

Lack of Rail Competition Hampers Coal Deliveries

Railroad transportation is the principal method of delivering coal to the electric generation facilities that provide power to Minnesota municipal electric utilities and their customers. This heavy reliance on rail has left these utilities vulnerable to significant market power abuses caused by the absence of competitors in the railroad industry. Those utilities and other rail commodity shippers, including those who are served by only one railroad and are often referred to as captive shippers, are facing significant rate increases due to the lack of competition in the railroad industry.

The consolidation of the railroad industry that has occurred over the last twenty-five years has been stunning. When Congress passed the Staggers Rail Act in 1980, the resulting industry deregulation was supposed to have ushered in a new era of competition that would benefit customers. However, instead of experiencing the intended result, shippers endured a period of unprecedented consolidation as the number of Class I railroad companies in the United States was reduced from 42 to 4. This has resulted in a duopoly of two major railroads serving the Western regions of the U.S. and a similar duopoly of two different railroads serving the East.

The federal government has been ineffective in its effort to control these uncompetitive rail transportation practices. In 1995, Congress abolished the Interstate Commerce Commission and gave the newly created Surface Transportation Board (STB) authority over mergers, rate and service disputes, construction, and operation and abandonment of railroad lines. Since that time, the STB has declined to use its legal and regulatory authority to protect railroad customers from the monopolistic practices of the railroad industry.

The lack of real competition in the railroad industry, coupled with an absence of effective regulation of industry operations, has had a negative effect on many Minnesota municipal utilities. Shipping costs are skyrocketing as current contracts expire and new rates are set. *Furthermore, even as the railroads dramatically increase their rates, they have begun refusing to provide service commitment guarantees or remedies for service failures.*

In 2006, the General Accountability Office (GAO) issued a report titled *“Freight Railroads: Industry Health Has Improved, but Concerns about Competition and Capacity Should Be Addressed”* which validated rail customer concerns. Among other things this report highlighted: a lack of competition in the national railroad industry; the inadequate STB efforts to ensure rail customer access to competition and to protect rail customers from monopoly abuse; the failure of the STB to collect adequate data from the railroads on all of their annual revenues from rail customers; and concerns over the ability of the national rail system to provide sufficient, reliable service in the future.

While the railroads argue that any rail customer legislation is an attempt at re-regulation, the goal of rail customers is not re-regulation but rather a national rail policy that will ensure reliable rail transportation and reasonable rates for all rail customers – particularly for those rail customers without access to meaningful competitive transportation alternatives.

There are a number of examples of the adverse impact caused by the lack of railroad competition on joint action agencies and Minnesota municipal electric utilities.

Missouri River Energy Services (MRES), supplying wholesale power to 23 member utilities in Minnesota, is a co-owner/participant in the Laramie River Station (LRS), a coal-fired power plant near Wheatland, Wyoming. Burlington Northern Santa Fe Railway Company (BNSF) currently transports some 8.3 million tons of coal per year 175 miles from coal mines in Wyoming’s Powder River Basin to LRS in rail cars owned by the LRS participants. After a long-standing contract for that service expired in 2004, BNSF published new “common carrier” rates for the same service that more than doubled the prior rate, increasing costs to LRS participants by about \$1 billion over 20 years.

Believing that the imposition of these unreasonably high rates was the result of the exertion of monopoly power, the coal providers and the plant operator filed a complaint with the STB in 2004 on behalf of LRS, spending more than \$6 million and three years on the case. After all filings were submitted, the STB put the case on hold while it developed a new rulemaking on captive shipper cases and then decided to retroactively apply the rule to the case, rejecting the complaint finally in 2007.

The STB did provide the LRS partners the opportunity to appeal for a rehearing at the STB based on analysis performed by the LRS partners in consideration of the new STB rules. The LRS partners have recently filed that appeal. Unfortunately this process will likely cost the LRS partners another million dollars, and a decision on the appeal could be another year away.

While LRS is paying significantly higher rates, service levels from BNSF have been erratic. As was widely reported,

the coal reserves at the LRS site in 2006 dropped to dangerously low levels that necessitated the development of a plan to curtail the operation of the plant. At one point, on-site coal reserves dropped to a five-day supply and plant owners were hours away from curtailing operation at LRS by 20 percent. Because turn-around time from BNSF has increased from 37 hours to more than 50 hours per train, the LRS owners decided to acquire a fourth unit train at an additional cost of \$1.9 million per year with no long-term guarantee that BNSF would sufficiently schedule the additional train to improve the coal reserve pile at the plant.

In another case, Southern Minnesota Municipal Power Agency (SMMPA) supplies wholesale power to 18 member municipal utilities in Minnesota. It is a 41% co-owner of Sherco 3, an 884 MW coal-fired power plant near Becker, Minnesota. SMMPA buys coal from the Absaloka mine in Montana. That coal is delivered by the BNSF to the Sherco 3 site. BNSF is the only railroad that serves Sherco 3. Recently SMMPA was informed by BNSF officials that coal transportation rates to Sherco 3 would increase 55 percent.

Individual municipal utilities have experienced similar problems with coal shipments to their local plants. Hibbing and Virginia, two small communities located on Minnesota's Iron Range, enjoy the benefits of owning and operating their own municipal electric utilities. Unfortunately, both communities have recently been forced to give up their rail service – they have resorted to trucking coal from Superior, Wisconsin to their respective towns to fuel small coal plants rather than deal with prohibitive rail transport costs. The Virginia Department of Public Utilities, for example, now pays upwards of \$44 per ton of coal, but only \$9 is for the coal itself. The remaining \$35 covers the costs of transportation.

Legislation to address the concerns of rail customers has been introduced in the 110th Congress. HR 2125, the Railroad Competition and Improvement Act of 2007, has been introduced by House Transportation and Infrastructure Committee Chairman Jim Oberstar (D-MN) and Representative Richard Baker (R-LA). S 953, the companion bill in the Senate, was introduced by a bipartisan group led by Senators John Rockefeller (D-WV) and Byron Dorgan (D-ND). Senator Amy Klobuchar (D-MN) is also a co-sponsor of this bill. This legislation would require railroads to quote rates between any two points on their system where traffic can originate, terminate or be interchanged, and to remove “paper barriers” that prevent short-line railroads from connecting to more than one major railroad (thus allowing short-line carriers that contract with major railroads to engage in competition without being penalized). The legislation also contains a clear statement of the railroads *obligation to serve* given the essential service they provide to many sectors of the economy and directs the STB to take action to investigate railroad practices that result in abuse of market power. Additionally, the proposed law attempts to develop a workable rate challenge process at the STB.

HR1650, the Railroad Anti-Trust Enforcement Act, introduced by Representative Tammy Baldwin (D,WI), and its companion bill in the Senate, S 772, introduced by Senator Herb Kohl (D,WI), would eliminate anti-trust exemptions relating to mergers and acquisitions, collective ratemaking and private antitrust lawsuits that the railroads currently enjoy. Senator Norm Coleman (R, MN) is also a co-sponsor of this bill.

MMUA strongly supports both the rail reform bill and the antitrust bill.

In the spring of 2006, the railroads began to express interest in receiving a federal Investment Tax Credit (ITC) of 25 percent to apply to new investment in rail infrastructure. Any additional federal subsidy for infrastructure improvement should not come without guarantees that dollars will be spent to enhance reliability, especially in captive shipper corridors. Minnesota municipal utilities and captive shipper groups like Consumers United for Rail Equity (CURE) support an ITC for the railroads only if STB reforms are enacted at the same time that provide relief for rail customers.

The captive shipping issue is not limited to utilities and affects many other large segments of our economy including agriculture, wood products and chemicals. This is best illustrated by the list of organizations supporting rail competition reform. Supporting organizations include:

- American Chemistry Council
- American Forest and Paper Association
- American Plastics Council
- American Public Power Association
- Edison Electric Institute
- Fertilizer Institute
- National Association of Wheat Growers
- National Barley Growers Association
- National Industrial Transportation League
- National Rural Electric Cooperative Association
- Portland Cement Association and others.

MMUA supports legislation that encourages structural and policy changes to promote competitive transportation alternatives for rail customers and improvements in the rail customer protection mechanisms that are implemented by the STB. We oppose enactment of a federal ITC for the railroads without these STB reforms.