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HEARING

SUBCOMMITTEE ON RAILROADS, PIPELINES AND HAZARDOUS MATERIALS

HOUSE TRANSPORTATION AND INFRASTRUCURE COMMITTEE
APRIL 23, 2008

"RAIL CAPACITY"

TESTIMONY OF

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Madam Chairwoman and Members of the subcommittee, thank you for the opportunity to testify before you today on the important subject of "rail capacity" and reliable rail service, which is critical to my organization. My name is Steve Sharp. I am the Principal Engineer of Arkansas Electric Cooperative Corporation (AECC). One of my major responsibilities is to ensure an adequate supply of fuel for our power plants, which depends on the reliable delivery of coal by the major rail carriers that provide coal transportation to our plants.

AECC is a membership-based generation and transmission cooperative that provides wholesale electric power to electric cooperatives, which in turn serve approximately 460,000 customers located in each of the 75 counties in Arkansas. Our interest in rail issues stems from our partial ownership interests in three major coal-fired power plants in Arkansas. These power plants were designed and permitted to burn coal from the Powder River Basin (PRB) in Wyoming. The one-way distance from the PRB to our plants is approximately 1,400 miles.

Over the years we have been affected by numerous issues related to rail service, including captive shipper pricing, rail build-outs, a paper barrier that prevents a short line railroad from serving one of our plants, rail merger impacts and major rail delivery shortfalls. As a result, AECC has been a regular participant in Surface Transportation Board (STB) proceedings and we have been very actively lobbying for legislative changes that we believe will help reduce or eliminate the rail transportation problems that we have been experiencing – problems that have cost our electric customers hundreds of millions of dollars over the years.

AECC and other PRB coal shippers have concerns with the anti-competitive conduct of the western railroads in recent years. The whole movement towards "public pricing" – as opposed to negotiated transportation contracts - seems to have coincided with the reduction of head-to-head rail competition and the resulting upward movement of rail rates. Today, I will

focus mainly on the service problems AECC has experienced in transporting PRB coal from Wyoming to our power plants in Arkansas, and our view that those problems appear to have resulted from limited rail competition.

AECC's coal-fired power plants were built, and we began transporting coal to them by rail from the PRB, in the period between the late 1970's and mid-1980's. For many years the rail service to these plants generally seemed reliable. However, since the early 1990's, AECC has experienced three major rail service disruptions, with the severity of each disruption progressively worse than the previous one. While the first disruption, in 1993, resulted from widespread regional flooding that was beyond the control of railroad management, the last two major rail service disruptions have been the direct result of railroad management actions. These include the service collapse in 1997 that followed the merger of UP and SP, and the massive problems stemming from the PRB Joint Line throughput problems that arose in May 2005 as a result of deferred roadbed maintenance.

Coal fired power plants attempt to keep an adequate inventory of coal "on the ground" at our plants to guard against supply interruptions that could disrupt the operation of the plant. When the Joint Line throughput problems first arose in 2005, we were already running about 25 percent below planned coal inventory levels due to rail delivery shortfalls that had occurred for other reasons. Even so, we still had about 42 days of coal "on the ground" at our plants, which normally would be adequate to protect against variations in rail delivery performance. However, the throughput problems were so severe and lasted so long that we were forced to impose burn restrictions on our plants, purchase coal from non-PRB sources and purchase power from the spot market, all of which was much more expensive than our PRB coal-fired generation. The non-PRB coal included coal from Colorado, Colombia and Indonesia. Today, almost three years after this episode began, AECC's PRB coal deliveries are just about back to pre-disaster levels.

As a precaution, we will still be purchasing some coal this year from non-PRB sources and we may continue to do so in coming years as well as a precaution.

In the aftermath of the initial Joint Line disruptions, the Union Pacific Railroad, our rail carrier, imposed an embargo on new PRB business that lasted through March 2007. During this time, BNSF, the only other railroad that can move PRB coal, was able to engage in monopoly pricing, even for movements that theoretically could be served by the UP, but for the embargo. As a result, rates for new PRB movements shot up during this period. This has effectively undone the long decline in competitive rail coal haulage rate levels that marked the first 20 years of rail competition for PRB coal movements (1984-2004).

Railroads have tried to create the impression that the volume increases they have experienced in the past, and expect to experience in the future, inevitably exhaust capacity and cause poorer service and/or higher rates. This may be intuitively plausible, but it is not a valid excuse for what has happened.

During the wave of railroad mergers that followed the Staggers Act, the railroads told a different story. Then, heavy volumes were good; shippers were told that high concentration in the rail industry was okay because the railroads have economies of scale and can handle higher volumes more efficiently than they can lower volumes. More recently, the railroads' own study of future capacity needs, performed by Cambridge Systematics, shows how the railroad arguments about capacity and congestion require that you ignore the way productivity improvements effectively add capacity, and ignore the greater contribution that's available to support infrastructure just from adding traffic volume at current rates.

Current railroad arguments about capacity constraints are also refuted by the railroads' own history of serving PRB coal movements. For 20 years between 1984-2004, the PRB rail carriers increased productivity and invested as needed in additional infrastructure to

accommodate the growth of PRB coal from a small initial volume to one of the largest, if not the largest, rail freight flows in the world. For 20 years, rail competition, productivity and economies of scale produced the result that the railroads are now trying to claim is impossible: infrastructure investment to move higher volumes at lower rates. Especially with the railroads now approaching or achieving revenue adequacy, there should be no question that they are earning the returns needed to support adequate capacity investment.

If capacity or service is inadequate under these conditions, we believe it is the result of insufficient competition. We specifically believe that much of the instability in the service performance that has been provided by the major railroads in recent years arises from the combination of the mega-mergers and the restrictions on competition imposed by the STB's "bottleneck" rule. The bottleneck rule gave carriers free reign to exercise their "long-haul preference" by keeping other railroads from competing for portions of their movements. At the same time, the mega-mergers extended the length of haul over which that preference could be exercised, and took away independent third carriers that would otherwise be willing and able to step into the breach when service problems arise. With the combination of the mega-mergers and the bottleneck rule, shippers have no way to separate the part of a large railroad that may be working from the part that isn't.

For example, at one of our plants, the serving railroad has a 43-mile "bottleneck" segment, and is not required to cooperate with any other carrier to bring us PRB coal. To get competition, we're facing a possible need to spend $100 million or more to construct a rail "build-out" to reach a second major railroad – which investment is not needed for capacity reasons – rather than just pay the current serving carrier a fair and reasonable rate for use of the bottleneck segment.

AECC and our member consumers have also suffered from a "paper barrier" at one of our plants. This "paper barrier", which is a provision in the track lease agreement between a major railroads and a short line railroad, prevents a short line with access to our plant from providing a second, competing route for PRB and other coal deliveries to our plant. This agreement, which the Department of Justice in 2004 said would violate the antitrust laws if those laws applied to the railroads, has denied the short line railroad our business and denied our customers access to lower rates for moving coal to our power plant. The rail infrastructure has been in place to move what we need, but it can't be used because of the market power held by the railroads.

These types of restrictions on transportation competition seem inequitable to us in part because we (like many other shippers) supply much of the equipment and infrastructure that enables our shipments to move by rail. Virtually all of our coal moves in railcars that we supply. Indeed, we supported rail company efforts to improve productivity by upgrading to lightweight aluminum railcars. Our coal is unloaded at facilities (including rail loops) that have been constructed at our expense and sized to meet the increased lengths of PRB coal trains operated by the railroads in recent years.

Despite supplying our share of infrastructure and equipment, we are still subject to the full market power of the railroads. For example, if the railroads decide to increase cycle times (i.e., the number of hours that it takes one of our unit trains to complete the "cycle" of leaving the coal mine with a load of coal, traveling to an AECC power plant, delivering the coal and then returning to reload), we are forced to increase the size of the car fleet we supply in order to enable our coal to be delivered. If the railroads want us to wait for them to get around to moving the PRB coal volumes we need, or don't want to move coal to a given plant from an alternative

source, there are no market forces upon which we can rely for effective protection against these unfair and unreasonable rail practices.

The railroads say that the volume and density they've been pursuing for decades, and that provided much of the rationale for their major mergers, is now preventing them from providing reliable service at reasonable rates. We believe rather that the volume and density now being enjoyed by the major railroads make it both possible and appropriate to place greater reliance on market forces ensure shippers receive reliable service at reasonable rates - and avoid the types of service problems that we and other shippers have been forced to endure.

AECC is doing everything we can to improve the quality of the rail service we are receiving. AECC wishes that the major railroads upon whom we and our customers rely would match our efforts. We believe the forces of competition, rather than monopoly power, would lead to the reliable rail service at reasonable prices that we seek.

Thank you, Madam Chairwoman. I would welcome the opportunity to answer any of your questions.