

Coal Captives

GUEST OPINION

By Duane L. Richards

There's a new spirit of rapacity in the air. When it comes to hauling coal — the nation's most abundant and affordable source of energy for generating electricity — electric utilities often find themselves captive to a single railroad either at the point of origin (the mine), destination (power plant), or both. This fact of life for utility executives places them at the mercy of a monopolist.

Twenty years ago, Western Fuels Association, Inc., a cooperative business supplying coal to consumer-owned utilities across the Great Plains, Rocky Mountain, and Southwestern states, negotiated a private contract with the Burlington Northern Santa Fe Railway (BNSF) for coal deliveries from surface mines in Wyoming's Powder River Basin (PRB) to the Laramie River Station (LRS), a three-unit 1,650-megawatt power plant located 175 miles away in Wheatland, Wyo.

The relatively short haul over one of BNSF's two main lines serving the PRB, coupled with the high volume of coal moved (which is more than 8 million tons of coal each year in continuously running, dedicated train sets), made this a highly profitable move for BNSF. Despite receiving significant returns under the longstanding contract, BNSF marketing executives took a curious stance when the contract re-opened late last year. They maintained that Western Fuels had reaped substantial benefit while BNSF had not earned enough revenue. It was payback time.

Today, BNSF insists that Western Fuels must pay more than twice as much as before and be subjected to unfavorable escalation terms that will double the rate again over time. Will the railroad, in turn, guarantee faster cycle times, ease the burden of the power plant owners providing their own rail cars for the move, or improve service? No. In fact, the new BNSF-imposed rates and service terms are worse than before.

Ultimately, neither Western Fuels nor its shareholders will bear this burden because it is a not-for-profit cooperative. Western Fuels passes its actual costs along to its member-owners, who are consumer-owned utilities in the LRS and other areas. The radically inflated cost imposed by BNSF because of its market dominance will be passed along to the 1.8 million people who live in eight northern Great Plains and Rocky Mountain states. But the victims are not simply electricity consumers. The households, farms, ranches, small businesses and rural industries that depend on LRS for electricity actually own a stake in the power plant as taxpayers in communities with municipally-owned utilities or as members of rural electric cooperatives. The excessive profit BNSF intends to extract from the users will



undoubtedly flow into corporate coffers in Ft. Worth, Texas, because BNSF hardly requires the extra revenue.

In January, BNSF President, Chairman and Chief Executive Officer Matt Rose announced that his railroad had experienced "all-time record" demand and revenues for the third consecutive quarter, with 2004's fourth-quarter earnings 49 percent greater than the year before on 40 percent greater operating income. BNSF also reported "all-time record" revenues for its coal business as well, reporting \$551 million in free cash flow in 2004 — a 91 percent increase over 2003 even after paying substantially higher dividends for the year and engaging in significant stock repurchase activities. Nonetheless, Rose is telling utility executives BNSF needs more cash. As a result, customers can expect even higher rates for coal hauls.

Western Fuels could turn to another railroad or mode of transportation and force BNSF to compete for its business. Unfortunately, LRS is captive to BNSF due to the fact that there are no feasible transportation alternatives. Even if Western Fuels could convince the Union Pacific System to originate coal from mines south of Gillette, Wyo., along what is called the "joint line" with BNSF, it still would control the price of delivery into the power plant. Therefore, LRS and Western Fuels have no other economically viable alternative — there is no way to barge coal across the arid plains, and air transportation is out of the question. It is physically and economically impractical to move eight million tons of coal by truck to LRS.

After unsuccessful negotiations over a new private contract for LRS service, and in the face of massive rate increases proposed under tariff by BNSF, Western Fuels and the LRS operator, Basin Electric Power Cooperative of Bismarck, N.D., filed a complaint with the federal Surface Transportation Board (STB) asking that the regulator do what is required under law, which is to set reasonable rates for service for the LRS rail movement. As the law now stands, the STB is the last line of defense against BNSF's price gouging. Western Fuels and Basin believe

we are entitled to significant rate rollbacks under properly applied STB ratemaking standards and will present our argument to the STB later this year.

Following massive industry consolidation, only four major railroads remain in the United States — only two of which are in the West: BNSF and the Union Pacific Railroad. Their increasing resistance to offer reasonable rates and service terms to their customers has stimulated shipper unrest, which is manifest in the work of the Alliance for Rail Competition (ARC) and Consumers United for Rail Equity (CURE). These two shipper coalitions urge Congress to provide meaningful regulatory relief for captive shippers. Coalition participants represent a wide range of industries and include Edison Electric Institute, American Public Power Association, and the National Rural Electric Cooperative Association.

What ARC and CURE intend, claims Association of American Railroads' CEO Ed Hamberger, is nothing less than re-regulation of the railroads — as though railroads operate in a free market devoid of regulation. In actuality, they don't. The railroads have lobbied hard to maintain status quo regulatory protections that allow them to stave off competition and engage in the kind of monopolistic pricing practices that led to the kind of greater than 200 percent rate markup imposed by BNSF on the LRS coal movement. It should be clear that the railroads function as monopolists across a broad sector of their business. In fact, many of the railroads' customers perceive an attitude from the railroads that they do not exist to serve customers' reasonable service needs. Rather, they treat their customers as if their purpose is to serve the railroads' profit-maximizing needs. The railroads all but admit it.

With the advent of railroad deregulation 25 years ago from passage of the Staggers Rail Act, Congress attempted to promote railroad competition where possible and leave backstop rate protections in place for captive shippers. However, the Staggers Act's core principles — the protection of rail customers who are dependent upon a single railroad for service and the promotion of rail-to-rail competition — gradually have been whittled away. A groundswell of railroad customers perceive a fundamental market imbalance on the regulatory playing field. Something clearly needs to be done.

A potential remedy is contained in legislation jointly advocated by ARC and CURE. The "Railroad Competition Act" will be re-introduced in the 109th Congress and is intended to clarify national rail policy by defining primary objectives for the STB. The clearly stated objectives are: (1) ensuring effective competition among rail carriers at origins and destinations; (2) maintaining reasonable rates in the absence of effective competition; and (3) maintaining consistent and efficient rail transportation for rail shippers, including the timely provision of rail cars.

Other major provisions require railroads to quote rates to their customers over so-called "bottleneck" line segments.

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Railroads strongly resist this approach for fear of opening up their systems to more competition. The proposed legislation also would remove so-called "paper barriers" that prevent short-line or regional railways from competing with the major railroads that spun them off. It would free up terminal access provisions imposed by statute and rendered unusable by subsequent STB decisions and those of its predecessor, the Interstate Commerce Commission. It also would permit a governor to declare all or part of a state to be an area of inadequate rail competition, triggering special rail customer remedies.

These rather modest legislative remedies do not create a new tier of regulation. Instead, they seek to make more effective laws and legal principles that already are in place. The legislation does not nationalize the railroads or grant a competitor new rights to move its trains over another railroad's tracks. It's neither radical nor re-regulatory. It's simply a remedy well within the bounds of the American free-market system as it has evolved to control anti-competitive behavior.

The Western Fuels Association and its members are threatened by the BNSF's behavior. Circumstances at the LRS appear to be only the first in a chain of contract reopeners Western Fuels' members can experience over the next few years. We intend to fight for our rights under the regulatory system as it exists today. We will do everything we can to make that system more hospitable to the real needs of captive shippers.

Western Fuels, its members, and utilities nationwide rely on coal as the source of more than half of the electricity they generate. Coal-reliant utilities require healthy, profitable railroads as partners in providing electricity, which has become the economy's primary source of energy outside the transportation sector since the mid-1980s. Given railroad business plans that rely upon maximum revenues from coal traffic, it is clear the railroads need utility and coal producer business if they are to survive. The nation needs coal to continue its role as a reliable, affordable and increasingly clean source of energy for electricity generation. Such interdependence cannot thrive in today's anti-competitive environment for coal transportation. ☒



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News Flash >>

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CARBON TRADE LAUNCH

Billions of dollars of carbon credits are expected to be traded in a newly launched European commodity market.

News reports stated that 12,000 facilities on the continent are being told what their allowable emissions levels will be.

Those that come under the limit can sell their credits - one credit per ton of carbon.

Official trading began this year and has grown to roughly 400,000 tons daily.

The procedure is part of the Kyoto Protocol which went into effect in February. Europe is a participant; the United States is not.