

Surface Transportation Board Issues Rulings in "PPL Montana" & "Arizona Electric" Rail Rate Cases

Surface Transportation Board (Board) Chairman Linda J. Morgan announced today that the Board has issued significant rulings in two proceedings involving challenges by electric utilities to railroad rates for the transportation of coal in the western United States. In one case, the Board found that the rates charged by The Burlington Northern and Santa Fe Railway Company (BNSF) for coal shipped to a utility in Montana, PPL Montana, LLC, had not been shown to be unreasonably high. In the other case, in which the evidence has yet to be filed, the Board denied a request by the defendant railroads--BNSF and the Union Pacific Railroad Company (UP)--to order the complaining shipper, the Arizona Electric Power Cooperative, Inc. (AEPCO), to make three separate evidentiary presentations. Both cases involved issues of cross-subsidies, and each Board decision emphasizes that, in determining whether a rate is too high, traffic is expected to pay its own way.

The Board typically evaluates the reasonableness of rail rates using the stand-alone cost (SAC) test. The SAC test seeks to determine the lowest cost at which a hypothetical, efficient railroad could provide the transportation service needed by a complaining shipper. Under the SAC test, the complaining shipper designs a hypothetical railroad (the stand-alone railroad) specifically tailored to serve its needs and the needs of other selected traffic as efficiently as possible. The costs of building and operating such an efficient railroad are then compared to the revenues that the hypothetical railroad could expect to earn from the traffic that it is designed to serve. If the shipper demonstrates that the stand-alone railroad would not need to charge it as much as the defendant railroad charges, then the shipper is entitled to rate relief.

The AEPCO Case. In the AEPCO case, the utility initially challenged the reasonableness of rates charged jointly by BNSF and UP for movements of coal from BNSF-served mines in New Mexico to a generating station in Cochise, Arizona served by UP. Later, AEPCO amended its complaint to also challenge joint BNSF-UP rates to Cochise from BNSF-served mines in the Powder River Basin (PRB) of Wyoming and Montana, and UP rates for single-line service (service involving only one railroad) from mines in Colorado.

The three sets of challenged rates cover services that originate at separate coal-producing areas hundreds of miles apart, that operate over lines with different physical characteristics and traffic patterns, and that move under different arrangements (two in joint-line service and the other in single-line service). For those reasons, among others, the railroads last year filed a motion for partial dismissal of the complaint, arguing that AEPCO should not be allowed to broaden its complaint in that way. The Board denied the motion to dismiss. But the agency in its decision did agree with the railroads that, when AEPCO develops its SAC evidence for its stand-alone railroad, revenues from one coal-producing area should not be used to improperly cross-subsidize operations from other coal-producing areas. Thus, for example, revenues from PRB traffic should not be used to pay for rail facilities needed to transport only the New Mexico coal to the power plant (see Surface Transportation Board "News" release No. 01-74 issued December 31, 2001).

Subsequently, UP and BNSF asked the Board to direct AEPCO to make separate evidentiary submissions--including separate SAC presentations--for each of the three sets of challenged rates. In the decision issued today, the Board denied that request as well, finding that AEPCO could pursue a single, three-tiered approach as long as AEPCO follows through with its stated intention to avoid any cross-subsidy among the three sets of mine origins. The Board also found that AEPCO could assume that its hypothetical railroad could avail itself of the same joint ownership or track-sharing arrangements currently available to BNSF and UP, and that AEPCO could assume that its traffic would move over different routings than those currently used by BNSF and UP, so long as AEPCO has not itself specifically requested the routing that the railroads currently use.

However, the agency stated that, because AEPCO challenges UP's single-line rates for its shipments from the Colorado mines, AEPCO's hypothetical railroad may not be designed to include traffic that UP does not now serve. The Board

explained that, just as the typical SAC analysis does not include costs not incurred by the defendant railroad, it should not include revenues not received by the defendant railroad. As the Board pointed out, although shippers have considerable discretion in designing their SAC cases, "there are limits on the creativity with which a complainant . . . may develop its [hypothetical railroad]."

PPL Montana. In the PPL Montana case, the Board found that the hypothetical railroad designed by the shipper would in fact depend upon an improper cross-subsidy. In that case, the challenged rate applies to coal shipments from mines in the PRB to a power plant in Billings, Montana. The hypothetical railroad that PPL Montana designed would consist of two distinct parts, a high-density "north-south" part and a lower-density "western" part (on which PPL's plant would be located). BNSF argued that the hypothetical railroad could not charge PPL Montana a lower rate without a subsidy from traffic moving only over the north-south part of the system.

When it evaluates a SAC case, the Board must resolve hundreds of issues about how a hypothetical railroad could feasibly operate and what it would cost. In reviewing the evidence in this case, the Board gave PPL Montana the benefit of the doubt on nearly all of those disputed issues. But even so, the Board found that the western leg of PPL Montana's hypothetical railroad would not earn sufficient revenues to cover the costs of that part of the system, but instead would need to be cross-subsidized by the more intensively used north-south portion of the railroad.

PPL Montana argued that, while it should not be required to cross-subsidize facilities from which it receives no benefit, there is no comparable prohibition in the SAC test against other traffic subsidizing its traffic. The Board disagreed, distinguishing between the permissible sharing of costs that traffic has in common and an impermissible cross-subsidy. The Board explained that permitting cross-subsidies from traffic not using many of the facilities needed by PPL Montana's traffic would fundamentally undermine the SAC principle that traffic carried by a hypothetical, efficient railroad would pay its own way. Therefore, the Board found that PPL Montana had not shown that BNSF's rate is unreasonable.

The Board's decisions were issued today in the cases entitled *Arizona Electric Power Cooperative, Inc. v. The Burlington Northern and Santa Fe Railway Company and Union Pacific Railroad Company*, STB Docket No. 42058, and *PPL Montana, LLC v. The Burlington Northern and Santa Fe Railway Company*, STB Docket No. 42054. Printed copies of the decisions are available for a fee by contacting **D~ 2 D~ Legal Copy Service, Suite 405, 1925 K Street, N.W., Washington, DC 20006, telephone (202) 293-7776**, or via da2dalegal@earthlink.net. The decisions also are available for viewing and downloading via the Board's website at <http://www.stb.dot.gov>.

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