rates under the *Guidelines* "should be determined by the Board, not by parties' litigation tactics."[30] WCTL respectfully submits that there is a need for swift and decisive Board action to give firm effect to that obvious truth in the administration of the discovery process.[31]

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27 *Compare, TMPA* at 58 and *WTU,* 1 S.T.B. at 721 (locomotive repair expense data for the same pool of locomotives that were relied upon by the Board in 1996 somehow no longer existed by 2003).

28 *Duke Energy Corp. v. Norfolk Southern Railway Co.* at 14.

29 *Id.* at 14-15.

30 *Carolina Power & Light Company*, Decision served December 23, 2003 at 32.

31 Two rather plain examples of areas in which the current handling of discovery leads directly to increased complexity and litigation cost concern SARR construction costs and revenue divisions. The least expensive and most straightforward ways to calculate SARR construction costs and allocate revenues from cross-over traffic would be by reference to the defendant railroad's actual

(continued...)

ii. <u>The Equal Percentage Reduction Method</u>

When in a particular case the SAC analysis shows that total annual SARR revenues exceed SAC, and thus that the rates at issue are unreasonably high, the Board requires them to be reduced by the percentage by which the overall SARR revenues exceed the level needed to maintain revenue adequacy; *i.e.*, the SAC level. As initially devised in *Coal Trading*, this "equal percentage reduction" method was intended to "preserve[] the rate structure for the traffic group by maintaining existing rate relationships, albeit at reduced levels, and thereby implicitly recognize[] varying demand elasticities." 6 I.C.C. 2d at 380. However, even as adopted, the percentage reduction method was not a hard and fast rule; it was to be applied only so long as the defendant carrier's "pattern of differential pricing" was not shown to be "seriously flawed." *Id.* at 435.

In point of fact, recent rate proceedings have demonstrated that the methodology itself is seriously flawed. Because the measure of a successful complainant's rate relief depends upon the level of the initially challenged rate, the equal percentage reduction approach allows the defendant railroad to control the end result through its unilateral control over the level of its common carrier rates. Since in most cases a request for a common carrier rate only comes after the unsuccessful conclusion of negotiations, when resort to the STB is the only remaining recourse, market dominant carriers have both the

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[31] (...continued)
experience in recent construction projects and their revenue divisions agreements with other railroads. However, with the Board's approval, rail carriers routinely refuse discovery requests for actual construction cost and divisions data.

motive and opportunity to "game" the SAC test in this manner – an opportunity which they plainly have seized. *See, e.g., Carolina Power & Light Company*, Decision served December 23, 2003 at 31.

An additional, serious problem with the equal percentage reduction method is that has the effect of rendering the SAC test useless as a tool for commercial negotiation. Because of the way that the method functions, a captive shipper cannot accurately estimate its applicable SAC rate until the railroad establishes a common carrier rate that can be used as a starting point. However, railroads need not – and generally will not – establish a common carrier rate until common carrier shipments are set to begin, which usually is only *after* contract negotiations have failed[32] and rate litigation is imminent. This scenario, which has been prevalent in the recent past, undermines a key, intended benefit of the *Guidelines* themselves. *See Coal Rate Guidelines*, 1 I.C.C. 2d at 524.

On several occasions, the Board has acknowledged that the equal percentage reduction method is seriously flawed, and that the problems it creates are "sufficient to warrant a change . . . ." *Carolina Power & Light Company*, Decision served December 23, 2003 at 32. *See also Public Service Company of Colorado* at 37. However, the Board has

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[32] The typical pattern of recent coal rate litigation is that a captive shipper and its serving carrier have been parties to a contract, and have undertaken to negotiate new rates and service conditions as the term of the contract draws to a close. In effect, the expiration date of the contract sets an end point for pre-litigation negotiations. *See, e.g., Public Service Company of Colorado* at 9; *Duke Energy Corp. v. Norfolk Southern Railway Co.*, at 40; *TMPA* at 9, 11.

declined to remedy these defects, ruling that various alternatives put forward by individual complainants are insufficiently consistent with Ramsey Pricing principles. *Id.* at 37-38.

WCTL submits that the Board need not and should not continue to apply an admittedly flawed methodology simply because the perfect substitute has not yet been offered to it. The Board has not been reluctant to develop new policies and solutions on its own initiative in other contexts, which have favored the railroads' interests. *See id.* at 28-32; *Duke Energy Corp. v. Norfolk Southern Railway Co.* at 13-14; *TMPA* at 19-21. As for Ramsey Pricing, it bears noting that the equal percentage reduction formula *itself* is not true to Ramsey principles. As the ICC explained in the original *Guidelines* decision, relative demand elasticities among members of a shipper group are reflected in the relative "mark-up above the long-run marginal cost" that their rates contain. The equal percentage reduction method focuses on *prices*; mark-ups over marginal cost are not measured or even considered, and the relative relationships among them (and relative demand elasticities) are not consistently maintained.[33]

[33] A simple example illustrates. Assume that Shipper A and Shipper B are members of a SARR group. Each has a starting revenue of $10, but Shipper A's marginal cost is $5 while Shipper B's is $7. If the percentage reduction formula decrees a 10% reduction, each shipper's rate decreases by $1. However, the relative relationship between their *mark-ups* is not preserved. Before the reduction, Shipper A's was 133% greater than Shipper B's (the difference between 100% and 43%). After the reduction, Shipper A's mark-up is 176% of Shipper B's (the difference between 80% and 29%).

iii. The Assymetric Approach to Indexing

Beginning with its decision in *TMPA*, the Board consistently has relied on the Energy Information Administration's index of projected changes in coal transportation rates to forecast future changes in a SARR's revenues, following the expiration of transportation contracts that actually were in place for members of the SARR shipper group in the first year of the SAC analysis. *TMPA* at 29; *Duke Energy Corp. v. Norfolk Southern Railway Co.* at 64 n. 78. *Inter alia*, the EIA forecast assumes a pass-through of a portion of the future coal-related productivity gains that railroads are expected to achieve, and tempers its projection of future rate increases accordingly. *Cf. Public Service Company of Colorado* at 33-34.

While the Board's current method of indexing a SARR's revenues assumes a pass-through of productivity gains, in every decision after *Wisconsin Power & Light* it has insisted on the use of the Rail Cost Adjustment Factor *unadjusted* for any productivity gains to project future changes in a SARR's operating expenses.[34] *See, e.g., Duke Energy Corp. v. CSX Transportation, Inc.* at 30. The effect of this dichotomy is that in every SAC analysis, regardless of the parties involved or the evidence presented, the operating expenses of the SARR are presumed to increase at a faster pace than the SARR's revenues, thereby

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[34] In *Wisconsin Power & Light*, the Board relied on an internal UP forecast of expected changes in coal-related system operating costs that had been produced in discovery, which showed a rate of increase considerably slower than the RCAF-U. *See id.* at 106. Not surprisingly, since that ruling railroad defendants have refused discovery requests to produce internal forecasts of expected changes in operating costs.

guaranteeing higher SAC rates in each year of the DCF analysis.[35] Put another way, the current approach to indexing contains a locked-in bias that works in favor of the railroads in *every case*.

The Board has never acknowledged, much less attempted to justify, the bias inherent in its conflicting approach to future SARR revenues and operating expenses. The Board has admitted on several occasions that use of the RCAF-U "may somewhat overstate" the SARR's costs,[36] but has consistently rejected alternative measures that include a productivity adjustment (and thus perpetuated the pro-railroad bias), principally on the ground that other available measures of productivity reflect the progress of "real world" railroads that would not be matched by a SARR that already starts out as an optimally efficient railroad with brand-new, modern assets. *See, e.g., Duke Energy Corp. v. CSX Transportation Inc.* at 29-30. However, this thesis runs counter to the Board's approach elsewhere in the SAC analysis – particularly in the area of the SARR operating plan – where the agency demands proof that an operating plan or procedure in fact replicates a "real world" railroad operation. If a SARR is presumed to be so efficient that no meaningful productivity gains remain to be realized, it cannot at the same time be burdened with

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35 To take a random example, in *Duke Energy Corp. v. Norfolk Southern Railway Co.*, in most years of the DCF model the Board calculated a rate of increase for operating expenses that was between 30% and 100% higher than the forecasted growth rate for revenues. *See id.* at 39.

36 *See, e.g., Carolina Power & Light Company* at 28.

inefficiencies exhibited by existing railroads who are acknowledged to look forward to significant future productivity improvements.

The Board should no longer defer action to remedy this obvious flaw in the current SAC test until such time as a litigant manages to offer what the Board believes is the perfect solution. As the Board itself ruled only recently, "[t]he Board has broad discretion to apply any appropriate analytical tool to the evidence, on its own motion or otherwise." *Public Service Company of Colorado* at 33.

iv. <u>The Threshold Cross-Subsidy Test</u>

In its August 20, 2002 decision in *PPL Montana, LLC*, without any warning to the parties, the Board adopted a new "threshold cross-subsidy" test that complaining shippers now must meet in order to avoid dismissal of a rate case. *Id.* at 7-10. The essence of the test is that "revenues from non-issue traffic should not be relied upon to pay for portions of a SAC system over which the non- issue traffic would not move." *TMPA* at 25. The Board administers this new test by looking at a SARR not as a whole system, but as a set of discrete segments, each of which must be independently self-sustaining. In *PPL Montana, LLC*, the Board found that the SARR designed by the complaint failed this test, and dismissed the proceeding.

The Board justifies its threshold cross-subsidy test with the claim that "a basic principle of the SAC test is that traffic not be subsidized by other traffic." *PPL Montana,* *LLC* at 9.[37] However, that is *not* the type of cross-subsidization that the *Guidelines* proscribe. The *Guidelines* decision makes clear that the purpose of the SAC test is to ensure that the *complainant's* captive traffic does not cross-subsidize other traffic, not to root out cross-subsidies across the defendant's (or the hypothetical SARR's) entire system:

> A captive shipper should not bear the costs of any facilities or services from which it derives no benefit .... Taken together, these constraints should ensure that a carrier does not use its market dominance to charge its captive coal shippers more than they should have to pay for efficient rail service.

Coal Rate Guidelines, 1 I.C.C. 2d at 523-24.

The "threshold cross-subsidy" test is not only not compelled by the *Guidelines*, but it is failed routinely by "real world" railroads. Indeed, it is the essence of differential pricing that demand inelastic traffic moving over one part of a system (*e.g.*, coal moving from Wyoming to Texas) pays higher rates in order to help support the infrastructure needed elsewhere to move competitive traffic (*e.g.*, intermodal traffic moving from Chicago to the West Coast). As the theory goes, so long as the competitive traffic is paying more than its directly variable costs, the railroad and its captive shipper are better off if the railroad retains it. *Id.*, 1 I.C.C. 2d at 526. Nowhere is it even suggested that an existing railroad should abandon any portion of its system or jettison any traffic that does not cover its *stand-alone* cost, when considered in isolation from the rest of the system. Yet, that is the central premise of the "threshold cross-subsidy" test.

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[37] *Citing Arizona Electric Power Cooperative, Inc.*, Decision served December 31, 2001 at 6.

v. <u>The Need to Mimic "Real World" Rail Operations</u>

While virtually all evidentiary elements of the SAC analysis have grown in scope and complexity since the *Guidelines* first were implemented, the matter of the SARR's operating plan and related expenses has expanded to a point which could not have been imagined in 1985.[38] In and of itself, this development, while costly, would not necessarily be troubling from the standpoint of substantive merit. Along with the trend toward greater complexity, however, the Board increasingly has come to require that complainants support each component of a SARR's operating plan with an example from "real world" railroad operations.[39] Apart from the burden of proof issue discussed *supra*, the Board's *de facto* mimicry requirement conflicts with the core SAC principle that a SARR is presumed to be "the lowest cost . . . hypothetical, efficient carrier" that could be posited for the issue traffic and the other members of the selected traffic group.

In case after case, the Board's near-wholesale adoption of the defendant's operating plan – which invariably mimics its own operations – leads to higher stand-alone operating expenses *and* construction costs,[40] and drives up the overall SAC rates. Additionally, this pattern produces a direct conflict with the Board's treatment of the issue

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[38] *Compare WTU*, 1 S.T.B. at 664-667, 689-695 and *Duke Energy Corp. v. CSX Transportation Inc.* at 28-29, 51-71.

[39] *See, e.g., Duke Energy Corp. v. Norfolk Southern Railway Co.* at 71-74.

[40] Construction costs go up because the defendant's operating plan inevitably calls for more yards, more sidings and other additional infrastructure.

of indexing SARR operating expenses over the DCF period. As discussed *supra*, the Board justifies its refusal to incorporate a productivity adjustment into the SARR operating expense index formula on the ground that the SARR, unlike "real world' railroads, is presumed to be an optimally efficient carrier that cannot be expected to realize future productivity gains that may be available to existing railroads. If the SARR is an "optimally efficient" carrier in name only, however, and saddled with the "real world" railroad's operating plan and practices, whatever foundation there otherwise might have been for the Board's approach to productivity collapses.

Unlike the three problems discussed immediately above, reform of the Board's one-sided approach to SARR operating expenses does not require any substantive change in any specific component of the SAC test. Rather, it can and should be achieved simply by the Board adopting a more even-handed approach to the issue in pending and future adjudications, and giving meaningful effect to the presumption of optimal efficiency mandated by the *Guidelines*.

vi. **The Inconsistent Treatment of "Settled Issues"**

In its March 12, 2001 Decision in Ex Parte No. 347 (Sub-No. 3), *General Procedures For Presenting Evidence In Stand-Alone Cost Rate Cases*, the Board admonished complainants and defendants alike "not to attempt to relitigate issues that have been resolved in prior cases." *Id*. at 6 (footnote omitted). This directive was part of a stated intent by the Board to simplify and streamline the presentation of SAC evidence.

For the most part, complainant shippers have sought to comply with the Board's admonition, even in circumstances where the "settled issue" had been decided adversely to captive shipper interests.[41] The same is not true for the railroads, however. Indeed, rail carrier defendants continue to challenge prior precedents and established principles in a wide range of issue areas, including: the legitimacy of including significant volumes of cross-over traffic in a SARR traffic group;[42] the use of " density adjusted" methods of allocating revenues on cross-over traffic;[43] engineering additives;[44] the calculation of movement-specific variable road property costs;[45] and the inclusion of premiums on "flotation fees" in determining a SARR's cost of capital.[46] These repeated attacks necessitate complainant response and rebuttal, which further complicates and drives up the cost of litigation under the *Guidelines*.

WCTL believes that the railroads continue to pitch rejected arguments and methodologies because the Board tolerates and even encourages them. For example, after

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[41] *See, e.g., Carolina Power & Light Company*, Decision served December 23, 2003 at 28 (shipper incorporated general rail industry cost of capital, even though it could show that a coal-only SARR easily could access less expensive sources of funds).

[42] *See Public Service Company of Colorado* at 13.

[43] *Id.* at 13; *Duke Energy Corp. v. Norfolk Southern Railway Co.* at 20-21.

[44] *Pubic Service Company of Colorado* at 118.

[45] *Id.* at 136.

[46] *Carolina Power & Light Co.,* Decision served December 23, 2003 at 29; *Wisconsin Power & Light* at 107.

repeatedly rejecting carrier challenges to use of the Speed-Factored Gross Ton-Mile formula for calculating variable maintenance-of-way costs, the Board suddenly reversed course in *TMPA* and rewarded the carriers' persistence.[47] Similarly, recent actions reversing long-standing precedent relied upon by shippers in the areas of SARR entry barriers[48] and locomotive spare margins[49] can only embolden the railroads to keep up their attacks on any "settled issues" that they find unfavorable. Notably, the Board has not hesitated to slam the door on shipper efforts to revisit adverse precedents.[50]

Fairness demands that the Board not discriminate between shippers and carriers when it comes to respect for precedent. If the Board is serious about streamlining the SAC analysis, repeated railroad challenges to the same settled issues should be stopped.[51]

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47 *See TMPA* at 55.

48 *Id.* at 151-155.

49 *Public Service Company of Colorado* at 142.

50 *See, e.g.*, *TMPA* at 158.

51 For example, even though the Board appears to have settled on the use of the Modified Straight Mileage Prorate methodology to allocate cross-over revenues (*Public Service Company of Colorado* at 17), it continues to equivocate in its written decisions (*id.; Duke Energy Corp. v.* CSX *Transportation* at 21), thereby encouraging defendants to repeatedly advance alternative approaches that already have been rejected.

C. Flaws In The Current Application of The *Guidelines* Can and Should Be Remedied In Pending And Future Adjudications

As noted *supra*, some of the defective elements of the current iteration of the SAC test under the *Guidelines* have been acknowledged by the Board, and a general willingness to consider proposals to remedy them has been expressed. In so doing, however, the Board also has opined that these remedies should only be considered in the context of a "notice-and-comment rulemaking." *Public Service Co. of Colorado* at 38. WCTL respectfully disagrees, and submits that for several important and inter-related reasons, the flaws in the Board's current approach to SAC that are identified in Part B of this Statement can and should be corrected in individual pending and future adjudications.

First, the *Guidelines* themselves clearly provide that issues of SAC implementation – be they simple or complex – are best left for resolution on a case-by-case basis. *See Guidelines*, 1 I.C.C. 2d at 542-43. In the earlier years of the use of the SAC test, the ICC consistently acknowledged this preference:

> The Commission's stand-alone railroad (SARR) methodology for maximum coal cases has evolved, and continues to evolve, since its adoption in 1985. The 1989 decision in this proceeding, which for the first time required a multi-year/discounted cash flow analysis, is only the latest such evolution. In these circumstances, litigants before the Commission must be allowed to develop a record consistent with the Commission's latest understanding of its methodology.

Nevada Power I, Decision served January 8, 1991 at 6. *See also Omaha Public Power District*, 3 I.C.C. 2d at 139.[52]

More recently, BNSF and UP petitioned the Board to depart from its established case-by-case approach and initiate a rulemaking to consider the resolution of several SAC issues which at the time were common to four separate, pending cases. In response, the Board ruled that "[w]hile the railroads have raised significant issues, some of which are not yet fully resolved, . . . we conclude that it is preferable to continue our general policy of addressing these types of issues as they arise in individual adjudications." *PPL Montana, LLC*, Decision served November 27, 2001 at 3. *See also TMPA* at 37. Even more recently, the Board acted *sua sponte* in an individual adjudication to modify its methodology for allocating revenues from cross-over traffic between the SARR and the residual incumbent. *See Duke Energy Corp. v. Norfolk Southern Railway Co.* at 22-25. WCTL submits that adherence to this established policy is called for with respect to the issues raised in this proceeding as well.

Second, *none* of the methodological or deliberative defects in the Board's current applications of the SAC test which WCTL identifies here were the products of notice-and-comment rulemaking. To the contrary, the equal percentage reduction approach, the problem of assymetric treatment of SARR revenues and operating expenses, and the

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[52] In that same decision, the ICC noted that the *Guidelines* "do not contain any hard and fast rules for the presentation of stand-alone evidence. Indeed, they are styled guidelines precisely because they do not contain rules." 3 I.C.C. 2d at 142.

"threshold cross-subsidy" test all were developed and/or adopted in individual cases,[53] and the other problems cited by WCTL derive solely from the Board's own interpretation of established rules and policies.[54] Plainly, the Board can effectively remedy a dysfunctional test through the same type of proceedings as those which gave rise to the problems.

Third, pursuing rulemaking at this stage will lead to delay, further complexity, and added expense, all with no assurance of a timely, meaningful outcome that itself would not become embroiled in appellate litigation.[55] All of these effects would serve only to benefit the railroads,[56] who – despite whatever submissions they may offer in this proceeding – cannot be anything other than very pleased with the *status quo*.

The ICC took nearly a decade to promulgate the *Guidelines* themselves, during which time virtually all coal rate proceedings were held in abeyance. In the more recent past, the Board's rulemaking to develop rate guidelines for small shipments and non-coal traffic

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[53] *See, e.g., Coal Trading Corp.*, 6 I.C.C. 2d at 380, 435-36 (percentage reduction); *Duke Energy Corp. v. Norfolk Southern Railway Co.* at 64 (adopting the EIA forecast for future use in indexing SARR revenues); *PPL Montana, LLC*, Decision served August 20, 2002 at 7-10 (threshold cross-subsidy).

[54] These could be corrected instantly in the next adjudication that is ripe for decision, once the Board resolves to restore genuine balance to its approach to the evaluation of competing evidence and arguments.

[55] *See, e.g., Association of American Railroads v. STB*, 146 F. 3d 942 (D.C. Cir. 1998) (denying as unripe a petition for review of the Board's initial non-coal and small shipment rate standards).

[56] WCTL submits that this will be apparent when the Board compares the positions of various parties on the question whether notice-and-comment rulemaking should be initiated.

– first begun in 1986 – still remains unresolved,[57] and even the relatively straightforward effort to promulgate rules to expedite and partially standardize discovery requests in SAC cases has been pending for two years without action.[58] It is neither logical nor efficient to delay individual adjudications in order to pursue a costly, lengthy and complex rulemaking to consider problems and remedies that already are addressed and clearly can be resolved in those very same adjudications.

It is true that in the first instance, the choice between rulemaking and adjudication as the context for resolving issues affecting regulatory methodologies lies within the informed discretion of the relevant agency. *S.E.C. v. Chenery Corp.*, 332 U.S. 194, 201 (1947). However, where the "rules" that might be promulgated would be generalized guidelines that still would be subject to interpretation and application based on individual evidentiary records, the Supreme Court has supported the agency following a case-by-case adjudicatory approach. *N.L.R.B. v. Bell Aerospace Co.*, 416 U.S. 267, 291-94 (1974). WCTL submits that the Board and its predecessor *always* have followed an adjudicatory approach to the evolution of key elements of the SAC test, that this policy has been and remains efficient and sound, and that such a course should be followed here. The problems with the current application of the SAC test that WCTL has identified all are capable of resolution in

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[57] *See* Ex Parte No. 347 (Sub-No. 2), *Rate Guidelines – Non-Coal Proceedings*, Notice served November 17, 1992.

[58] *See* Ex Parte No. 638, *Procedures to Expedite Resolution of Rail Rate Challenges to be Considered Under the Stand-Alone Methodology*, Decision served April 3, 2003.

individual adjudications, where solutions already are presented for the Board's adoption (either as presented or with modification). The Board should act expeditiously in those cases to remedy the flaws in question.

CONCLUSION

WCTL appreciates the opportunity to present to the Board its views concerning the important issues respecting the administration of the SAC test that have been raised by recent decisions rendered under the *Coal Rate Guidelines*. If applied in a reasonable and objective manner, consistent with the governing statutory mandate to protect captive shippers from abuse of a railroad market power, WCTL believes that the SAC test can be an appropriate and effective regulatory counterweight to a highly concentrated rail transportation sector with a manifested intent to exploit its market dominance over coal.

In this Statement, WCTL has outlined what it considers to be the principal flaws in the Board's recent administration of the SAC test, which have produced skewed results that have undermined the confidence of the coal shipper community in the effectiveness of the current regulatory regime . Each of these problems can and must be remedied in the specific context of pending and future adjudications before the Board. Effective remedies either are self-evident, or can be found in the evidentiary presentations of complainants in pending cases and adopted or modified by the Board. Further proceedings in this docket are unnecessary, and the initiation of new, separate rulemakings would be costly, inefficient and ineffectual.

Respectfully submitted,

THE WESTERN COAL TRAFFIC LEAGUE

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APPENDIX A

BEFORE THE SURFACE TRANSPORTATION BOARD

RAIL RATE CHALLENGES UNDER THE STAND-ALONE COST METHODOLOGY	**Ex Parte No. 657**

JOINT STATEMENT BY

ALLIANCE FOR RAIL COMPETITION
AMERICAN PUBLIC POWER ASSOCIATION
COLORADO WHEAT ADMINISTRATIVE COMMITTEE
CONCERNED CAPTIVE COAL SHIPPERS
CONSUMERS UNITED FOR RAIL EQUITY
EDISON ELECTRIC INSTITUTE
IDAHO BARLEY COMMISSION
IDAHO WHEAT COMMISSION
MONTANA WHEAT & BARLEY COMMITTEE
NATIONAL ASSOCIATION OF WHEAT GROWERS
NATIONAL BARLEY GROWERS ASSOCIATION
NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION
OKLAHOMA WHEAT COMMISSION
SOUTH DAKOTA WHEAT COMMISSION
TEXAS WHEAT COMMISSION
WASHINGTON WHEAT COMMISSION
WESTERN COAL TRAFFIC LEAGUE

Alliance for Rail Competition, American Public Power Association, Colorado Wheat Administrative Committee, Concerned Captive Coal Shippers, Consumers United for Rail Equity, Edison Electric Institute, Idaho Barley Commission, Idaho Wheat Commission, Montana Wheat & Barley Committee, National Association of

Wheat Growers, National Barley Growers Association, National Rural Electric Cooperative Association, Oklahoma Wheat Commission, South Dakota Wheat Commission, Texas Wheat Commission, Washington Wheat Commission, and Western Coal Traffic League (collectively "Subscribing Shippers") hereby submit the appended Subscribing Shippers' Joint Statement of Principles in this proceeding. Many of the Subscribing Shippers will be separately submitting individual statements.

Respectfully submitted,

Alliance for Rail Competition
American Public Power Association
Colorado Wheat Administrative Committee
Concerned Captive Coal Shippers
Consumers United for Rail Equity
Edison Electric Institute
Idaho Barley Commission
Idaho Wheat Commission
Montana Wheat & Barley Committee
National Association of Wheat Growers
National Barley Growers Association
National Rural Electric Cooperative Association
Oklahoma Wheat Commission
South Dakota Wheat Commission
Texas Wheat Commission
Washington Wheat Commission
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Dated: April 20, 2005

EXHIBIT

SUBSCRIBING SHIPPERS' JOINT STATEMENT OF PRINCIPLES

- The decisions in recent SAC cases have been uniformly unfavorable to captive shippers. These decisions have resulted in the transfer of hundreds of millions of dollars in rate increases from railroad customers and the public to four (4) dominant coal-carrying railroads.

- As a direct result of the Board's recent decisions, many captive shippers are paying considerably higher rates and charges than had been in place as little as three years ago. The burdens associated with these rate increases have been compounded by poor service, thus exacerbating the harm experienced by captive shippers and their customers.

- Railroad managements have interpreted these recent STB decisions as a "green light" for even greater increases in rail rates and charges, with the net effect that the bargaining power between railroads and their customers has become significantly biased towards the railroads. The railroads have been so emboldened that many captive shippers have now been forced into a new era of "take-it-or-leave-it" negotiations, in which carriers even have refused to enter into contracts.

- Although the Board properly has stated that it is not the "umpire, blandly calling balls and strikes" when adjudicating rate cases, and that "the right of the public must receive active and affirmative protection at the hands of the [Board]," these principles have been applied inconsistently in recent decisions and there is little evidence of meaningful protection.

- The Board has recognized that major case-specific problems exist in its current approach to SAC and these problems are leading to skewed results. The failure to resolve such problems in individual cases -- the context in which they arose -- threatens to deprive captive shippers for which a SAC case is even theoretically possible of any meaningful regulatory review.

- In a related context, small and non-coal captive shippers currently are experiencing particular harm. STB Chairman Nober testified before Congress that "[I]f no small cases are brought, this means that in practice, only about 75 coal shippers have a meaningful opportunity to challenge rail rates. This is unacceptable." Yet the Board has not offered any meaningful solution to the particularly acute difficulties faced by the 99%+ of captive shippers in the nation that cannot bring cases under the SAC constraint.

- The statutory requirement that captive shippers' rail rates must be "reasonable" needs to be implemented in a manner that ensures that captive rail shippers of all sizes and in all locations are protected by effective remedies to limit monopoly pricing by market dominant railroads. This includes non-coal shippers who have no tested or approved methodology for rate relief.

- If private-sector solutions are to be preferred, there must be more effective rail-to-rail competition. Private-sector solutions equate to a free hand for monopoly railroads where there is neither effective competition nor effective regulation.

- Using notice-and-comment proceedings to consider issues of SAC implementation which arose in individual SAC cases serves the railroads' interests in making rate cases even more difficult and expensive. The SAC problems which have arisen by Board action or inaction in individual cases should be resolved by Board remedial actions in individual cases.

- The Board is urged not to use rulemaking or other notice-and-comment procedures to address issues of SAC implementation, for four interrelated reasons:

  • First, the Coal Rate Guidelines clearly provide that complex SAC issues are best left to case-by-case resolution.[1] See Guidelines at 542-43 (SAC computations are "left to the parties to make in each case"). See also PPL Montana, et al. at 5 (Board denied request by BNSF and UP to institute separate proceedings, citing the policy of addressing SAC issues "as they arise in individual adjudications.")[2]

  • Second, the SAC standards themselves are not hard-and-fast "rules." See OPPD at 142 (the Guidelines "are styled guidelines precisely because they do not contain rules").[3] The STB does not need to initiate rulemakings to change guidelines that are not rules. All SAC implementation issues can – and should – be addressed in individual cases.

  • Third, side-bar proceedings will divert the Board's attention from correcting case-specific SAC implementation issues where they should be corrected – in pending coal rate cases. Many coal rate cases were left in limbo for years as the ICC struggled to develop the Guidelines. Reopening the Guidelines for rulemaking proceedings raises the specter of similar delays and added expense, as coal shipper-complainants get caught in the cross-fire between their cases and the generic rulemaking proceedings.

  • Fourth, any SAC-related rulemaking proceedings paralleling pending complaint cases are likely to be complex, time-consuming and expensive. If past is prologue, any STB decisions are likely to be appealed, resulting in further delays and uncertainty.[4] It took the Board's predecessor, the ICC, almost a decade to promulgate the Coal Rate Guidelines, and the appeals took another two years. Shippers have no assurance that any new "rulemaking" proceedings concerning the Guidelines will be on a faster track or produce meaningful results.

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[1] See Coal Rate Guidelines, Nationwide, 1 I.C.C. 2d 520 (1985) ("Coal Rate Guidelines" or "Guidelines"), aff'd sub nom. Consolidated Rail Corp. v. United States, 812 F.2d 1444 (3rd Cir. 1987).
[2] PPL Montana, LLC v. Burlington Northern and Santa Fe Ry., STB Docket No. 42054, et al. (STB served Nov. 27, 2001).
[3] Omaha Public Power District v. Burlington Northern R.R., 3 I.C.C. 2d 123 (1986).
[4] See, e.g., Ass'n of Am. R.Rs. v. STB, 146 F.3d 942 (D.C. Cir. 1998) (denying as unripe the AAR's challenge to the STB's small rate case standards).

Appendix B

MEMBERS OF THE
WESTERN COAL TRAFFIC LEAGUE MEMBERS

Alliant Energy
Ameren Energy Fuels and Services
Arizona Electric Power Cooperative, Inc.
Arizona Public Service
Associated Electric Cooperative, Inc.
Cleco Corporation
City of Austin, Texas
CPS Energy
Kansas City Power & Light Company
Lower Colorado River Authority
MidAmerican Energy Company
Minnesota Power
Nebraska Public Power District
Omaha Public Power District
Texas Genco, LP
Texas Municipal Power Agency
Westar Energy
Western Farmers Electric Cooperative
Western Fuels Association, Inc.
Wisconsin Public Service Corporation
Xcel Energy