Recent Developments in the STB's Application of Coal Rate Guidelines

National Coal Transportation Association
April 2004

Philip H. Burris
Senior Vice President

Introduction

- Coal Rate Guidelines were adopted in 1985, since then:
  - Thirty-one proceedings have been filed with the ICC/STB
  - Twenty proceedings have been decided
  - Five proceedings are in the evidentiary process or waiting for a decision
  - One decided proceeding is being reconsidered
  - Petitions for reconsideration are pending in three proceedings
- Guidelines have been used in the negotiation process numerous times
- Have the Guidelines become more complicated?

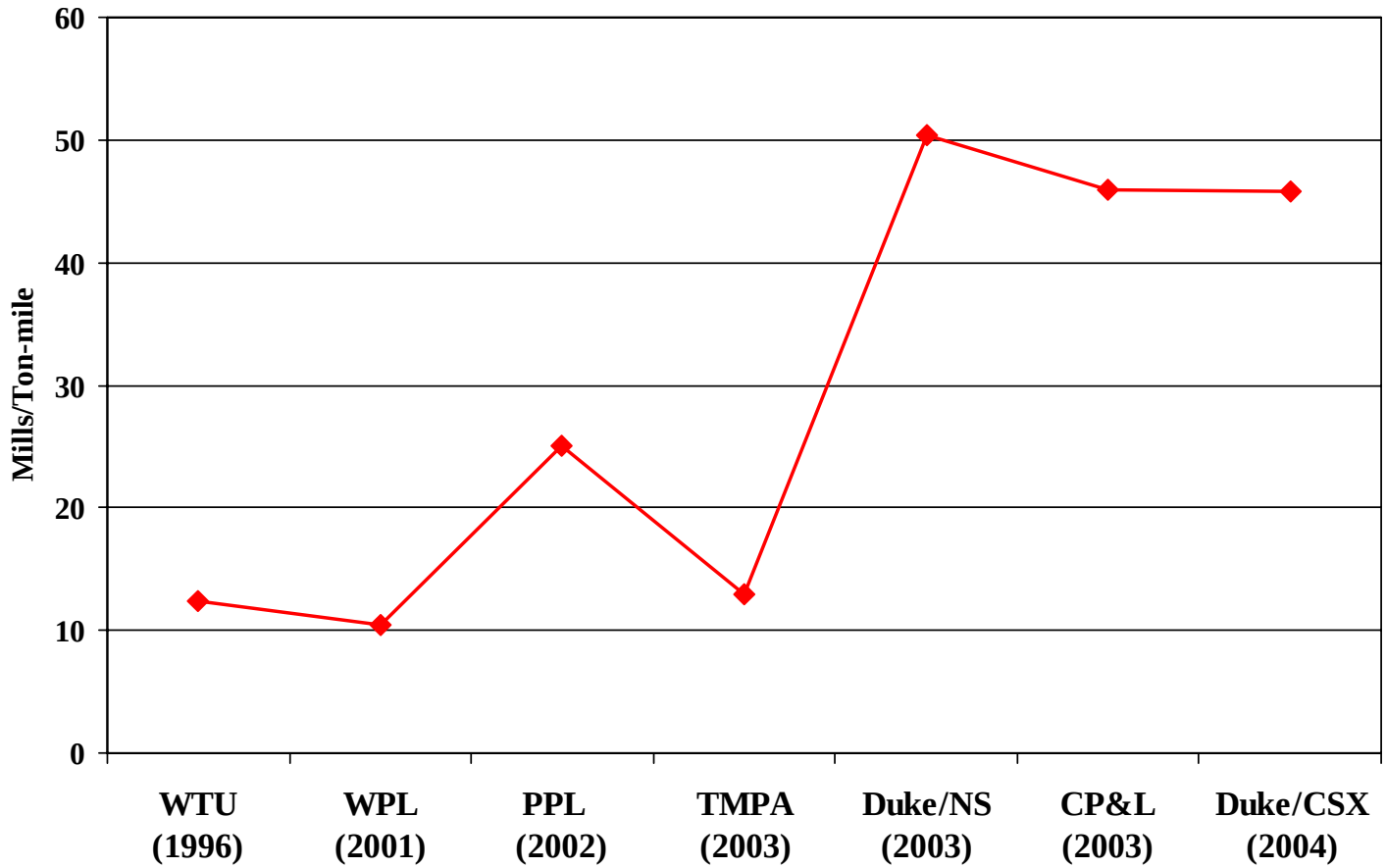
Recent Maximum Coal Rate Proceedings Before the STB

- STB Recent Decisions
  - West Texas Utilities
  - Wisconsin Power & Light
  - PPL Montana, LLC
  - Texas Municipal Power Authority
  - Duke Energy/NS
  - Carolina Power & Light
  - Duke Energy/CSX
- Cases Pending
  - Public Service of Colorado (Xcel Energy)
  - Arizona Electric Power
  - Otter Tail Power
  - West Texas Utilities (Reopened)
  - Arizona Public Service (Reopened)

Recent Maximum Coal Rate Proceedings Before the STB

Utility	Prescribed Rate	Miles	Mills/Ton-mile
WTU	$13.68	1,108.1	12.4
WPL	$13.30	1,272.5	10.5
PPL Montana	$6.64	265.8	25.0
TMPA	$18.20	1,413.0	12.9
Duke/NS	$16.45	326.1	50.4
CP&L	$15.68	341.0	46.0
Duke/CSX	$17.88	390.5	45.8

Progression of Maximum Reasonable Rates



Recent Changes in Application of Goal Rate Guidelines

- Capital Recovery Based on Time vs Tons
- PPL Cross Subsidy Test
- Productivity
- Rerouted Traffic
- Divisions of Revenue on Cross-over Traffic
- Rate Reduction Methodology

Capital Recovery Based on Time vs Tons

- When ICC began using the DCF model, capital recovery was allocated on a tons basis. i.e., each ton was responsible for an even increment of investment.
  - Developed to address a situation where traffic levels fluctuated (both rising and falling)
  - A larger portion of capital costs are recovered in the years when the greatest volume moves
- In FMC (2000), the STB rejected the allocation based on tons and shifted to an allocation based on time because tons were forecasted to increase dramatically over time

PPL Cross Subsidy Test

In PPL the Board determined:

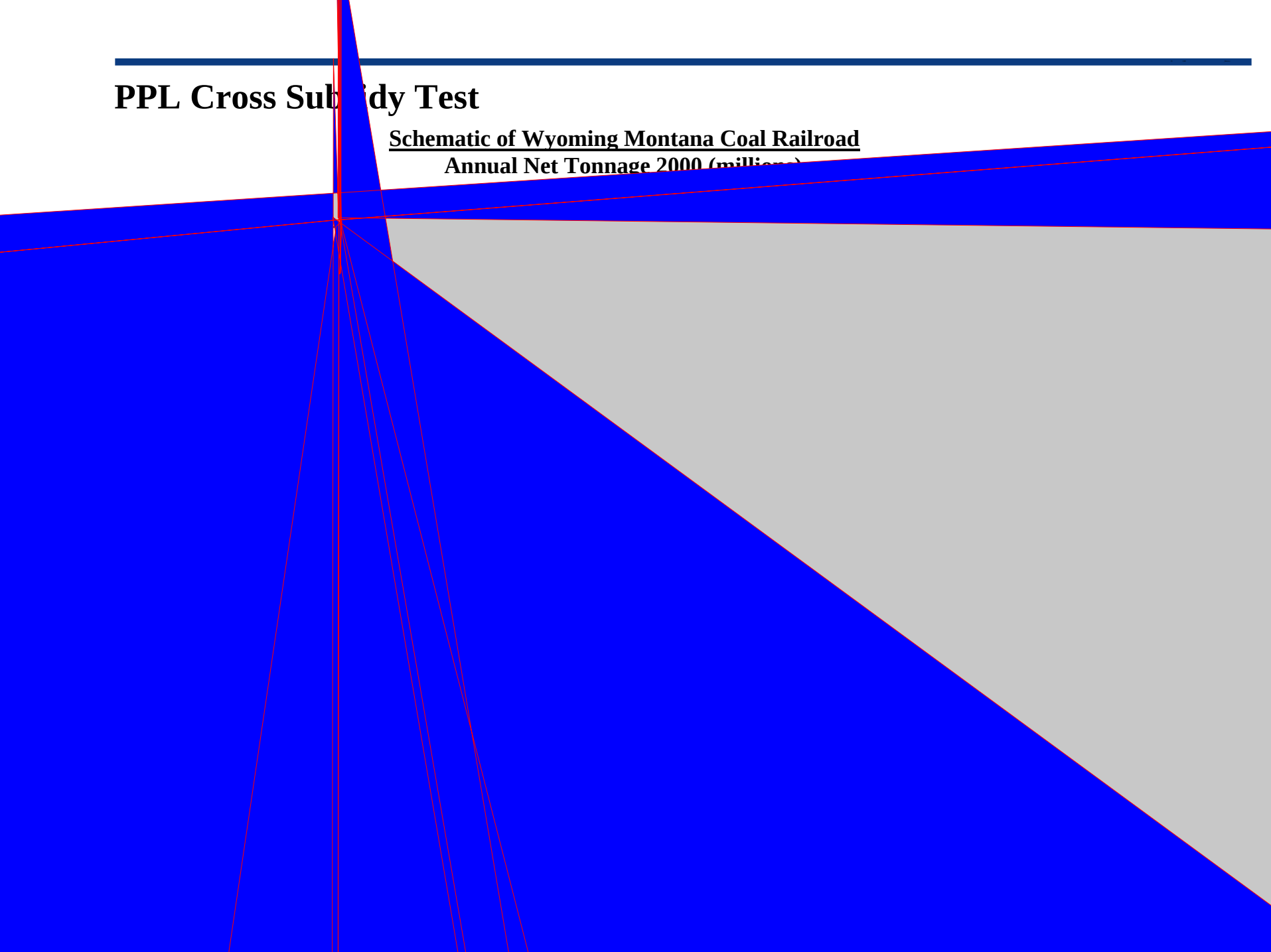
"Revenues from non-issue traffic should not be relied upon to pay for portions of a SAC system over which the non-issue traffic would not move"

"The appropriate inquiry is not … whether a particular subset of traffic is generating revenues in excess of the SAC associated with serving that subset of traffic, but whether there is a readily identifiable subset of traffic that would not cover the collective attributable costs associated with serving the traffic."

PPL Cross Sub dy Test

Schematic of Wyoming Montana Coal Railroad

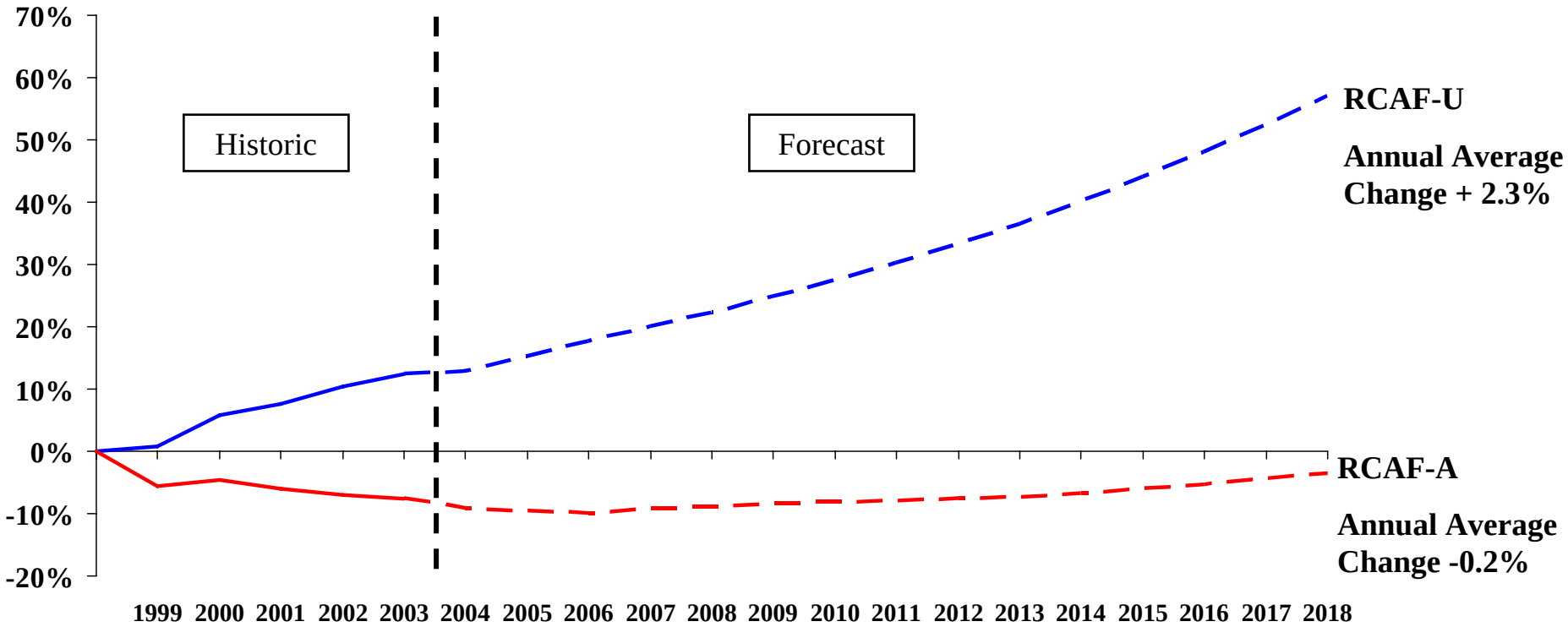
Annual Net Tonnage 2000 (millions)



Application of Productivity to SARR Operating Cost

- In WPL, the STB accepted use of a UP internal forecast of change in operating expense to estimate operating costs
- In subsequent proceedings:
  - Complainants have used the RCAF-A
  - Carriers have used the RCAF-U
  - Board has accepted the RCAF-U to forecast operating costs, indicating:
    - The RCAF-A is based on all traffic on all Class I carriers
    - The SARR is not expected to achieve the same productivity as is forecast for the Class I carriers
    - The RCAF-U would result in a smaller overstatement in cost than the understatement of cost resulting from use of the RCAF-A

Historic and Forecasted Rail Cost Adjustment Factor



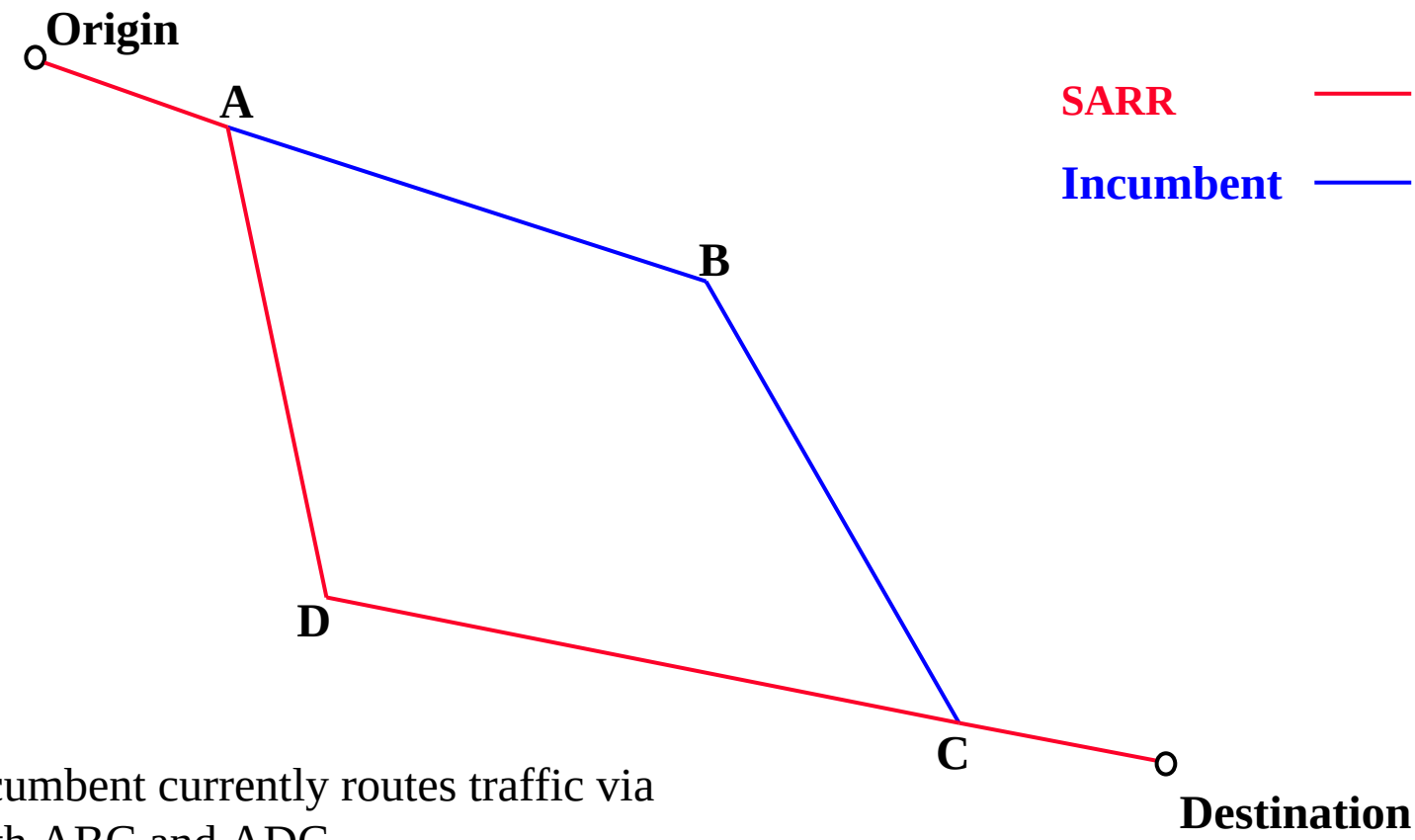
STB is Interested in How to Calculate Productivity for a SARR

- Chairman Nober requested the parties address productivity for a SARR in both the CP&L and Xcel Energy oral arguments
- Alternatives to RCAF
  - Measure of productivity that is specific to coal shipments is the productivity factor that is embedded in the EIA coal transportation price forecast
  - Measure Productivity using the STB's total factor approach and the characteristics of the SARR's traffic and expense levels over time
- Areas of productivity likely to be available to SARR
  - Traffic growth compared with investment
  - Locomotive improvements
  - Train and car size
  - Information Technology
  - Maintenance Techniques

Types of Reroutes

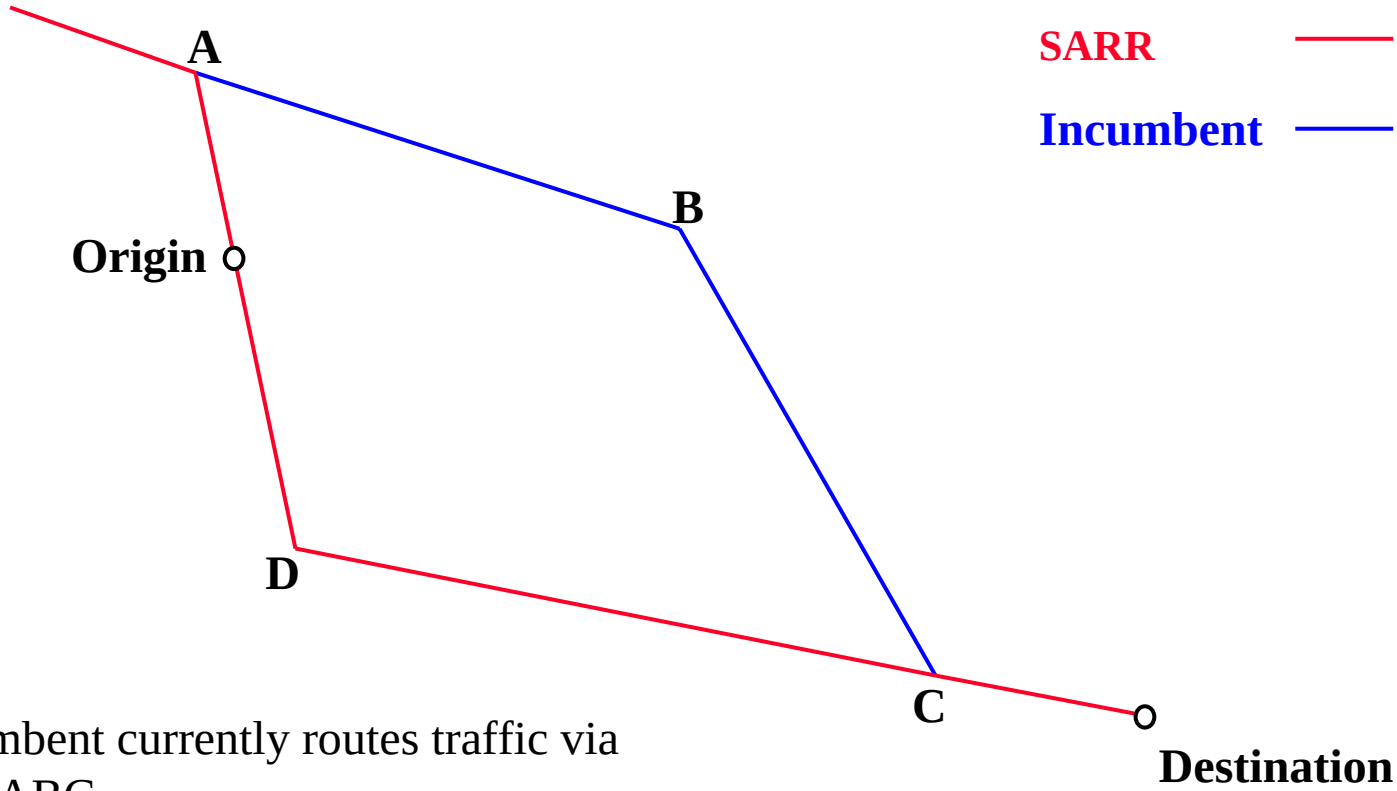
- Reroute 1 – Traffic currently moves via multiple routing alternatives
- Reroute 2 – Change internal to a SARR system
- Reroute 3 – Change to the residual incumbents' route of movement on non-issue traffic
- Reroute 4 – Traffic that currently does not move over a portion of the SARR network

Reroute 1 - Traffic currently moves via multiple alternatives



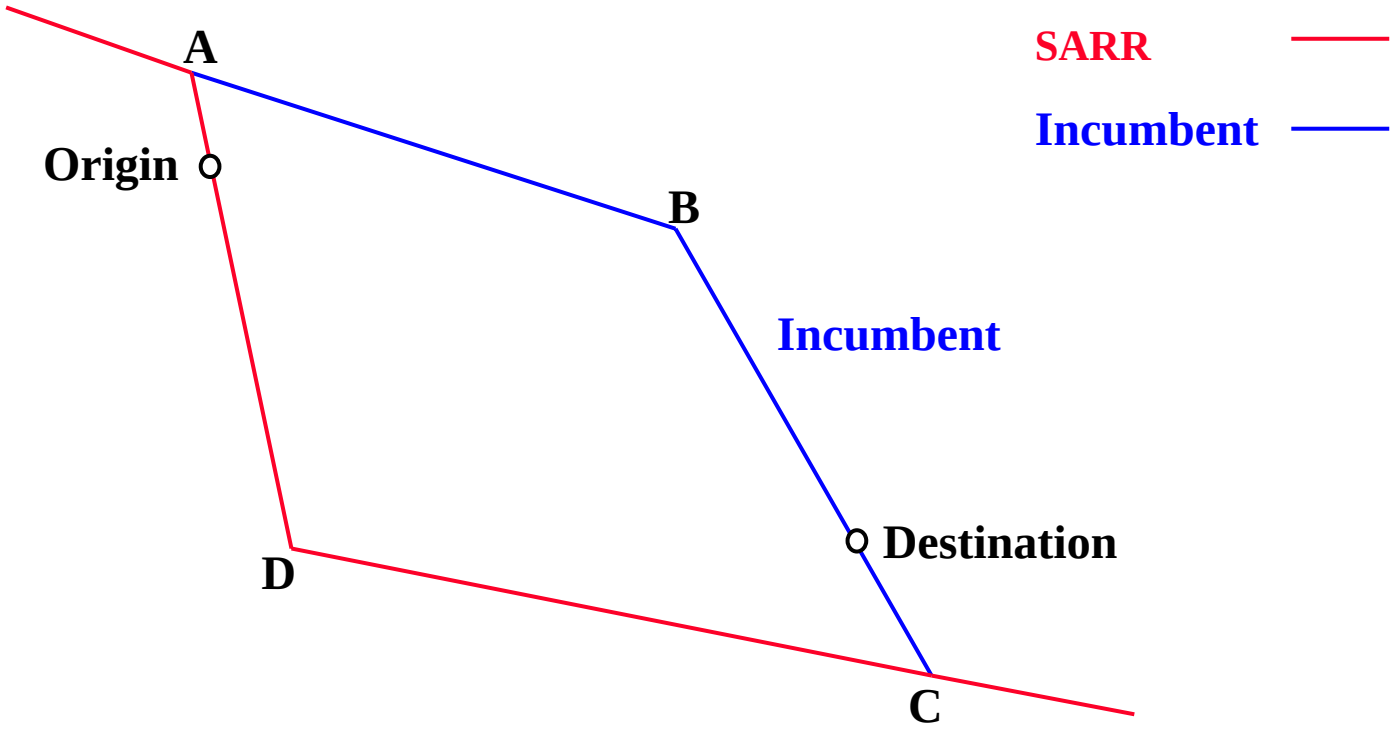
- Incumbent currently routes traffic via both ABC and ADC
- SARR constructs only ADC and routes all traffic via that route

Reroute 2 - Change internal to SARR system



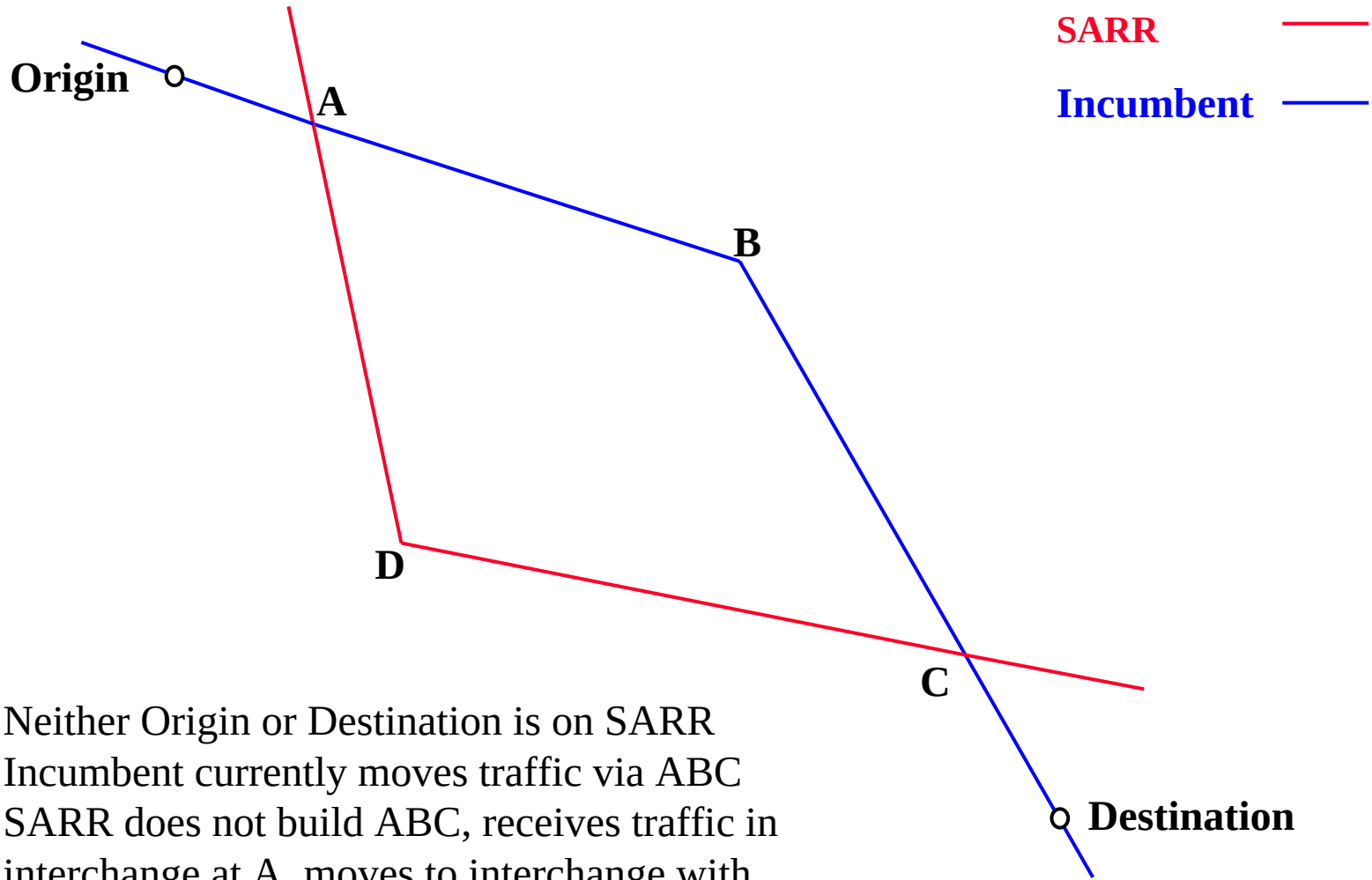
- Incumbent currently routes traffic via only ABC
- SARR does not construct ABC and moves traffic via DC

Reroute 3 - Change to Residual Incumbent's route of movement



- Incumbent currently moves traffic via AB to destination
- SARR does not construct ABC and routes traffic via DC to interchange with incumbent

Reroute 4 - Traffic that does not currently move over SARR network



- Neither Origin or Destination is on SARR
- Incumbent currently moves traffic via ABC
- SARR does not build ABC, receives traffic in interchange at A, moves to interchange with residual incumbent at C

Rerouted Traffic – Coal Rate Guidelines

"The ability to group traffic of different shippers is essential to the theory of contestability. It allows the captive shipper to identify areas where production economies define an efficient subsystem or alternative system whose traffic is divertible to a hypothetical competitor."

"We see no need for any restrictions on the traffic that may potentially be included in a stand-alone group."

"The proponent of a particular stand-alone model must identify, and be prepared to defend, the assumptions and selections it has made."

STB Decisions Regarding Rerouting Traffic

- Certain rerouting permitted previous to TMPA (eg. WTU and McCarty)
- Texas Municipal Power Authority
  - Allowed internal rerouting of issue traffic, adding approximately 36 miles to the length of haul
  - Retained the rerouted non-issue traffic but disallowed routing changes that caused the residual incumbents route of movement to change

STB Decisions Regarding Rerouting Traffic

- In Duke/NS the STB established certain presumptions regarding rerouting traffic
  - If shorter line-haul distance, presumed to be acceptable, unless defendant demonstrates otherwise
  - If longer line-haul distance, presumed to be less efficient and therefore rejected unless complainant demonstrates otherwise
  - Must present evidence quantifying the impact of rerouting on revenues and costs on both shippers and residual incumbent
- Duke/CSX disallowed rerouted traffic that does not share SARR facilities in its existing route of movement

Divisions of Revenue on Cross-over Traffic

- In Nevada Power (1989), the Board indicated that, in the absence of market-based divisions of revenue, divisions on cross-over traffic should be based on a mileage prorate of the incumbents' existing revenues
- In McCarty Farms (1997), the Board began using a modified mileage block division methodology when actual division data is not available
- The Board continued to use the modified mileage block method in subsequent proceedings as market based divisions were not available (e.g. FMC, WPL, PPL, TMPA)

Divisions of Revenue on Cross-over Traffic

- In Duke/NS the Board reversed 15 years of precedent, stating: " a market-based inquiry [regarding divisions] is not appropriate for a SAC analysis"
- Regarding use of NS actual divisions the Board stated "their divisions presumably reflect a wide range of commercial considerations across a broad spectrum of traffic and gateways"
- In rejecting the use of market-based divisions the Board relied on a new methodology – Modified Straight Mileage Prorate ("MSP") methodology and rejected use of Mileage Block Method because it can result in "lumpy" divisions, thereby enticing the Complainant to design a SARR to take advantage of the divisions method

Division Methodologies

Straight Mileage Prorate	CARRIER A	CARRIER B
	75 Mile	325 Miles
Percent Division	18.8%	81.2%

Modified Mileage Block	CARRIER A	CARRIER B
	75 Mile	325 Miles
	1 Origin Block	1 Destination block
	1 Mileage Block	4 Mileage blocks
	2	5
Percent Division	28.6%	71.4%

Modified Straight Mileage Prorate	CARRIER A	CARRIER B
	75 Mile	325 Miles
	100 Miles for Origin	100 Miles for Destination
	75 Miles	325 Miles
	175	425
Percent Division	29.2%	70.8%

Determination of Maximum Reasonable Rates When SAC Revenues are Found to Exceed SAC Costs

- Historically the STB has use the “percent reduction method”
  - Originally used in Coal Trading
  - The STB claims it maintains the existing demand elasticity relationships between shippers in the SAC group
- The percent reduction method is susceptible to “gaming”, ie., when negotiations are unsuccessful, the carrier publishes a tariff rate that is substantially higher than that offered in negotiations, in order to produce an artificially high rate through the maximum rate process

Alternatives to the Percent Reduction Methodology

- SAC applied on a ton-mile basis
  - Rejected because it does not allow for demand-based differential pricing
- Replace published rate with last “good faith” offer in negotiations
  - Rejected because would “chill” the negotiation process
- Differential pricing based on marginal cost mark-up’s
  - Overpayment allocated on an iterative basis to those SAC group shipments with the highest mark-up above marginal cost

Impact to the Transportation Community from Continual Changes in the Guidelines

- When Guidelines were adopted, the were to be used as both a negotiating tool and a litigating tool (if necessary) for a captive shippers and rail carriers
- When Guidelines can be mechanically applied with a high degree of certainty, the parties will be able to agree on rates for captive traffic and the need for litigation will diminish
- Constant changes in the principles, such as those we have seen recently, serves only to frustrate the process and increase the chances of litigation
- Stated differently, if the principles from the last case don't apply to the next case, the parties will never be able to agree on a captive shipper rate without litigation