

THE CURRENT STATUS OF STB COAL RATE REGULATION AND IMPLICATIONS OF PENDING LEGISLATIVE PROPOSALS

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PRESENTATION OVERVIEW

- Governing Maximum Coal Rate Standards
- Recent Decisions
 - SAC Cases
 - Western Fuels Association/Basin Electric v. BNSF
(Decisions Served February 18, 2009; July 23, 2009; October 21, 2009)
 - Jurisdictional Threshold Cases
 - Oklahoma Gas Electric Company v. UP
(Decision served July 24, 2009)
- Pending Rate Cases
- Implications of S. 2889, The Surface Transportation Act of 2009, for maximum coal rate litigation

GOVERNING STATUTES

- Rates on “market dominant” common carrier rail traffic “must be reasonable” (49 U.S.C. §10701(d)(1))
- Market dominance means a shipper is captive and is being charged rates with R/VC ratios equal to or greater than 180% (jurisdictional threshold) (49 U.S.C. §10707)
- Shippers pursue rate relief by filing cases at the STB (49 U.S.C. §11701(b))

COAL RATE GUIDELINES

- Coal Rate Guidelines (“Guidelines”) were promulgated in 1985 to set methods to determine whether rates on market dominant coal traffic are reasonable
- Guidelines set four constraints on railroad pricing: stand-alone cost (“SAC”), revenue adequacy, management efficiency and phase-in
- Guidelines were fleshed out between 1985 and 2005 on a case-by-case basis
- Basic standard: STB sets maximum rates on captive traffic at greater of 180% of variable costs or SAC

STAND-ALONE COSTS

- Shipper models hypothetical “Stand-Alone Railroad” (“SARR”) to provide O/D service for the issue traffic
- SARR also serves other traffic selected by shipper along O/D SARR route
- Shipper forecasts SARR revenues and SARR costs over the analysis period
- If SARR revenues exceed SARR costs, the shipper is entitled to rate relief

REVISIONS TO COAL RATE GUIDELINES

- Promulgated in 2006 rulemaking proceeding – Major Issues in Rail Rate Cases, STB Ex Parte No. 657 (Sub-No. 1)
- Retains basic standard: rates on captive traffic may be unreasonable if they exceed the greater of 180% of variable costs or SAC
- Changes method for calculating variable costs
- Changes some key inputs on how SAC is calculated

REVISIONS TO COAL RATE GUIDELINES

Old Rules

Calculate VC with adjusted URCS

SAC relief if SARR revenues exceed SARR costs over model period

SAC relief = percent reduction

Set cross-over traffic revenue using Modified Mileage Prorate

Index operating costs using RCAF-U

Twenty-year prescription period

Revised Rules

Phase III URCS

Same

Maximum Markup Method (MMM)

Average Total Cost (ATC)

Hybrid RCAF-U/A

Ten-year prescription period

VARIABLE COST INPUTS – OLD RULES

1. Involved Railroad
2. Miles
3. Number of Terminals
4. Number of Interchanges
5. Car ownership
6. Tons Per Car (Load)
7. Tare Per Car
8. Car Type
9. Car Ownership
10. Empty Return
11. Number of Cars Per Train
12. Number of Locomotives
13. Helper Service Operations
14. Actual Switching
15. Station Clerical Adjustment
16. Actual Locomotive Acquisition Costs
17. Actual Locomotive Maintenance Costs
18. Actual Fuel Costs
19. Actual Car Ownership Costs
20. Actual Car Maintenance Costs
21. Actual Crew Costs
22. Actual Maintenance of Way Costs
23. Actual Road Investment Costs
24. Actual Joint Facility Costs
25. Actual Loss & Damage

VARIABLE COST INPUTS – REVISED RULES

1. Involved Railroad
2. Loaded Miles
3. Type of Movement (local, interline, overhead)
4. Tons Per Car
5. Car Type
6. Car Ownership
7. Number of Cars Per Train
8. Shipment Type (single car, multiple car, unit train)
9. Commodity
10. (Indexing)

IMPACT OF REVISED VARIABLE COST RULES

- Simplifies costing procedures
- Produces higher VC and JT for most unit train coal shippers
- Example: WPL v. UP decision at 2Q 2000 levels
 - JT = \$13.72 per ton, 10.8 mills (Old Rules)
 - JT = \$16.97 per ton, 13.4 mills (Revised Rules)

RATE RELIEF – OLD RULES

- Percent Reduction Method
- If SARR revenues exceeded SARR costs by 20% during the involved time period, all SARR traffic group members rates were reduced by 20%
- If the challenged rate was \$10 per ton during the involved time period, the rate would be reduced by 20% to \$8 per ton

RATE RELIEF- REVISED RULES

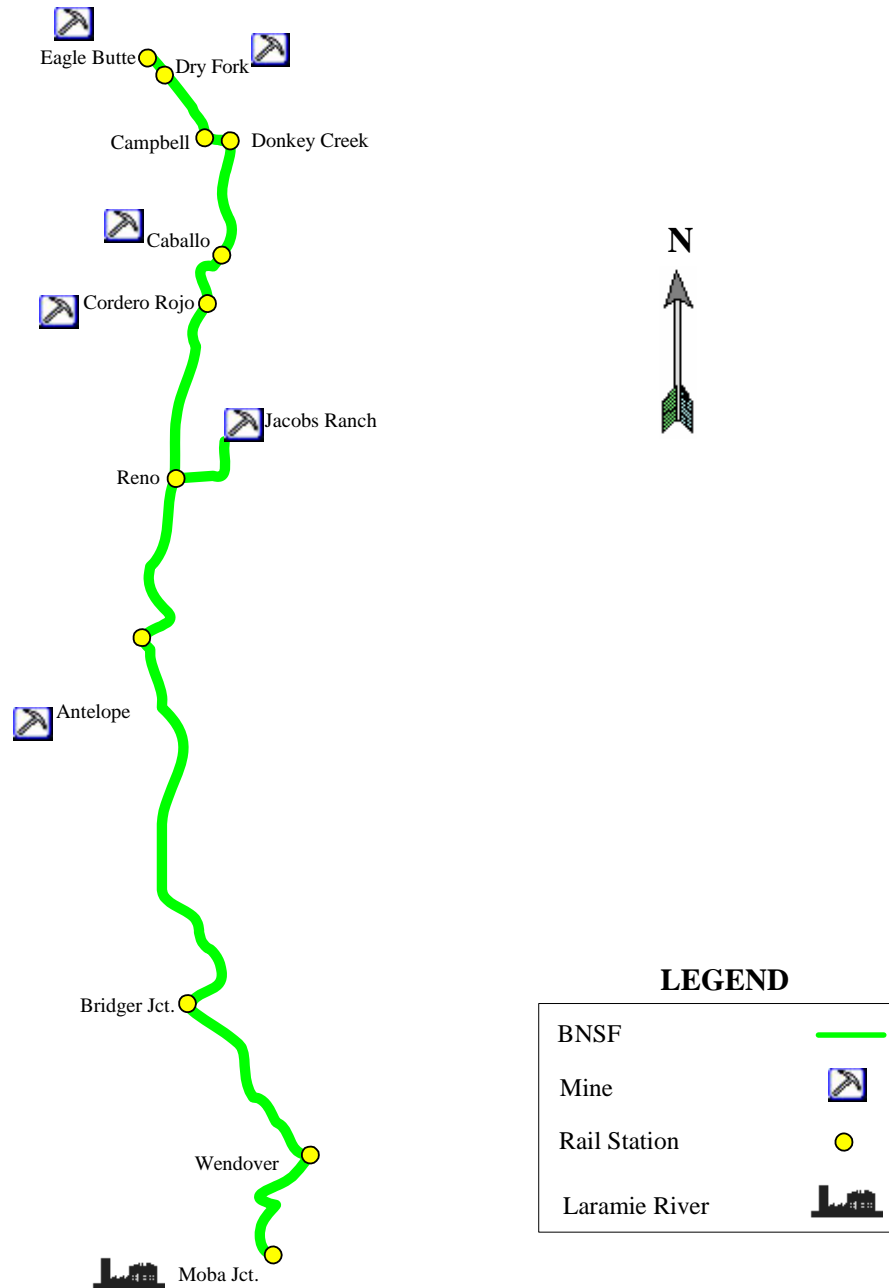
- MMM example
- Assume SARR revenues exceed SARR costs and SARR revenues will equal SARR costs if rates on high R/VC ratio traffic movements are reduced to rates with R/VC ratios of 200% and other traffic rates remain unchanged

<u>SARR Shipper</u>	<u>On-SARR R/VC Ratio</u>	
	<u>Pre-MMM</u>	<u>After MMM</u>
Shipper 1	500%	200%
Shipper 2	350%	200%
Shipper 3	<u>200%</u>	<u>200%</u>
Shipper 4	175%	175%
Shipper 5	150%	150%
Shipper 6	135%	135%

WFA/BASIN ELECTRIC CASE

- Case involves unit train coal shipments from the Wyoming PRB to the Laramie River Station, near Moba Jct., WY
- Single Line BNSF routing
- Rail O/D distance approximately 186 miles (from Dry Fork)
- Approximately 8 million tons transported annually
- Shipper-supplied rail cars

Schematic of Current Route from PRB, WY to WFA Basin's Laramie River Station



WFA/BASIN ELECTRIC CASE

- WFA/Basin Electric filed complaint in October of 2004
- Challenged Pricing Authority rates initially doubled and, over time, tripled expiring contract rates
- Record initially closes December, 2005
- In November, 2006, STB reopens record for receipt of evidence under revised SAC rules
- Parties submit multiple rounds of additional SAC evidence, STB issues several interim decisions
- STB served merits decision on February 18, 2009

WFA/BASIN ELECTRIC CASE

- STB finds BNSF exerts market dominance over the involved traffic
- STB finds SARR revenues exceed SARR costs over the 20-year analysis period
- STB prescribes maximum MMM R/VC ratios for each year of the 20-year analysis period

WFA/BASIN ELECTRIC CASE

<u>Year</u>	<u>Maximum MMM R/VC Ratio</u>
4Q04	241%
2005	244
2006	229
2007	236
2008	243
2009	240
2010	244
2011	245
2012	247
2013	249
2014	253
2015	266
2016	267
2017	263
2018	260
2019	260
2020	259
2021	258
2022	259
2023	259
2024	257

WFA/BASIN ELECTRIC CASE

- STB directs BNSF to publish conforming tariff rates by March 20, 2009
- STB directs BNSF to pay WFA/Basin Electric reparations for 4Q04 to 1Q09 overpayments
- STB estimates relief in 4Q04 to 2024 time period at \$345 million (in current dollars)
- “These amounts are the single largest reduction in rail rates ever ordered by this agency” (Decision at 2)

WFA/BASIN CASE – 2009 MMM CALCULATIONS

- Weighted average issue traffic MMM
R/VC Ratio = 600%
- Maximum MMM R/VC Ratio = 241%

RATE RELIEF DISPUTE

- This is the first case where the Board has applied its new MMM procedures
- WFA/Basin Electric and BNSF disputed how to translate the maximum MMM R/VC ratios into maximum rates per ton
- STB decided issue in a decision served on July 27, 2009 (See results next slide)
- In decision served October 22, 2009 STB ordered BNSF to pay \$120 million in reparations
- BNSF has appealed STB decisions to U.S. Court of Appeals for D.C. Circuit

WFA/BASIN ELECTRIC CASE

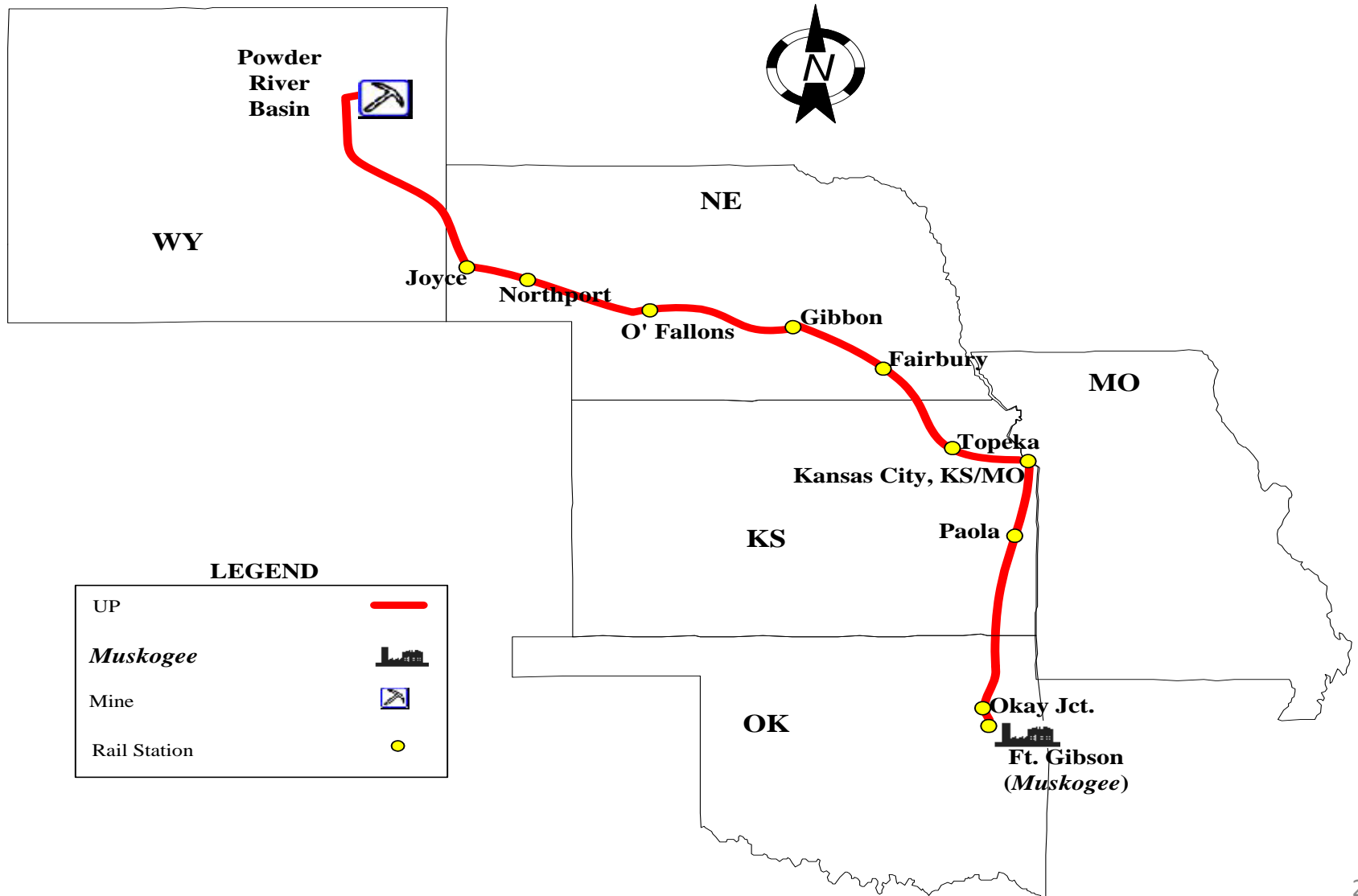
1Q 2009 RATES – AT 241% R/VC RATIO

<u>Mine Origin</u>	<u>Tariff Rate (\$/ton)</u>	<u>BNSF Calculation (\$/ton)</u>	<u>WFA/Basin Calculation (\$/ton)</u>	<u>STB Maximum Lawful Rates (\$/ton)</u>
Antelope	8.39	3.89	2.74	3.51
North Antelope	8.40	4.07	2.83	3.67
Black Thunder	8.42	4.52	3.19	4.08
Jacobs Ranch	8.43	4.67	3.24	4.21
Cordero	8.86	4.95	3.49	4.46
Belle Ayr	8.87	5.10	3.62	4.60
Caballo Rojo	8.87	5.10	3.59	4.60
Caballo	8.87	5.17	3.65	4.67
Dry Fork	9.16	5.73	4.06	5.16
Rawhide	9.16	5.78	4.10	5.21
Eagle Butte	9.16	5.83	4.09	5.25
Buckskin	9.17	5.90	4.06	5.33
Reduction (%)		(43%)	(60%)	(48%)

OG&E CASE

- Case involved unit train coal shipments from the Southern Wyoming PRB to OG&E's Muskogee Generating Station, in Fort Gibson, OK
- UP transports the coal in single line service to Muskogee
- Rail O/D distances approximately 1,002 to 1,053 miles from SPRB mines
- Approximately 6 million tons transported annually
- Challenged rates involved service in both shipper – provided and railroad – provided rail cars

Schematic Of Current Route From PRB, WY To OG&E's Muskogee Plant



OG&E CASE

- OG&E filed case in November, 2008
- Parties submitted joint stipulation to STB on procedure for case.
- UP stipulated SAC out of case; agreed that if Board found that its rates exceeded the JT, UP would cap rates for a ten-year period at levels not to exceed the JT

OG&E CASE

- Final decision served on July 24, 2009
- STB finds challenged rates exceed the 180% JT in 2009
- Rates at JT, under STB calculations, range from \$17.02 per ton to \$20.09 per ton (16.1 mills to 20.0 mills)
- STB directs parties to make JT calculations for later time periods in manner “consistent” with the procedures described in the decision
- STB estimates rate relief (reparations for past overcharges and projected future rate savings) at \$10 million per year for 10 year rate prescription period

OTHER JT CASES

- In its 2001 WPL v. UP decision, the STB sets maximum rates at 180% JT; STB finds SAC rates are well below the JT
- UP stipulated out SAC in the next three PRB rate cases where UP was the only defendant: NSP (settled 2003), KCPL (decided 2008) and then OG&E

OTHER PENDING COAL RATE CASES

- AEPCO v. BNSF/UP In Evidentiary Phase
 - Movements of unit train traffic in shipper-owned railcars from mines in NM, MT and WY to Apache Generating Station at Cochise, AZ
 - Average O/D distance – approximately 1284.5 miles
 - Approximate annual volume – 1.4 million tons
 - Challenged rates range from \$13 - 44 per ton before fuel surcharge.
(Sample mills level 28.66 mills)

OTHER PENDING COAL RATE CASES

- Seminole v. CSXT In Evidentiary Phase
 - Movements of unit train traffic in both shipper and carrier- owned railcars from mines in KY, IN, IL, WV and PA to Seminole Generating Station at Palatka, FL
 - Average O/D distance – approximately 946 miles
 - Approximate annual volume – 4 million tons
 - Challenged rates (not subject to fuel surcharges) range from \$41-51 per ton. (Sample mills level 49.20 mills)

IMPLICATIONS OF S. 2889 FOR MAXIMUM COAL RATE CASES

- SAC Cases
- Bottleneck Rate Cases

SAC CASES

- Variable Cost Calculation
 - Rulemaking proceeding to examine URCS – Section 207
 - Initiate within 180 days of enactment
 - Updating, revision or replacement of URCS to be completed within 3 years of enactment
 - Until Board updates/revises/replaces URCS, parties in SAC cases “may make reasonable movement-specific adjustments” to URCS variable costs
 - If URCS “materially changed” STB shall develop a “one-time adjustment factor” “to adjust the variable costs in rate prescriptions determined under the changed procedures to equal those that would have been obtained under the prior procedures” and will apply, upon request, to hold harmless existing rate prescriptions in effect on date of enactment.

SAC CASES

- Variable Cost Calculation (Continued)
 - STB study to review the use of a replacement cost approach to value the assets of rail facilities – Section 208
 - Initiate within 180 days of enactment
 - Complete within 2 years after initiation, provide report to Congress on findings
 - In October, 2008 STB rejected AAR request to initiate rulemaking to consider replacement cost methodology – STB Ex Parte No. 679
 - Replacement cost methodology also rejected by Railroad Accounting Principles Board (in 1987) And by U.S. General Accounting Office (in 1986)
 - Three critical problems:
 - Estimation of current replacement costs – bridges, tunnels, land, etc.
 - Estimation of “real” cost of capital (to avoid double count of inflation)
 - Identification of assets that will not be replaced

SAC CASES

- Advance Rate Challenges – Section 307
 - Board may consider reasonableness of a rate quoted up to 1 year before rate's effective date
 - May result in change of Board's view on Railroad's obligation to quote rates in advance of application
- SAC Case Timelines – Section 308
 - One year for discovery evidence and briefs, six months for Board decision

BOTTLENECK RATE CASES

- Bottleneck Rates – Section 302
 - Carriers must quote rates over bottleneck segments when carrier has market dominance. Section 302, §10710(a) and (b)
 - If it is established that Railroad has market dominance, rates must be reasonable. Id., §10710(c)(1)
 - Within one year of enactment Board must establish standards for determining if bottleneck rates are reasonable, along with “simplified and expedited method.” Id., §10710(c)(2)(A)
 - Provides detailed language about costs, return, contribution to be included in determining reasonableness. Id., §10710(c)(2)(B)
 - Rail carrier has burden of proof in bottleneck rate cases. Id., §10710(d)

BOTTLENECK RATE CASES

- Bottleneck Rates – Section 302
 - These provisions would result in standards for the reasonableness of “bottleneck rates” that are different from those that apply to other rates.
 - The STB is given one year to develop the new reasonableness standards.
 - Development of the current Coal Rate Guidelines/SAC approach has entailed more than 20 years of experience and refinement
 - Development of other current reasonableness standards (Simplified SAC Methodology, Three Benchmark Methodology) has also taken several years.

BOTTLENECK RATE CASES

- Bottleneck Rates – Section 302
 - One of the elements to be included in the new reasonableness standards is very problematic:
 - “(v) a reasonable contribution, to the extent appropriate, to that carrier’s network infrastructure costs of the non-bottleneck segment of the route offered by the incumbent rail carrier that is sufficient, along with other traffic on the segment, to maintain the non-bottleneck segment.”

BOTTLENECK ROUTE SCENARIOS

