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Ms. Cynthia Brown
Chief, Section of Administration
Office of Proceedings
Surface Transportation Board
395 E Street, SW
Washington, DC 20423-0001

Re: STB Finance Docket No. 30186, Reply of Tongue River Railroad Company, Inc. to Supplemental Comments of Northern Plains Resource Council and SMART-386

Dear Ms. Brown:

Please find attached the Reply of Tongue River Railroad Company, Inc. to the Supplemental Comments of Northern Plains Resource Council and SMART-386. Public and Highly Confidential versions of this Reply are being submitted to the Board pursuant to the protective order issued in this proceeding.

Respectfully submitted,

A handwritten signature in black ink that reads "David H. Coburn".

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cc: All parties of record

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB FINANCE DOCKET NO. 30186

**TONGUE RIVER RAILROAD COMPANY, INC. – RAIL CONSTRUCTION
AND OPERATION – IN CUSTER, POWDER RIVER
AND ROSEBUD COUNTIES, MT**

**TONGUE RIVER RAILROAD COMPANY, INC.’S SUPPLEMENTAL
REPLY TO THE SUPPLEMENTAL COMMENTS
OF NPRC AND OF SMART-386**

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Dated: May 14, 2015

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Tongue River Railroad Company, Inc.’s (“TRRC”) hereby submits this supplemental reply (“Supplemental Reply”) in response to the supplemental comments submitted by Northern Plains Resource Council Inc. and Clint and Wally McRae, dba Rocker Six Cattle Company, Inc. (jointly, “NPRC”) dated March 26, 2015, and the supplemental comments of Jay L. Schollmeyer, for and on behalf of SMART-Transportation Division, General Committee of Adjustment-GO386 (“SMART-386”) dated April 9, 2015 in the above-referenced proceeding. This Supplemental Reply is in support of TRRC’s December 17, 2012 Supplemental Application (“Application”) under 49 U.S.C. § 10901 to construct a rail line in Montana to be operated by one of TRRC’s owners, BNSF Railway Company (“BNSF”).

I. INTRODUCTION

NPRC filed comments on TRRC’s Application almost two years ago. Following substantial document and deposition discovery of two TRRC co-owners, NPRC submitted its supplemental comments in late March 2015. NPRC’s Supplemental Comments consist of the

comments themselves supported by reports from two new experts, Thomas Sanzillo regarding the market for coal and Michael Nelson regarding financial fitness and public interest issues, verified statements from a few landowners and a real estate agent, and many other exhibits.¹

Despite the massive size of NPRC's Supplemental Comments, they do not come close to meeting their burden to demonstrate that the construction and operation of the TRRC rail line would be "inconsistent with the public convenience and necessity," as the Board would need to find in order to deny TRRC's Application under section 10901. As discussed further below, many of the arguments made in NPRC's Supplemental Comments are completely unrelated to the discovery conducted since mid-2013 and could have been presented in NPRC's 2013 comments on the Application. Those arguments should be discounted by the Board as they are being raised too late in this proceeding. TRRC nonetheless shows here that those arguments have no merit.

First, NPRC argues, as it has previously in this proceeding, that there is no need for the TRRC rail line because there is no domestic or international demand for the Otter Creek/Ashland area coal that would be transported by the rail line and because Arch Coal is purportedly unable to develop the Otter Creek mine in the foreseeable future. As explained below and in the attached Supplemental Verified Statement of Seth Schwartz, NPRC's latest arguments along these lines, which are asserted now by its third and latest coal market witness in this proceeding, are not well-supported. They are based on a distortion of the discovery record in this case and are inconsistent with the most recent long-term EIA and private

¹ Many of the exhibits included in NPRC's Supplemental Comments are filings previously made in this docket, including many TRRC filings such as the previous verified statements of TRRC's expert, Seth Schwartz, as well as the exhibits to Mr. Schwartz's verified statements, and the verified statements of TRRC witnesses Stevan Bobb and William M. Rowlands. NPRC also includes the full deposition transcripts for several TRRC depositions and duplicates of some voluminous exhibits.

forecasters projections of growth in the market for Powder River Basin (“PRB”) coal. They are also not supported by the draft Environmental Impact Statement (“Draft EIS”) issued by the Board’s Office of Environmental Analysis (“OEA”) on April 17, 2015. In the Draft EIS, the OEA concluded that there is a market for the coal that will be transported by the Tongue River Railroad (“TRR”). NPRC’s additional claims regarding Arch Coal’s ability to open the Otter Creek mine which will supply the coal transported by TRR are speculative. In any event, the relevant question is whether the Otter Creek reserves are a highly valuable asset. A highly valuable asset like the Otter Creek reserves will be developed.

Second, NPRC reiterates many of the arguments made in its 2013 comments regarding TRRC’s alleged failure to meet the financial fitness test. These arguments are similarly without foundation. They are legally deficient since the financial fitness test has minimal applicability in this case given that TRRC seeks to build a new rail line without existing customers. In any event, TRRC has previously provided ample evidence showing that it meets the financial fitness test.

Third, NPRC argues that the TRR rail line is contrary to the public interest. Most of those arguments are unrelated to the discovery received by NPRC and could have been made in NPRC’s 2013 comments. Moreover, none of them has substantive merit as described below.

Finally, SMART-386’s submission raises only the question of whether TRRC, in addition to BNSF, will operate the TRRC line. The short answer, as TRRC has noted previously and as discussed further below, is no.

II. PROCEDURAL BACKGROUND

Comments on the merits of TRRC’s Application were filed back in 2013. Specifically, on April 2, 2013, three sets of comments, including a set from NPRC, were filed regarding the

Application. TRRC filed its reply comments in support of the Application on June 7, 2013 (“June 2013 TRRC Reply Comments”). Although not authorized by the Board’s rules, in early July 2013 NPRC filed additional merits comments in response to TRRC’s Reply Comments² and TRRC filed a reply to NPRC’s additional merits comments on August 9, 2013.³ The Board subsequently accepted these additional merits comments.⁴

On June 5, 2013, two days before TRRC’s Reply Comments were submitted, NPRC filed a petition seeking discovery from TRRC in this matter. In its August 27, 2013 Decision, the Board granted NPRC’s petition for discovery “in part” and provided a 90-day period for “limited discovery.”⁵ Contrary to NPRC’s claims, in that decision, the Board did not “recognize” four issues raised by NPRC as legitimate topics for discovery. *See* NPRC Supplemental Comments at 7. In the background section of its decision, the Board simply identified the issues that NPRC claimed to need discovery on in its petition. *See* Aug. 27, 2013 Decision at 2-3.

Following the Board’s order, NPRC served extensive (rather than limited) discovery on TRRC consisting of 66 interrogatories and 60 document requests. Subject to objections, TRRC provided substantive responses to most of NPRC’s interrogatories, and TRRC agreed to produce documents in response (or stated no responsive documents existed) to the majority of NPRC’s document requests. TRRC collected potentially responsive documents from eleven persons and completed the production of thousands of pages of documents it agreed to produce on December 6, 2013.

A month later, on January 13, 2014, NPRC filed a motion to compel seeking, among other things, to require NPRC to produce documents responsive to certain requests from a time

² NPRC Surreply to TRRC Reply Comments filed on July 2, 2013.

³ TRRC Reply to NPRC’s Surreply filed on August 9, 2013 (“Aug. 2013 TRRC Surreply”)

⁴ *Tongue River Railroad Company, Inc.---Rail Construction and Operation---in Custer, Powder River and Rosebud Counties*, Docket No. FD 30186 (August 27, 2013) at 4 (hereafter “August 27, 2013 Decision”).

⁵ *Id.* at 4, 3.

period two years earlier than the date selected by TRRC. TRRC opposed the motion. On September 10, 2014, the STB granted in part and denied in part NPRC's motion to compel. Thereafter, TRRC expended significant resources to collect and produce additional documents. TRRC completed this subsequent round of production in January 2015. TRRC's total production in this case consists of almost 40,000 pages. In February and early March of this year, TRRC also made four witnesses available to NPRC for deposition – two employees of BNSF, one of TRRC's owners, and two employees of Arch Coal, Inc. ("Arch"), another TRRC owner.⁶

When it granted in part NPRC's motion to compel, the Board also established a schedule not only for completion of discovery but also for NPRC to file a reply and then for TRRC to file a rebuttal following the completion of discovery. Since merits comments had been submitted prior to a decision on the motion to compel, the new opportunities to submit comments were clearly established to allow NPRC and then TRRC to submit further evidence based upon the information learned in discovery.

However, NPRC's Supplemental Comments go far beyond bringing information learned in discovery to the Board's attention. NPRC makes many arguments that are unrelated to what it learned in discovery and that could have been raised in NPRC's 2013 merits comments. For example, NPRC argues that TRR is not in the public interest because it deprives landowners of the full use and economic value of their property and because it allegedly may violate provisions in ICCTA, including Rail Transportation Policy Goals. It further argues that TRR is not in the public interest based on a 2011 decision in DME condemnation proceedings. *See* NPRC Supplemental Comments at 31-39. The Board should disregard such untimely arguments.

⁶ The full transcripts of three of these depositions, William M. Rowlands and Andrew Blumenfeld of Arch and Stevan Bobb of BNSF are attached as exhibits to NPRC's submission. NPRC relies on this deposition testimony only very sparingly, and did not attach or cite to the deposition testimony of the fourth witness it deposed, Scott Castleberry of BNSF.

In late December 2014, NPRC filed another motion to compel, seeking to require TRRC to supplement its production in response to particular requests for “the nearly one-year period between Northern Plains’ September 2013 document requests and the Board’s September 9, 2014 Order” on Northern Plains’ Motion to Compel.”⁷ On January 20, 2015, TRRC filed an opposition to this most recent motion, arguing, among other points, that any such supplementation would impose a “heavy burden” on TRRC, particularly given NPRC’s ability to ask the Arch and BNSF deponents about current demand and financial relationships, the subjects of NPRC’s motion. In fact, in the depositions taken in February and March of this year, NPRC asked the Arch and BNSF deponents several questions about current market demand and financial relationships. NPRC’s December 2014 motion to compel remains pending.

The Board should deny this pending motion. These TRRC supplemental reply comments, the final merits comments authorized by the Board, should be the last of the merits comments. The Board should not accept any later-filed, unauthorized reply comments. A huge record has been submitted on which the Board can make a merits decision. Further discovery and any subsequent comments based upon “more current” information relating to the market for Otter Creek coal would be unduly burdensome, particularly since NPRC has extensive deposition testimony from Arch and BNSF witnesses about current market conditions.

III. TRRC’S APPLICATION MEETS THE APPLICABLE PUBLIC CONVENIENCE AND NECESSITY TEST FOR APPROVAL; NPRC’S CLAIMS TO THE CONTRARY SHOULD BE REJECTED

A. Legal Standard

Under the governing statute, 49 U.S.C. § 10901(c), the Board must authorize construction of a rail line unless it finds that construction is “inconsistent with the public convenience and

⁷ NPRC’s Motion to Compel Supplemental Document Production filed December 30, 2014 at 2.

necessity.” This statute was revised in 1980 and in 1996, when it took its current form. With each revision, Congress relaxed the standard for approval to reduce barriers to entry into the rail market. Prior to 1980, the statute directed the Board to approve construction only where public convenience and necessity will “require or *will be enhanced by*” the proposed construction. 49 U.S.C. § 10901 (1976). In 1980 Congress amended the statute to allow the Board to approve construction when public convenience and necessity (“PCN”) “require *or permit*” the proposed construction. 49 U.S.C. § 10901 (1980) (emphasis added). As the Board and the various Courts of Appeal have recognized, this revision signaled that Congress intended to relax the policy concerning rail construction to permit easier entry into the rail market. *See N. Plains Res. Council, Inc. v. Surface Transp. Bd.*, 668 F.3d 1067, 1089-90 (9th Cir. 2011) (finding that the change in language signaled a relaxation in the standard and that this conclusion is supported by the legislative history); *Mid States Coalition for Progress v. Surface Transp. Bd.*, 345 F.3d 520, 552 (8th Cir. 2003) (“Congress subsequently relaxed this restrictive policy by providing that the ICC need only find that public convenience and necessity ‘permit’ the proposed construction.”).

In 1996, with the passage of the Interstate Commerce Commission Termination Act (“ICCTA”), Congress relaxed the standard even further by directing that the Board “shall issue” construction licenses, “unless the Board finds that such activities are inconsistent with the public convenience and necessity.” 49 U.S.C. § 10901(c) (emphasis added). The Board along with the Courts of Appeal for the Eighth and Ninth Circuit have recognized that this language creates a presumption in favor of approving rail construction. *Mid States*, 345 F.3d at 552 (“When read in conjunction with Congress's broad policy directives to promote ‘effective competition among rail carriers’ and to ‘reduce regulatory barriers to entry into ... the industry,’ 49 U.S.C. § 10101, we believe that the Board correctly maintains that there is a statutory presumption that rail

construction is to be approved.”); *N. Plains Res. Council*, 668 F.3d at 1091-92 (agreeing with the Eight Circuit’s and the Board’s conclusion that the present version of section 10901(c) creates a presumption in favor of construction).

1. **NPRC Misstates the Presumption Favoring Approval of Construction Applications**

While NPRC concedes that there is a presumption in favor of construction, it erroneously asserts that opponents “do not have a heavy burden of rebuttal” and satisfy that burden by “providing credible evidence challenging the elements that make up the public convenience and necessity determination.” NPRC relies on an STB decision in the *Dakota Minnesota and Eastern Railroad Corporation* (“DM&E”) construction application proceeding, but that reliance is misplaced.⁸ In that decision, the Board merely held that when a party provides credible evidence challenging an application, the presumption in favor of construction is not so strong that the Board will approve construction without requiring the applicant to respond to the challenging party’s allegations. *DM&E*, 1998 WL 398189, at *3. In its prior submissions, including its June 2013 Reply Comments and these Supplemental Reply Comments, TRRC has responded in detail to NPRC’s allegations, demonstrating that NPRC has failed to overcome the presumption in favor of approving the Application.

Further, in a more recent decision, the Board made clear that the opponents must actually establish that a proposal is inconsistent with public convenience and necessity in order for the burden to shift to proponents. It stated:

Under the current law, rail construction is presumed to be in the public interest. As such, the burden is on opponents to establish that a proposal is inconsistent with the public interest because there

⁸ NPRC Supplemental Comments at 8-9, citing *Dakota, Minnesota and Eastern Railroad Corporation Construction into the Powder River Basin*, Finance Docket No. 33407, 1998 WL 398189 (STB served July 16, 1998) (“DM&E”).

is no public demand or need for the construction, thus shifting the burden back to proponents.

Norfolk Southern Corp. and Norfolk Southern Ry. Co.— Construction and Operation—in Indiana County, PA, Finance Docket No. 33928, 2003 WL 21132522, at *5 (STB served May 16, 2003). NPRC has not met this burden as demonstrated in TRRC’s June 2013 Reply Comments, including exhibits, and as further demonstrated in these Supplemental Reply Comments and accompanying exhibits.

2. Factors Considered in Applying PCN Standard

TRRC agrees with NPRC that the PCN standard applied by the Board is generally a three-part test examining whether (1) there is a public demand or need for the service, (2) the applicant is financially fit to undertake the construction and provide service; and (3) the construction project is in the public interest and will not unduly harm existing carrier services. NPRC Supplemental Comments at 8.

NPRC’s implication that TRRC did not satisfy the three-part PCN test because TRRC provided “generalized, speculative statements” rather than “specific information” is wrong. *See* NPRC Supplemental Comments at 9. TRRC has provided specific information addressing each part of the PCN test. To the extent that NPRC is complaining about projections of future events, the Board has recognized in other construction cases that “[n]either [the Board] nor any of the parties can predict the future with certainty.” *Dakota, Minnesota and Eastern Railroad Corporation Construction into the Powder River Basin*, 2002 WL 121210 at *20, Finance Docket No. 33407 (STB served Jan. 30, 2002). This uncertainty regarding the future requires some degree of generality in the evidence provided by applicants in construction cases. Further, TRRC has provided much more than mere speculation in support of its Application.

B. NPRC's Claims That There is No Public Demand or Need for TRRC's Proposed Rail Line Are Without Merit

1. TRRC Showed There Is Public Demand for the TRR Rail Line

Contrary to NPRC's claims, TRRC has presented ample evidence in its Application and other previous TRRC filings, augmented here by the Supplemental Verified Statement of Seth Schwartz ("Supplemental Schwartz VS") showing beyond doubt that there is a public need for the TRRC rail line. This is substantiated by the Draft EIS issued in this proceeding on April 17, 2015.

In its 2013 merits comments and other previous filings, TRRC presented substantial evidence regarding the market for such coal. *See* June 2013 TRRC Reply Comments at 11-23 and accompanying Verified Statement of Seth Schwartz ("June 2013 Schwartz VS"); Aug. 2013 TRRC Surreply at 9-15 and accompanying Rebuttal Verified Statement of Seth Schwartz ("Aug. 2013 Schwartz Rebuttal VS"). *See also* Application at 6-7 and 17-22; Verified Statements of Stevan Bobb ("Bobb VS") and William M. Rowlands ("Rowlands VS") (both submitted with the Application); Verified Statement of Andrew Blumenfeld ("Blumenfeld VS") submitted with TRRC's January 28, 2013 Reply to NPRC's Petition to Revoke this proceeding; and TRRC's February 6, 2013 Reply to Information Request #1 from Ms. Vicki Rutson (included as Appendix 2 to NPRC Comments).

As reported in the Application, the Otter Creek mine, being developed by a subsidiary of one of TRRC's owners, Arch, is the subject of a permitting proceeding at the Montana Department of Environmental Quality ("MDEQ") and a draft EIS is expected regarding the mine application in the coming months. When developed, the Otter Creek mine will be an important source of sub-bituminous coal as it is located in a generally contiguous 1.5 billion ton coal reserve, one of the largest remaining undeveloped reserves of low sulfur, sub-bituminous coal in

the United States.⁹ Arch's subsidiary leased certain tracts in this coal reserve from the State of Montana ("State") and adjacent tracts from private owners. *Id.* The Otter Creek mine development will generate substantial tax revenues for the State over and above the \$85 million lease payment already made by Arch to the State and provide substantial benefits to Montana citizens.¹⁰

Despite the substantial evidence of public need presented by TRRC in its 2012 Application and 2013 pleadings, including its merits comments, NPRC claimed that it needed discovery from TRRC to, among other things, test TRRC's claims that there is a market for the coal that will be transported by the TRRC rail line. The Board ordered TRRC to produce "limited discovery" but TRRC produced much more than that. As noted, TRRC has produced almost 40,000 pages of documents and made four witnesses available for deposition. As shown below, the discovery provided by TRRC confirms that there is every reason to believe that a market will exist for Otter Creek coal several years from now when the Otter Creek mine is likely to begin producing coal.

NPRC nevertheless argues the opposite -- that TRRC's discovery shows that "[c]oal markets are struggling and will not create sufficient demand for Otter Creek in the foreseeable future." NPRC Supplemental Comments at 9. NPRC continues by claiming that "[t]his collapsing coal market is not cyclical; it is part of a long-term structural change." *Id.* at 3. NPRC's arguments are not well-founded. As explained by Mr. Schwartz, NPRC's claim that that there has been "a structural, long-lasting decline in demand for coal"¹¹ is inconsistent with current coal projections. As even NPRC's latest coal market expert, Thomas Sanzillo, recognizes, current coal projections show an upward trend in coal production over the long-term.

⁹ Application, Rowlands VS at 2.

¹⁰ Application, Rowlands VS at 4.

¹¹ NPRC Supplemental Comments at 13.

While the increase in production is not expected to be of the same magnitude as it was expected to be in projections from a few years ago, the long-term coal projections still forecast an increase in coal production.¹²

While the coal market has been volatile and struggling in recent years-- making it difficult to predict precisely what the market will be when the Otter Creek mine will begin producing coal -- TRRC's recent discovery and the Supplemental Verified Statement of Mr. Schwartz confirm that a market will in all likelihood exist for Otter Creek coal in several years when the mine may begin producing coal and the TRR is constructed.

Significantly, the Board's OEA also has concluded that there is a market for the coal that will be transported by the TRR based upon extensive modeling of coal demand using the Integrated Planning Model ("IPM"), a model created by its third-party contractor, ICF International.¹³ This model is "widely used, both in the United States and globally, by private sector companies . . . and financial institutions, as well as public sector entities, . . ." *Id.* Among other things, OEA's coal production analysis examined "the impacts of economic and regulatory uncertainties with a focus on low natural gas prices and CO2 emission regulations." *Id.* Based on this analysis, the OEA concluded that "[t]he development of the Tongue River Railroad could induce coal mining. Tongue River coal production would be economically viable in most market conditions from 2018 to 2037 . . ."¹⁴ With respect to the Colstrip Alignment proposed by TRRC, the OEA concluded that "annual production would range from a low of 20.0 million tons per year . . . to a high of 50 million tons per year . . ."¹⁵

¹² See Supplemental Schwartz VS at 12-13; Verified Statement of Thomas Sanzillo (Exh. J to NPRC Supplemental Comments) at 11.

¹³ Draft EIS, Appendix C at C.1-9.

¹⁴ Draft EIS, Appendix C at C.1-1.

¹⁵ Draft EIS at C.1-12. Arch plans to mine up to 20 million tons of coal annually once the Otter Creek mine is operating at full production. This is at the low end of the range of projections set forth in the Draft EIS.

Contrary to NPRC's claims, there is ample reason to believe that the markets *will* support the opening of the Otter Creek mine, and the need for the TRRC line, in the foreseeable future.

2. NPRC's Claim That the Owners Are Not Prepared to Dedicated Significant Resources to the Project Is Baseless

NPRC's reliance on TRRC's discovery as support for its claim that there will not be sufficient demand for Otter Creek coal is misplaced and based on a distortion of the record. For example, NPRC is simply wrong when it claims that lack of demand is demonstrated because TRRC's owners purportedly are not prepared to dedicate significant resources to the TRR and Otter Creek mine.¹⁶ In fact, Arch and BNSF, two co-owners, have expended significant resources to fund the permit process for the TRR as well as the Otter Creek mine.

As support for its assertion that Arch is not prepared to dedicate substantial resources, NPRC cites to recent deposition testimony

Thus,

this Arch witness' testimony supports the existence of market demand rather than undercut it.

¹⁶ NPRC Supplemental Comments at 10.
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¹⁹ NPRC Supplemental Comments at 10.

With respect to BNSF, NPRC claims that BNSF is in a wait and see status because BNSF has not yet decided to dedicate the funds needed to construct the TRR. But since the permitting process is not yet complete, BNSF does not need to decide to fund the construction of the rail line now. The Board's approval of a construction application is permissive not mandatory – it permits a railroad to construct the rail line that is the subject of the application but does not require such construction. When the construction application is approved, TRRC's owners will consider the market to determine when to invest the millions of dollars necessary to construct the TRR. TRRC's owners are large, sophisticated entities and they will not invest hundreds of millions of dollars to construct the railroad unless the market indicates there will be there will be demand for the transportation offered by the TRR.

The arguments to the contrary made by Mr. Nelson, one of NPRC's experts, in his verified statement are nonsensical. Mr. Nelson argues that a rail carrier “approaching or exceeding revenue adequacy could become receptive to investments in projects it otherwise would reject as unsound.”²⁰ According to Mr. Nelson, “[e]ven a ‘bad’ project increases the investment base, thereby inflating the earnings that can be generated without causing the Board to adopt pro-competitive priorities.”²¹ Mr. Nelson also claims that for any project that does not generate “increased earnings” to cover its own cost of capital, such “increased earnings” would arise from “increased differential pricing applied to customers and traffic unrelated to the project.”²²

Mr. Nelson's argument is faulty for several reasons. It assumes that a rail carrier approaching revenue adequacy owns the TRRC rail line. But TRRC has three owners, only one

²⁰ Verified Statement of Michael A. Nelson (hereafter “Nelson VS”) at 7. Mr. Nelson's verified statement is Exhibit T to NPRC's Supplemental Comments.

²¹ Nelson VS at 7-8.

²² Nelson VS at 8.

of which, BNSF, is a rail carrier. The non-rail owners own more than 50% of the project and would have no incentive to invest in a “bad” project under Mr. Nelson’s purported rationale. Even if BNSF controlled the investment decision, Mr. Nelson’s argument is baseless. Mr. Nelson improperly relies upon economic principles involving an allowed rate-of-return investment base that apply in traditional public utility regulation but do not apply to railroads. *See Nelson VS* at 8 and n. 11. Under the traditional public utility regulation model, the regulator identifies a level of firm-wide revenues that will cover the costs of the regulated firm (the rate-base) and then establishes a rate structure that generates the required level of revenues. The utility is essentially guaranteed a return on its investment because it has a monopoly franchise with ratepayers who have nowhere else to turn for service. In such circumstances, the utility could potentially benefit from making unnecessary investments. The railroad industry is not such an industry. As the Third Circuit explained, “[p]ublic utility regulation . . . provides for an assured rate of return to regulated monopolies. . . . Railroad regulation by the ICC, is not, however, classic public utility regulation. For the most part railroads operate in a competitive environment. It is true that . . . they are subject to regulation of rates for market dominant traffic. They are not, however, assured of a compensable rate of return even on the investment to serve that traffic.” *Bessemer & Lake Erie Railroad Co. v. I.C.C.*, 691 F.2d 1104, 1113-14 (3rd Cir. 1982). Mr. Nelson’s argument that BNSF would increase its differential pricing on traffic unrelated to the TRR to generate sufficient earnings for its investment in the TRR is nonsensical. BNSF cannot simply increase rates on its traffic. Most of BNSF’s traffic is subject to competition and the market will define the price that BNSF may charge for that traffic. A shipper without competitive options is protected by the Board’s rate reasonableness standards if it believes the rail carrier has priced its services too high. Consequently, shippers unrelated to

the TRR rail line will not be subject to unreasonably high differential pricing as Mr. Nelson suggests.

Further, Mr. Nelson's argument ignores the public benefits that will be realized once a rail line is constructed. His argument is also inconsistent with Board precedent, identified in TRRC's June 2013 comments,²³ recognizing that the financial markets should be allowed to determine whether the rail line will be constructed following approval of the construction application. *See, e.g., Dakota, Minnesota and Eastern Railroad Corporation Construction into the Powder River Basin*, Finance Docket No. 33407, 2002 WL 121210 at *20, (STB served Jan. 30, 2002) ("[I]f the financial community is not persuaded that this line would attract the levels of traffic needed to justify the investment, this line will not be built, notwithstanding our approval. On the other hand, were we to disapprove the construction of this line because of MSC's pessimistic projections, the public benefits of this project would never be realized. Because we do not wish to deprive shippers of the anticipated improved rail service that would result from the addition of this new line and attendant rehabilitation of DM&E's existing lines, we will not stand in the way of DM&E's going forward with this project if it can obtain the necessary financing"); *Tongue River R.R. Co.—Rail Construction and Operation—Ashland to Decker, Montana*, 1 S.T.B. 809, 829 (1996) ("We note that, as with any business transaction, the financial market itself, of course, will ultimately determine if the project is economically viable—i.e., private financing approval will depend in part on current market economics, partners' willingness to contribute substantial amounts of capital, and other factors that may change by the time the project is under way."); *Tongue River R.R. Co.—Construction and Operation—Western Alignment*, Fin. Docket No. 30186 (Sub-No. 3) at 19 (STB served Oct. 9, 2007) ("In any event, while we believe that TRRC would secure sufficient traffic to make the Western Alignment

²³ June 2013 TRRC Reply Comments at 24-26.

project financially viable, the market ultimately will determine whether or not the line is built. The venture capitalists, banking institutions, and overall financial sector will provide the necessary financing if they agree that TRRC is financially viable. Given the liberal nature of our licensing statute, they should have that opportunity.”²⁴

3. NPRC’s Claim That There is No Domestic Market for Otter Creek/Ashland Area Coal Is Without Merit

Relying on a distortion of the discovery produced in this case and the invalid assertions of NPRC witness Sanzillo, NPRC claims that “there is no domestic demand for Otter Creek and other Ashland area coal.”²⁵ However, as explained below and in the attached Supplemental Verified Statement of Seth Schwartz, NPRC’s claim is not supported by discovery produced in this case or the most recent long-term coal market projections for PRB coal which, as explained below, all show growth in PRB production. Further, it is inconsistent with the conclusions of the Draft EIS issued in this proceeding. Each of NPRC’s claims is addressed in turn below.

First, NPRC cites to snippets from various Arch documents produced in discovery,

²⁴ Mr. Nelson also argues that the financial market should not ultimately determine whether a project should proceed to construction because the uncertainty arising from the threat of condemnation that exists while “wait[ing] for the market to determine its viability” imposes unacceptable costs on society. Nelson VS at 5-6. This baseless argument is addressed below in the Public Interest section of this Reply.

²⁵ NPRC Supplemental Comments at 11-20. The coal market experts that NPRC relied on in its 2013 merits comments – Synapse Energy Economics and Power Consulting – do not appear in NPRC’s 2015 Supplemental Comments.

NPRC's next claim -- that declining production in the PRB is evidence of a declining coal market³² -- is also baseless. As Mr. Schwartz explains, this claim ignores the causes of the recent decline in PRB coal production (a few mild winters and surplus of natural gas) and improperly relies upon those short-term events, as the basis to predict long-term demand for PRB

²⁶ NPRC Supplemental Comments at 12.
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²⁸ NPRC Supplemental Comments at 12.
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³² NPRC Supplemental Comments at 13-14.

coal.³³ However, the development of TRRC and the Otter Creek mine depend upon the long-term market for PRB coal (2020 and beyond), not the short-term changes in the recent past or short-term coal forecasts. All of the recent long-term forecasts by government agencies (EIA) and private forecasters cited by Sanzillo (Wood Mackenzie and SNL Energy) show significant growth in PRB coal production. The EIA long-term forecasts show growing long-term demand for PRB coal, even though its short-term forecasts show little growth in 2015 and 2016.³⁴ NPRC and its expert emphasize the fact that EIA has reduced the forecasted growth of PRB coal demand in more recent EIA long-term forecasts compared to earlier EIA long-term forecasts but that does not change the fact that EIA is still projecting long-term growth in PRB coal production. Moreover, EIA's new 2015 long-term forecast does not fit the trend emphasized by NPRC and Mr. Sanzillo. That 2015 EIA forecast (released subsequent to NPRC's Supplemental Comments) projects even higher growth in PRB coal demand than its previous 2014 forecast cited by Mr. Sanzillo.³⁵ Further, the most recent long-term forecasts by the private forecasters cited by Mr. Sanzillo also project growth in PRB coal demand. Wood Mackenzie's April 2015 long-term forecast projects a slight decline in PRB production in 2016 to 414 million tons but projects strong PRB growth to 457 million tons in 2020, 493 million tons in 2025, and 518 million tons in 2035.³⁶ Similarly, SNL's most recent long-term forecast projects PRB production

³³ Supplemental Schwartz VS at 6, 7. Another short-term event that NPRC relies upon is the recent lower than capacity production at Arch's PRB mine, Black Thunder. NPRC argues there will be no development of the Otter Creek mine by Arch given the excess capacity at Arch's existing Black Thunder. NPRC Supplemental Comments at 13-14.

As further explained by Mr. Schwartz, Arch would still open the Otter Creek mine because it would have very low production costs compared to Black Thunder and its cost advantage will rise as Black Thunder's coal reserves become depleted in the next decade. Supplemental Schwartz VS at 29-31.

³⁴ Supplemental Schwartz VS at 12-13.

³⁵ Supplemental Schwartz VS at 12.

³⁶ Supplemental Schwartz VS at 15.

of 428 million tons in 2015 rising to 459 million tons in 2025.³⁷ As explained above, in the draft EIS, OEA has projected growth in PRB production as well.

Next NPRC repeats a claim made in its 2013 merits comments regarding the sodium content of Otter Creek/Ashland area coal, arguing that “electric utilities generally do not prefer high-sodium coal.”³⁸ In making this argument, NPRC ignores Mr. Schwartz’s 2013 testimony in which Mr. Schwartz defined the domestic market for Otter Creek/Ashland area coal as consisting solely of electric power plants that *do* prefer high-sodium coal. Specifically, Mr. Schwartz limited the potential domestic market that he considered for Otter Creek/Ashland area coal as mines that had used Montana PRB coal, or had purchased other PRB coal in the past and had the type of boilers that prefer high-sodium coal. That potential domestic market is 118 million tons annually, many times the 20 million tons expected to be produced annually from the Otter Creek mine at full production.³⁹

Finally, NPRC and its expert Mr. Sanzillo criticize Mr. Schwartz’ 2013 testimony regarding the domestic market for Otter Creek/Ashland area coal, claiming Mr. Schwartz (a) incorrectly attributed the 2012 decline in the coal market to mild weather and a temporary decline in the price of natural gas, (b) incorrectly asserted the drop in coal demand was expected to turn around in 2013, (c) presented testimony “at odds” with a January 2013 analysis by someone at his firm, and (d) incorrectly claims that there will be robust growth in Montana coal production.⁴⁰ As Mr. Schwartz explains more fully in his Supplemental Verified Statement,

³⁷ Supplemental Schwartz VS at 15.

³⁸ NPRC Supplemental Comments at 12. *See also id.* at 14-16.

³⁹ Supplemental Schwartz VS at 24-25; June 2013 Schwartz VS at 16-17 and Appendix 1.

these criticisms are unfounded.⁴¹ In brief, Mr. Schwartz was not the only analyst to attribute the decline in 2012 coal demand to mild weather and the low price for natural gas.⁴² Coal demand (coal burn) did increase in 2013 from 2012. NPRC's focus on coal production between 2012 and 2013 (which did not increase) is a red herring. The reason coal production did not increase is that utilities burned excess inventories in 2013 to meet some of the increased demand.⁴³ Mr. Schwartz' testimony was consistent with the January 2013 presentation of his colleague.⁴⁴ Mr. Schwartz' assertions about growth in the Montana coal market were valid. It is reasonable to expect growth in the market for Montana low-sulfur subbituminous coal of about 18 million tons per year based on EIA forecasts and expected closure of the Decker mine in the near term.⁴⁵

In sum, the current long-term PRB coal projections as well as the Draft EIS in this proceeding are evidence that there is a reasonable expectation there will be demand for Otter Creek/Ashland area coal by the time it can be produced and transported by the TRR. The arguments made by NPRC and its expert to the contrary are not well-founded.

4. NPRC's Claim That There is No International Market for Otter Creek Coal Is Without Merit

Focusing on the current decline in the international market for US coal, NPRC claims that there is no international market for Otter Creek coal either.⁴⁶ While it is true that the international market for US coal is weak currently, NPRC fails to mention the principal cause for

⁴¹ Supplemental Schwartz VS at 35-42.

⁴² Supplemental Schwartz VS at 39- 40.

⁴³ Supplemental Schwartz VS at 9-10, 40.

⁴⁴ Supplemental Schwartz VS at 41.

⁴⁵ Supplemental Schwartz VS at 37-39. Mr. Schwartz does acknowledge that he was incorrect when he described the AEO 2013 forecast of Montana coal as a forecast of domestic demand. *Id.* at 42.

⁴⁶ NPRC Supplemental Comments at 20-25. Without basis and contrary to the evidence in the record, NPRC incorrectly asserts that TRR changed its preferred alignment to the Colstrip Alignment "with the hope of increased West Coast export markets." NPRC Supplemental Comments at 21. In fact, in TRRC's Application Mr. Bobb explained that TRRC chose the Colstrip Alignment "based on engineering and other data that show that the Colstrip Alignment offers an operationally feasible, cost-effective and less environmentally impactful routing for the rail line." Bobb VS at 2.

the current weakness in the competitiveness of US coal exports: the relative strength of the US dollar compared to other non-US sources of coal exports. Right now the US dollar is very strong relative to the currencies of other countries. When the US dollar is strong relative to the currency of other countries, world coal prices in US dollars are low and supplies from other countries are relatively more economic than US coal exports. When the US dollar is relatively weaker than other currencies, US coal exports are more economic and US coal exports rise.⁴⁷

Historically, the relative strength of the US dollar compared to other currencies has been cyclical.⁴⁸ Based on history, there is every reason to believe that the cycle will continue and the strength of the US dollar will weaken compared to other currencies in the future. When that occurs, US coal exports can be expected to rise.

Indeed, contrary to NPRC and Mr. Sanzillo's claims, recent long-term forecasts of US thermal coal forecasts to Asia predict a significant increase in such exports. EIA's most recent AEO 2015 projects US thermal coal exports to Asia will double between 2014 and 2030.⁴⁵

⁵⁰ Wood Mackenzie's most recent forecast projects significant growth in world thermal coal demand in China and India.⁵¹ The Draft EIS also found that PRB thermal coal exports to Asia would be economic under all of the scenarios it studied, up to the maximum amount of export terminal capacity available.⁵² While the Draft EIS does not project significant

⁴⁷ Supplemental Schwartz VS at 19.

⁴⁸ Supplemental Schwartz VS at 19-21.

⁴⁹ Supplemental Schwartz VS at 22-23.

⁵⁰ Supplemental Schwartz VS at 21-22.

⁵¹ Supplemental Schwartz VS at 22.

⁵² Supplemental Schwartz VS at 23.

Otter Creek coal exports, as shown above it projects significant domestic demand for the coal demonstrating a public need for the TRR to transport such coal.⁵³

5. NPRC's Claims Regarding Arch's Ability to Open the Otter Creek Mine Are Speculative

NPRC's claim that Arch will not be financially able to open the Otter Creek mine given its current debt and the negative outlook for the coal market are speculative and should be rejected. Contrary to NPRC's claim and as explained above, the coal business is not facing a structural, long-standing decline in demand but rather is a cyclical business.⁵⁴ While the market is currently in a lower part of the cycle, demand is expected to increase as part of the normal cycle. Recent losses by Arch identified by NPRC are part of the cyclical business and do not show that Arch is financially unstable.

In any event, the permitting process for the Otter Creek mine is not yet completed. The draft EIS for the Otter Creek mine has not yet been issued, meaning that it will be a while before the Otter Creek mine can even be developed. By the time the permitting application has final approval, Arch's financial condition may have improved given the cyclical nature of the coal business.

Even if Arch's financial condition has not improved, that does not mean the Otter Creek mine project will not be developed subsequent to being permitted. The Otter Creek mine permit, like a TRR rail construction permit, will be permissive, not mandatory. As they do with respect to rail line construction, the financial markets can and should be allowed to decide whether the Otter Creek mine will be developed following approval of the mine permit application. The fact

⁵³ NPRC's discussion of a late 1990s investment in a Los Angeles Export Terminal as evidence there is no Asian market for Otter Creek coal because "[t]he prospect of an Asian market for coal has fooled investors before" is a stretch. The current weak Asian market for US coal is due to the strength of the dollar which is cyclical and likely to change in the future. Supplemental Schwartz VS at 23-24.

⁵⁴ Supplemental Schwartz VS at 6.

is that if the Otter Creek mine is a highly valuable asset in terms of its size and location (and it is, as confirmed in OEA's Draft EIS and other evidence presented in this proceeding),⁵⁵ then the mine will be developed once the permit is in place. See Supplemental Schwartz VS at 4-5, 34-35. NPRC's focus on Arch's finances with respect to the opening of the Otter Creek mine is a red herring.

C. NPRC's Financial Fitness Claims Are Legally and Factually Deficient

As explained in TRRC's June 2013 Reply Comments at page 23, "[t]he purpose of the financial fitness test is not to protect the carrier or those who elect to invest in the proposed project, but, rather, to protect existing shippers from carrier financial decisions that could jeopardize a carrier's ability to carry out its common carrier obligation to serve the public ..."
Tongue River R.R. Co.—Rail Construction and Operation—Ashland to Decker, Montana, 1 S.T.B. 809, 828 (1996). In cases like this one where the applicant seeks to build a new rail line without any existing shippers, the Board has held that an examination of applicant's financial ability to construct, maintain and operate a line has little, if any, relevance. See, e.g., *Great Salt Lake and S. R.R., L.L.C.-Constr. and Operation-in Tooele County, UT*, Finance Docket No. 33824, 2000 WL 1844695 at *4 (STB served Dec. 15, 2000) (because the proposed line was "a new railroad without existing shippers, the financial fitness test has little, if any, bearing on the [] rail construction application").

Nevertheless, the requisite financial information provided by TRRC in its Application shows that TRRC is financially fit. It shows that TRRC has reasonable options available for financing the construction of the Tongue River Railroad and that the rail line is expected to be profitable in the two years following construction based on projected payments from the

⁵⁵ See also Deposition of William M. Rowlands taken on Feb. 12, 2015 at 100-101. (attached as Exhibit E to NPRC Supplemental Comments).

operator, BNSF. *See* Application at 31-32, and Exhibits E, F, G and Appendix B thereto. In addition, TRRC subsequently provided an Exhibit G for the operator, BNSF, showing that BNSF is expected to achieve net income in the two years following construction of the TRR rail line.⁵⁶

Improperly ignoring Board precedent regarding the minimal applicability of the financial fitness requirement in this case given that TRRC seeks to build a new rail line without existing shippers, NPRC argues that the TRRC is not financially viable because Arch, one of its owners, is supposedly not financial fit and BNSF, another owner, purportedly has not yet committed to develop the project or to be operator of the TRR. NPRC also claims BNSF's income projections for the first two years of operation would not justify the investment. *See* NPRC Supplemental Comments at 29-30. One of NPRC's experts, Michael Nelson, makes a few other financial fitness arguments.⁵⁷ Even if the financial fitness requirement were relevant in this case (and it is not), the claims of NPRC and its expert, Mr. Nelson, are deficient.

NPRC's claims relating to Arch's financial fitness are without legal or factual basis. As a legal matter Arch is not the applicant so TRRC was not required to provide information regarding Arch's financial fitness. Arch is just one of TRRC's three owners, and NPRC does not challenge the financial viability of the other two large owners – BNSF nor TRRC Financing, LLC, a company controlled by Forrest E. Mars, Jr. In any event, as explained above, it is speculative to assume Arch will not withstand the current downturn in the cyclical coal market.

NPRC's claim that BNSF has not yet committed to construct the TRRC rail line is simply a rehash of its argument discussed above

⁵⁶ *See* Rebuttal Exhibit G (BNSF) attached to Aug. 2013 TRRC Surreply.

As explained above, the Board expects the market to determine whether a rail line will be built *after* the project is approved by the Board.

⁵⁸ NPRC Supplemental Comments at 30.
⁵⁹

Mr. Nelson also argues that there might be a lower cost method of moving coal from the Otter Creek mine than building the TRR rail line, such as trucks, barges, overland conveyors or coal slurry pipelines.⁶² But an assessment of whether there are viable alternative modes of transportation is made by the Board's OEA in the course of the environmental review. The OEA evaluated this issue in the Draft EIS and reached the opposite conclusion -- "non rail alternatives" are not feasible due to issues of "technological feasibility, economic

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⁶¹ Nelson VS at 11.

⁶² Nelson VS at 12.

competitiveness, and comparatively greater environmental impacts . . .” Draft EIS at Ch. 2, p. 2-2.

D. NPRC’s Assertion that the TRR Rail Line is Contrary to the Public Interest is Legally Flawed and Factually Unsupported

NPRC makes a variety of arguments in an effort to show that the TRRC project is not in the public interest. Most of these arguments are not even remotely related to the discovery undertaken by NPRC and thus most of them could have been made in NPRC’s prior comments in response to TRRC’s Application. The presentation of these arguments at this late stage of this proceeding underscores NPRC’s strategy of seeking multiple bites at the apple in an obvious continuation of its effort to delay and complicate this proceeding. For these reasons, the Board should give little or no credit to the arguments. Moreover, as we will show next, none of the arguments has any substantive merit and none deserves credit for that reason as well.

1. NPRC’s Property Value Claims

The first “public interest” argument that NPRC makes is that the TRRC Project, which NPRC characterizes as speculative, has deprived neighboring landowners of the full use and economic value of their private property. NPRC Supplemental Comments at 31-35. Their argument is entirely unrelated to any evidence adduced during discovery and could have been presented in their initial comments on the TRRC Application.

NPRC’s claim about reduced property values appears to be based on the assertion that the approval of a railroad construction project by the Board carries with it “a right of condemnation,” that the Board should transfer this right “only upon a demonstrated public need,” and that private property rights in the TRRC project area are being held hostage to the risk of an eminent domain taking. NPRC Supplemental Comments at 32. The argument suffers a fatal flaw: Board

approval of a rail construction project does not carry with it the right of eminent domain, and in fact the Board has no role in determining whether a railroad may attain or use the right of eminent domain. That right is solely a function of state law, not federal law. Nor is there any evidence to support NPRC's contention that Congress regulates railroads because of a concern about the use of eminent domain. NPRC Supplemental Comments at 32. Not only is eminent domain a state law right that has been rarely exercised by railroads in recent years, but if there were a concern in Congress that the right has somehow been overused or abused, it is hard to understand why Congress has been loosening, and not elevating, the burden on railroads to attain approval of new construction, as evidenced most recently in the presumption favoring approval of construction adopted in ICCTA and discussed above.

Moreover, it is pure speculation that TRRC would ever use eminent domain to take property it needs to build its rail line. As it has stated before, TRRC's goal would be to negotiate with landowners to acquire the property it needs. And, were at some future stage TRRC to assert eminent domain rights in order to attain right-of-way that a landowner refused to sell, TRRC could not do so without due process and court approval, and without payment of a constitutionally appropriate amount to the landowner.

NPRC's Comments and the testimony of Mr. Nelson discuss a 2011 eminent domain proceeding involving an effort by the DM&E Railroad to take property needed for a line that the Board had approved. Mr. Nelson focuses on a case in which he was involved that arose out of DM&E's efforts to build a line into Wyoming.⁶³ There, defendant landowners asserted that DM&E's attempt to condemn their property was an abuse of the Wyoming condemnation statute in part because the project, which they contended was financially unviable and would not be

⁶³ *Dakota, Minnesota & Eastern Railroad Corp. v. 46.271 Acres of Land, More or Less, Located in Campbell County, State of Wyoming*, Docket No. 07-CV-144-D (D. Wyo. Jul. 20, 2011). (Attached as Exhibit F to NPRC Supplemental Comments.)

built, failed to satisfy statutory requirements.⁶⁴ NPRC and Mr. Nelson appear to be arguing here that the Board should deny construction applications because railroads with construction authority might abuse state condemnation proceedings. Mr. Nelson's argument, particularly as applied to this case, would have the Board deny TRRC's application based on speculation that eminent domain authority might be used and then further speculation that the particular circumstances of its use might be inappropriate. However, Mr. Nelson offers no evidence that condemnation proceedings would occur at all as a result of the approval of TRCC's application. Nor does he offer any reason for the Board to believe that TRCC would attempt to abuse those proceedings if they did occur by invoking eminent domain improvidently to take property prematurely before it was settled that the railroad would in fact be constructed, as was the allegation in the DM&E case.⁶⁵ The Board cannot conclude that an application violates public policy on the highly speculative basis advocated by Mr. Nelson and argued by NPRC. And, like so many other arguments belatedly offered now by NPRC, is unrelated to the discovery in this proceeding and could have been made when NPRC first filed its comments on the TRRC Application in 2013.

NPRC also relies on verified statements that it is now also belatedly offering from area landowners Clint McRae (of Rocker Six ranch) and Mark Fix. These new verified statements, which are unrelated to any discovery in this proceeding, are offered to support NPRC's argument that the TRRC Project should be disapproved because of its impact on property values. Ironically, it is the aggressive and long-standing "not in my backyard" opposition of these very

⁶⁴ *Id.*, slip op. at 2.

⁶⁵ Indeed, the court in the Wyoming case on which Mr. Nelson relies, after describing DM&E's conduct as "an abuse of the condemnation process," noted that "cases such as this are rare." *Id.*, slip op. at 6-7.

landowners that has contributed to the prolongation of the licensing process, and the resulting uncertainty about which they now complain.

Mr. McRae argues that the existence of the TRRC Project has curtailed his ability to make certain improvements to his ranch, specifically fencing and livestock watering pipelines. If his claims are assumed to be accurate, it is far from a sufficient reason for the Board to deny the TRRC Application. Rather, approval of the TRRC Application will not only serve the public interest in this transportation project, but help to remove the uncertainty about which Mr. McRae complains by moving the project closer to the point where TRRC and Mr. McRae can have an opportunity to negotiate for whatever right-of-way may be needed on his property. But if it were sufficient to deny an application to build a railroad that is designed to serve a major new source of coal that there might be such impacts, then there would never be any possibility of building any new rail infrastructure subject to the Board's jurisdiction. That is not a result that comports with the liberalized standard for the approval of construction adopted by Congress.

TRRC understands that a railroad will have impacts to landowners and is prepared to work with Mr. McRae (assuming that the Board licenses a route through his property) and other are landowners to minimize those impacts to the extent practicable. In this regard, TRRC has proposed to the Board several land use mitigation measures to reduce impacts to landowners, and the Draft EIS issued by the Board's OEA has proposed several more measures to reduce impacts to ranchers and farmers. *See* DEIS, Chapter 19 at pp. 19-22 to 19-23. These measures include: the required installation of cattle underpasses; working with landowners to limit the loss of property and redress any damage that may occur from construction; and relocation of capital improvements.

The Board's parallel environmental review process is of course the proper vehicle in which to address specific impacts to landowners. Adherence to land use mitigation measures that are likely to be imposed as part of any Board decision should significantly reduce or eliminate any adverse impacts of the sort which concern Mr. McRae and Mr. Fix. As to Mr. McRae's specific concerns, it is far from clear that the TRRC Project would have any significant adverse impact on his ability to fence his land or construct water pipelines. Assuming that the TRRC line were built along the Colstrip Alignment, the right-of-way would parallel and be adjacent to an existing transportation corridor, namely Greenleaf Road, that already traverses Mr. McRae's property. *See* Exhibit 3. The only easement that would be needed for the rail line would be directly adjacent to the road and no other parts of Mr. McRae's ranch would be involved. Also, that road right-of-way is already fenced, as can be seen on the photo at Exhibit 4. Constructing the railroad adjacent to the road would thus not appear to impact Mr. McRae's ability to fence off certain other parts of his ranch property. It also would not affect his ability to construct a pipeline, which can readily be placed under the rail right of way.

As to Mr. Fix, TRRC's proposed Colstrip Alignment does not cross his property at all. While other alternative routes under review could do so, Mr. Fix's amorphous concerns about impacts to the value of his property offer no sufficient reason for the Board not to approve the TRRC line. To the contrary, the gist of his testimony is that he would like to better understand and be able to plan for the impacts of the rail line on his property. The best way to address this concern is for the Board to approve the TRRC line as soon as possible so that the line can be built at the earliest possible time coal is available to be mined. Moreover, if the Colstrip Alignment is approved, Mr. Fix's land will not be impacted at all, and in fact the DEIS indicates

a lower number of landowners will be impacted by construction of that Alignment as opposed to other alignments under review. *See* DEIS, Ch. 12, at Table 12.2-3.

NPRC offers the testimony of a real estate professional, Roger Jacobs, who purports to show that the possibility of a TRRC line being built in the area has reduced area property values. As with the testimony of the landowners, this testimony could have been offered when parties were required to respond to the TRRC Application, in 2013, and no reason is offered by NPRC as to why it is being offered now.

Further, assuming that the TRRC proposal has impacted property values, approval of the line along a specified route will eliminate the current uncertainty for landowners that will and will not be traversed by the rail line. To the extent that landowners' property is needed for the railroad, they will be fairly compensated for any property rights needed for the rail line. The situation confronting landowners is not essentially different from that which confronts landowners who own property near any proposed infrastructure project, whether it be a highway, pipeline or railroad. Some degree of uncertainty is inevitable while alternative routings are studied as part of the NEPA process. The answer to reducing that uncertainty is to complete the alternatives review process and to promptly approve a final route. This is what the Board should do here to best address the landowner concerns.

2. NPRC's Discrimination Claims

NPRC and Mr. Nelson argue that the TRRC Project might violate a stricture against discrimination by railroads. NPRC Supplemental Comments at 36-37; Nelson VS at 13-14. As with the above claims, these arguments bear no relationship to any discovery conducted by NPRC, could have been presented when NPRC commented on the merits of the TRRC Application in 2013 and should not be credited at this stage of the proceeding.

Mr. Nelson contends that it would be improperly discriminatory if BNSF were to “subsidize access to rail service for Otter Creek relative to the degree of support it provides for other mine sites.” Nelson VS at 14. The only non-discrimination provision of the statute cited by Mr. Nelson is 49 U.S.C. § 10741(a)(1).

Neither Mr. Nelson nor NPRC cite any authority that section 107041 applies to decisions by rail carriers regarding the construction of new rail lines to reach previously unserved facilities, and it appears that no such authority exists. By its terms, section 10741 primarily addresses charging different persons different rates for “like and contemporaneous service in the transportation of a like kind of traffic under substantially similar circumstances.” 49 U.S.C. § 10741(a)(2). The statute makes clear that the obligation is narrow in scope, and does not apply where, for example, the rates are for different routes, 49 U.S.C. § 10741(b)(2), or if the services being provided are different. 49 U.S.C. § 10741(c). It is not clear how the Board could apply the statute to the significantly different issue of whether some businesses or facilities might benefit more than others as a result of new rail line construction.

In light of the latitude given to railroads under the current statute for decisions about when and where to construct rail lines, it would be an unwarranted expansion of Board jurisdiction, not to mention an impossible task, for the Board to attempt to evaluate whether affected businesses benefit equally from construction project to construction project. Nor is it obvious what the remedy would be if the Board concluded, for example, that a completed construction project was less beneficial to affected industries than a proposed one. Mr. Nelson’s apparent view – that construction projects should be prohibited if there is a possibility that they will be more beneficial to affected businesses or facilities than prior projects – is clearly unworkable, and has no statutory or sound policy basis.

3. NPRC's Rail Transportation Policy Claims

NPRC argues that the TRRC proposal runs counter to the Rail Transportation Policy (“RTP”) at 49 U.S.C. § 10101 in several respects. NPRC does not link these arguments to the discovery it conducted, and in fact there is no link. The arguments could have been asserted when NPRC offered its comments on the TRRC Application, and therefore should not be credited at this late stage of this proceeding.

NPRC argues that a plan to build a rail line to serve a single mine “arguably runs afoul of sections 10101(5) and (12),” provisions of the RTP which, respectively, direct the Board to promote sound economic conditions and effective competition in transportation and prohibit predatory practices, undue concentration of market power and unlawful discrimination. NPRC Supplemental Comments at 37-38. This new line of attack is apparently rooted in the notion that it is unreasonable for BNSF to expend resources to build a line to serve a single mine. However, the TRRC line will be a common carrier line available to serve other mines that may be developed in the future, including the mines that the Draft EIS posits could be induced by the construction of the TRRC line. *See* DEIS, at Ch. 1, pg. 1-5, and Ch. 18, pgs. 18-5 to 18-6. It would also hold out to serve any other businesses that might in the future locate along the TRRC line.

Further, left unexplained is how (even assuming that the TRRC would for some period of time serve only Arch’s planned Otter Creek mine) BNSF’s service on the TRRC line would be contrary to any RTP goals. There is no discrimination when a railroad builds a line to serve a new mine. *Southwest Gulf Railroad Company—Construction and Operation Exemption—Medina County, TX*, Docket No. FD 34284 (December 18, 2008) (STB granting authority for railroad to build and operate a common carrier rail line designed initially to serve a single

quarry). To the contrary, BNSF's service will promote competition among mines to provide coal to utilities.

NPRC also argues, again based on Mr. Nelson's testimony, that it is unreasonable for BNSF to invest in the TRRC Project in light of service issues it has had on the Northern Corridor, citing the Board's responsibility under Section 10101(4) to foster a "sound transportation system." NPRC Supplemental Comments at 38-39; Nelson VS at 14-15. Mr. Nelson speculates that construction and operation of the TRRC line could divert financial and management resources necessary to improve Northern Corridor service. However, he does not support his speculation with any quantitative analysis or any other type of evidence. As with the other speculative views contained in his verified statement, Mr. Nelson's unsubstantiated opinions on service issues do not provide any basis for denying the application. He also overlooks important facts. First, BNSF is making substantial investments in the Northern Corridor and taking other steps to address and eliminate the referenced service issues faced in 2014.⁶⁶ Second, and perhaps more importantly, the TRRC line will not be built for several more years, and thus correlating its construction to service issues being faced today, or suggesting that BNSF should not provide service to a major resource as to which there is an anticipated future demand for service, is entirely speculative and unwarranted.

⁶⁶ BNSF has explained that it has undertaken significant efforts to increase capacity in response to increased demand for rail transportation. "[T]he BNSF network and the U.S. rail network are experiencing tight capacity with current volume demands. BNSF and the rest of the industry are investing in the necessary additional capacity [I]ncreased capacity is a key solution; and we are well along and, in some cases, ahead of plan in all facets of capacity: people, maintenance, rail, terminal, locomotives, and railcars." Testimony of Steve Bobb, Transcript of Hearing in *U.S. Rail Service Issues*, STB Docket No. EP 724, at 96 (Sept. 4, 2014). "BNSF is investing more than \$1 billion for network capacity expansion alone, with a significant emphasis on the Northern region. . . ." Letter from Roger Nober, *U.S. Rail Service Issues*, STB Docket No. EP 724, at 2 (filed Oct. 28, 2014). BNSF has described short-term and long-term steps that it has undertaken to improve velocity for all of its customers, including its coal customers. *Id.*

4. NPRC's Environmental Claims

NPRC's Supplemental Comments at 39-47 are directed to the environmental impacts of the proposed rail line. Its arguments are no more than a rehash of arguments that it has previously raised.⁶⁷ Like so much of NPRC's filing, the arguments also have nothing whatever to do with the discovery NPRC conducted and thus amount to no more than yet another unwarranted and belated bite at the apple.

In any event, as TRRC has observed in its June 2013 Reply Comments, such impacts are being addressed through the NEPA process in which OEA is actively engaged. The recently-issued DEIS in fact addresses each of the points raised by NPRC, including the unsupported allegations that construction of the rail line would be a disaster for local soil conditions, air quality and water resources. The DEIS, with fact-based analysis rather than rhetoric, dispels each of these contentions, as well as the repeated contention that coal dust dispersed through rail cars will harm public health.⁶⁸ Likewise, the DEIS addresses downline impacts (no significant impacts are foreseen for lines running west of the Tongue River area, contrary to NPRC's claims) and greenhouse gas impacts.⁶⁹ If NPRC disagrees with the DEIS conclusions, it has ample opportunity to raise its concerns during the public comment period, which is now open.

5. Mr. Nelson's Claim that BNSF is Undermining Board Authority

In the last section of his statement, Mr. Nelson alleges that BNSF is trying to evade Board jurisdiction by failing to file for approval of its ownership stake in TRRC under 49 U.S.C. § 11323.⁷⁰ Mr. Nelson's claim is baseless. As Mr. Nelson acknowledges, the applicants have

⁶⁷ See, e.g., NPRC Comments to TRRC Supplemental Application at 44-48 (April 2, 2013) .

⁶⁸ DEIS at Chapter 6 and Appendix G.

⁶⁹ DEIS at Chapter 17 and Appendix V.

⁷⁰ Nelson VS, at 16-17.

indicated that BNSF will make the appropriate filing under 49 U.S.C. § 11323(a)(3) at an appropriate time.⁷¹ For purposes of the control provisions in the Interstate Commerce Act, it bears note that section 11323(a)(3) applies to acquisition of control of a “rail carrier.” Under the statute, “‘rail carrier’ means a person *providing* common carrier railroad transportation for compensation” 49 U.S.C. § 10102(5) (emphasis supplied). Thus, for the specific purposes of the control provisions in the Interstate Commerce Act, the applicants have determined that it would be premature for BNSF to seek control of TRRC at this time, although it remains BNSF’s intention to apply for control authority at an appropriate future point. Mr. Nelson’s section 11323 claim is a non-issue, and once again an argument that has nothing to do with the discovery NPRC conducted.⁷²

IV. SMART-386’S CONCERN IS MISPLACED

SMART-386’s April 9, 2015 Supplemental Comments make clear, as that party has previously, that it does not object to TRRC’s Application to construct a rail line and does not object to BNSF’s operation of that rail line. SMART-386 Supp. Comments at 5. Rather, SMART-386’s only concern would be if TRRC were to operate the rail line. However, as TRRC’s Application and SMART-386’s own Supplemental Comments make clear, that is not what TRRC has applied to do. Nor is what TRRC plans to do. In that regard, TRRC acknowledges that a BNSF witness deposed by NPRC seemed to suggest that either TRRC or BNSF could operate the line. However, that witness, who is not at present affiliated with TRRC, simply misspoke on that issue, and his comments do not and of course cannot override or

⁷¹ TRRC Application at 13.

⁷² Mr. Nelson also overlooks that the Board has already determined that the TRRC Application is complete. *See* Docket No. FD 30186, (Jan. 8, 2013). Further, his effort to tie this proceeding to an entirely separate proceeding in without merit.

supersede TRRC's own Application. In short, SMART-386 has raised a non-issue; TRRC will not be the operator of the TRRC line.

CONCLUSION

For the above reasons, and those set forth in TRRC's prior submissions, the Board should grant TRRC's Application.

Respectfully submitted,



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May 14, 2015

VERIFIED STATEMENT
OF
SETH SCHWARTZ

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB FINANCE DOCKET NO. 30186

**TONGUE RIVER RAILROAD COMPANY, INC. – RAIL CONSTRUCTION
AND OPERATION – IN CUSTER, POWDER RIVER AND
ROSEBUD COUNTIES, MT**

**SUPPLEMENTAL VERIFIED STATEMENT OF SETH SCHWARTZ
IN SUPPORT OF
TONGUE RIVER RAILROAD COMPANY’S REPLY TO
NORTHERN PLAINS RESOURCE COUNCIL AND
ROCKER SIX CATTLE CO.’S
SUPPLEMENTAL COMMENTS**

My name is Seth Schwartz. I am President of Energy Ventures Analysis, Inc. (“EVA”). My business address is 1901 North Moore Street, Suite 1200, Arlington, VA 22209. I have been a principal at EVA since it was founded in 1981. Since that time, most of my work has been consulting for the energy industry regarding coal markets and economics of coal operations and coal procurement. My clients include coal producers, coal consumers, coal transporters, and investors in coal operations and coal-fired power plants, as well as regulatory agencies and industry associations. I have testified in person or by affidavit numerous times regarding coal markets in Federal courts (district court, bankruptcy court and the U.S. Supreme Court), State courts, arbitration hearings and regulatory agencies, including the Surface Transportation Board, the Federal Energy Regulatory Commission, the Environmental Protection Agency, and state public utility commissions. I have previously filed a Verified Statement in June 2013 and a Rebuttal Verified Statement in August 2013 in this proceeding on behalf of the TRRC.

I am providing this supplemental verified statement in response to the March 26, 2015 Comments submitted by Northern Plains Resource Council and Rocker Six Cattle Company (jointly, “NPRC”), as well as the verified statement in support of NPRC by Thomas Sanzillo (“Sanzillo”).

My opinions are summarized as follows:

- **Contrary to the implications by NPRC and Sanzillo, the demand for Powder River Basin (“PRB”) coal is projected to increase.** NPRC relies upon Sanzillo’s statements that “Coal production in the PRB is shrinking due to structural, long-term changes in the domestic and international markets” and “coal production is expected to continue declining nationally and in the PRB”¹ to support its claim that “coal markets are struggling and will not create sufficient demand for Otter Creek in the foreseeable future”². Like the previous Verified Statement of Thomas Michael Power on behalf of NPRC in 2013³, NPRC and Sanzillo cite the fact that the U.S. Energy Information Administration (“EIA”) has a lower forecasted demand growth rate for PRB coal in its more recent forecasts than it did in the past to imply that demand for PRB coal is projected to decline (NPRC – “diminishing future demand projections”⁴ and Sanzillo – “EIA’s declining production forecasts”⁵ and “declining demand projections for PRB coal”⁶). The fact is that all of EIA’s long-term forecasts in recent years show substantial growth in demand for PRB coal from its level at the time of the forecast. In addition, the recent Draft Environmental Impact Statement (“DEIS”) prepared by the Surface Transportation Board’s Office of Environmental Analysis (“OEA”) also projects substantial growth in PRB coal demand with or without construction of the Tongue River Railroad (“TRRC”). Both EIA and OEA

¹ Verified Statement of Thomas Sanzillo (hereafter, “Sanzillo Statement”) at 4.

² Comments of Northern Plains Resource Council and Rocker Six Cattle Company to Tongue River Railroad Company’s Supplemental Application (hereafter “NPRC Comments 2015”) at 9.

³ Verified Statement of Thomas Michael Power on behalf of NPRC Comments at 5.

⁴ NPRC Comments 2015 at 16.

⁵ Sanzillo Statement at 6.

⁶ Id at 19.

project the amount of growth from 2013 and 2014 levels to exceed the amount of projected coal production shipped by the TRRC.

- **Regardless of whether demand for PRB coal will grow in the future, the proposed Otter Creek coal mine will still be economic to develop because of depletion of existing PRB coal reserves.** Like other mineral resources, coal reserves deplete over time as they are mined. Coal producers develop the most economic coal reserves first (considering cost, quality and access to markets) and steadily mine less economic reserves as the best reserves are depleted. The Wyoming PRB coal reserves are being mined at 10 times the rate of the Montana PRB reserves and, as the Wyoming reserves are depleted, the costs are rising making a new undeveloped mine in the Montana PRB (like Otter Creek) steadily more economic over time. I testified to this in my previous verified statement and this issue was not addressed by NPRC. Sanzillo concedes that the Otter Creek mine would be much lower cost than Arch Coal’s existing PRB mines (40% - 45% lower cost)⁷, but asserts that the decline in world coal prices “eviscerates the profit margin identified by ACI and Peabody”.⁸ Mr. Sanzillo misses the point. The economics for Otter Creek to be justified to replace depleting PRB mines are not based on the world market price, they are based upon the cost difference between the depleting mines and the untapped Otter Creek mine, whose advantage will steadily grow over time as the costs rise at the existing mines due to depletion. My previous testimony on this point has been recently affirmed by the recent DEIS for the Tongue River Railroad prepared by OEA in this proceeding.
- **While NPRC asserts that the market for Otter Creek coal is limited by its high sodium content, this issue was already addressed in the market study in my Verified Statement and was not rebutted by NPRC’s experts.** NPRC cites an old email produced from the files of Arch Coal (“ACI”)

⁷ Id at 24.

⁸ Id at 25.

⁹ However, the market study that I performed and submitted in my June 2013 Verified Statement demonstrated a domestic market for high-sodium Montana PRB coal of about 118 million tons per year, which is much more than the planned capacity of the Otter Creek mine.¹⁰ This analysis was not rebutted by either Mr. Sanzillo or Mr. Power in their testimony on behalf of NPRC.

- **While NPRC asserts that “there is no international market for Otter Creek coal”¹¹, recent long-term forecasts continue to project a growing market for PRB coal exports.** NPRC and Sanzillo cite evidence regarding the recent downturn in international markets, but ignore the long-term fundamentals of growing demand in Asia. The recent long-term forecast by OEA as well as forecasts by EIA and Wood Mackenzie (both cited by Sanzillo) project rising coal demand for PRB coal, both in domestic and export markets.
- **While it is true that world coal prices have declined since my previous testimony in 2013, the primary reason for the decline is the stronger U.S. dollar, which affects world prices denominated in U.S. currency.** NPRC and Sanzillo rely on the short-term price changes and do not recognize that world prices and currencies have fluctuated in the past and are likely to fluctuate in the future. While the U.S. dollar has strengthened recently, that does not mean that the long-term prospects for coal exports has changed.
- **Arch Coal’s current financial condition does not impair the long-term prospects for development of the Otter Creek mine.** While Sanzillo has seriously exaggerated ACI’s current financial condition¹², the future development of Otter Creek does not depend upon the current financial condition of ACI, it depends upon the economics of the project. If Otter Creek is economically attractive, which is largely a function of the market and the cost of the operation, it will be developed, either by ACI or a successor when the market fundamentals

⁹ NPRC Comments 2015 at 14.

¹⁰ STB Docket No. 30186, June 2013 Verified Statement of Seth Schwartz at 16 – 17.

¹¹ NPRC Comments 2015 at 22.

¹² While Sanzillo states that ACI’s “liquidity has depleted” (Sanzillo Statement at 36), as of March 31, 2015 ACI had available liquidity of \$1.1 billion, including cash and short-term investments of \$939 million (ACI First Quarter 2015 Results, page 1), hardly a company whose liquidity has depleted. See <http://news.archcoal.com/phoenix.zhtml?c=107109&p=irol-newsArticle&ID=2038138>.

support the development. ACI's current financial condition is not permanent, but the geology of Otter Creek is.

- **Sanzillo's criticisms of my June 2013 Verified Statement and August 2013 Rebuttal Verified Statement are wrong.** Sanzillo makes several inaccurate claims in criticizing my 2013 testimony, including that demand for PRB coal was falling in 2013¹³, that my testimony was inconsistent with another presentation by my company regarding the displacement of coal by natural gas¹⁴, and that the EIA forecasts do not support an outlook of growth in demand for PRB and Montana PRB coal.¹⁵

¹³ Sanzillo Statement at 13.

¹⁴ Id at 10.

¹⁵ Id at 12 and 14.

I. Independent Long-Term Forecasts Continue to Project Growing Demand for PRB Coal which Could be Supplied by Otter Creek

NPRC and Sanzillo contend that “there is no need or market demand for Otter Creek coal”¹⁶. Their opinion is based upon the following contentions:

- The domestic PRB coal market has been declining, not growing;¹⁷
- Forecasts of future growth have been revised downward;¹⁸
- World coal prices have declined, imports to China are lower, and industry analysts forecast low world coal prices, which indicates no export market for Otter Creek coal;¹⁹ and,
- The domestic market for Otter Creek coal is limited by its sodium content.²⁰

I address each of these assertions below.

A. Recent Short-Term Declines in Domestic Demand for PRB Coal have been Caused by Periods of Low Natural Gas Prices and are not indicative of Future Long-Term Demand for PRB Coal

NPRC and Sanzillo emphasize the fact that PRB coal production (and thus implied demand) was lower in the years 2012 – 2014 than previous years 2005 – 2011.²¹ Sanzillo describes this recent decline as “either a long-term trend or a permanent secular decline”.²² This testimony ignores the causes of the recent decline in PRB coal production and relies upon short-term events as the basis to predict the long-term demand for PRB coal. Mr. Sanzillo cites EIA’s **Short-Term** Energy Outlook (“STEO”) to support his opinions regarding the **long-term** demand for PRB coal.²³

¹⁶ Sanzillo Statement at 5; NPRC Comments 2015 at 9.

¹⁷ NPRC Comments 2015 at 13; Sanzillo Statement at 6 – 11.

¹⁸ NPRC Comments 2015 at 16; Sanzillo Statement at 12 – 18.

¹⁹ NPRC Comments 2015 at 20 – 25; Sanzillo Statement at 19 – 23 and 26 – 34.

²⁰ NPRC Comments 2015 at 14.

²¹ NPRC Comments 2015 at 13; Sanzillo Statement at 6 – 8.

²² Sanzillo Statement at 7.

²³ Sanzillo Statement at 8.

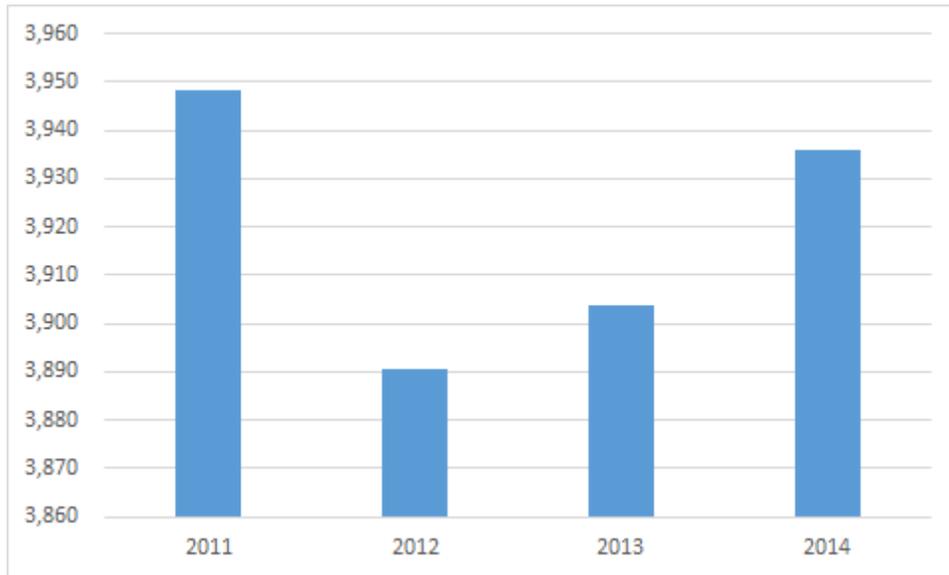
As I previously testified in my June 2013 Verified Statement, the drop in PRB coal demand in 2012 was due to temporary factors: the very mild winter weather and the massive surplus of natural gas which resulted from the mild weather.²⁴ The mild weather depressed the demand for electricity in 2012 and the surplus of natural gas displaced coal for power generation. In 2013 and 2014, the demand for electricity recovered due to more normal weather and the surplus of natural gas receded, resulting in increased demand for coal generation, including PRB coal. However, mild winter weather in 2015 and a large increase in natural gas supply has led to another surplus of natural gas (reflected in low natural gas prices) in 2015 which will depress coal demand in 2015 and likely 2016 and is reflected in EIA's latest STEO issued in April 2015.²⁵

The change in total U.S. electricity generation from 2011 to 2014 is shown on Exhibit 1. The drop in total demand for electricity, reflected in total generation, from 2011 to 2012 was largely due to the mild weather and steadily recovered through 2014.

²⁴ June 2013 Verified Statement of Seth Schwartz at 5.

²⁵ EIA, "Short-Term Energy and Summer Fuels Outlook, April 2015" at 12; see <http://www.eia.gov/forecasts/steo/?src=home-bl>

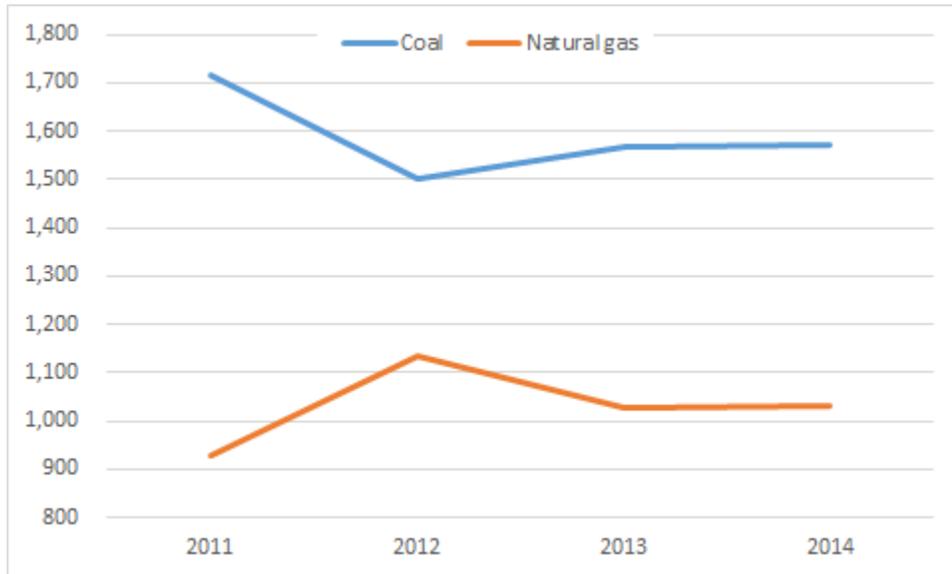
Exhibit 1: Total U.S. Electricity Generation (million megawatt-hours)²⁶



The impact of the surplus of natural gas and low gas prices on electric power generation from coal and natural gas is shown on Exhibit 2. In 2012, the natural gas surplus displaced coal generation and, combined with the lower demand for electricity, caused coal generation to fall by 13% from 2011 to 2012, while generation from natural gas jumped 22%. More normal weather and higher natural gas prices caused power generation from natural gas to fall 9% in 2013 and coal generation recovered, growing 4% in 2013 from 2012.

²⁶ Source: EIA electricity data browser at <http://www.eia.gov/electricity/data/browser/#/topic/0?agg=2,0,1&fuel=vvt8&geo=g&sec=008&linechart=ELEC.GEN.ALL-US-98.A&columnchart=ELEC.GEN.ALL-US-98.A&map=ELEC.GEN.ALL-US-98.A&freq=A&start=2001&end=2014&ctype=linechart<ype=pin&rtype=s&pin=&rse=0&maptype=0>

Exhibit 2: U.S. Electricity Generation from Coal and Natural Gas (million megawatt-hours)²⁷



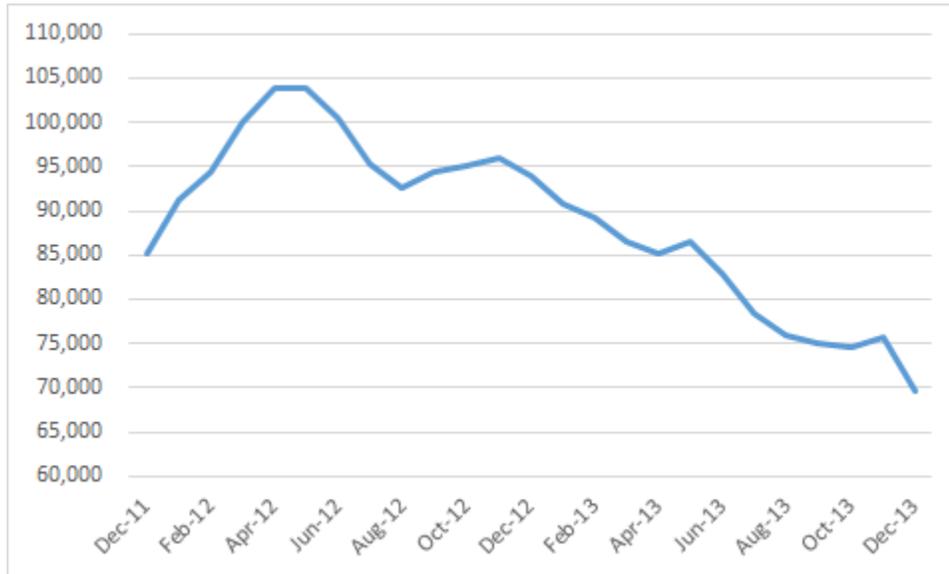
It is not valid to draw conclusions about the long-term future from short-term market events, as NPRC and Sanzillo have done. The development of the TRRC and the Otter Creek mine are dependent upon the long-term market for PRB coal (2020 and beyond), not the short-term changes in the recent past.

Mr. Sanzillo concluded that demand for PRB coal declined in 2013 from 2012, but he has confused the production of PRB coal with the demand (consumption) of PRB coal. The difference is the change in coal inventories (stocks). Because the decline in consumption of PRB coal was so unexpectedly large in 2012, customers took delivery of substantially more coal than they consumed (it is common practice for PRB coal customers to enter contracts to purchase over 90% of their expected coal demand in advance of the year of delivery). As a result, the

²⁷ Source: EIA electricity data browser at <http://www.eia.gov/electricity/data/browser/#/topic/0?agg=2,0,1&fuel=vvt8&geo=g&sec=008&linechart=ELEC.GEN.ALL-US-98.A&columnchart=ELEC.GEN.ALL-US-98.A&map=ELEC.GEN.ALL-US-98.A&freq=A&start=2001&end=2014&ctype=linechart<ype=pin&rtype=s&pin=&rse=0&maptype=0>

customer inventories of PRB coal²⁸ grew 8.7 million tons in 2012 and were burned down by 24.1 million tons in 2013 as shown on Exhibit 3.

Exhibit 3: Stocks of Subbituminous Coal for Electric Power Generation 2012 – 2013 (1000 tons)²⁹



The effect of the changes in customer inventories caused PRB coal production in 2012 to be higher than consumption, while PRB coal production in 2013 was lower than consumption. This caused Mr. Sanzillo to come to the erroneous conclusion that PRB coal demand fell from 2012 to 2013, when it actually increased significantly. Exhibit 4 shows the annual receipts and consumption of subbituminous coal³⁰ by the U.S. electric power sector for the years 2011 –

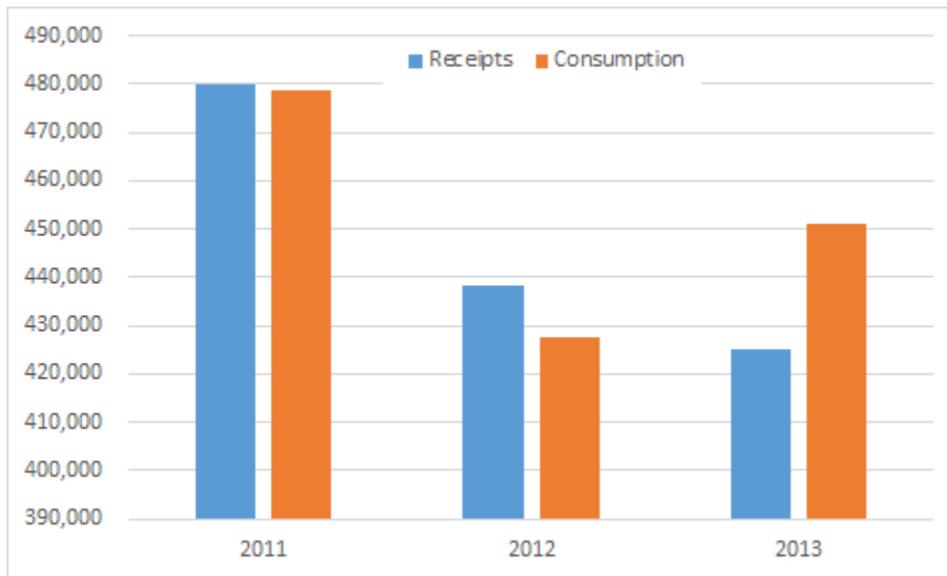
²⁸ EIA collects data on monthly coal inventories for the electric power sector, classified by rank: bituminous, subbituminous and lignite. While EIA does not collect data on PRB coal inventories, PRB coal comprises almost 94% of the subbituminous coal produced in the U.S. (see EIA “Annual Coal Report 2013” at 12, available at <http://www.eia.gov/coal/annual/>), so inventories of subbituminous coal closely track inventories of PRB coal.

²⁹ Source: EIA electricity data browser at <http://www.eia.gov/electricity/data/browser/#/topic/11?agg=2,0,1&fuel=0002&geo=g&sec=008&freq=M&start=200801&end=201411&ctype=linechart<ype=pin&rtype=s&maptype=0&rse=0&pin=>

³⁰ As discussed in footnote 28, while EIA does not collect data on PRB coal consumption, the data which it collects for subbituminous coal are a very close correlation with PRB coal.

2013. While subbituminous coal burn increased by 23.7 million tons from 2012 to 2013, receipts of such coal fell by 13.2 million tons as stocks declined. Because coal receipts are very closely tied to coal production, the reduction in coal inventories explains why PRB coal production declined in 2013 even as underlying demand (consumption) was growing.

Exhibit 4: Receipts and Consumption of Subbituminous Coal for Electric Power Generation 2011 – 2013 (1000 tons)³¹



B. Long-Term Forecasts Project Growth for PRB Coal Markets, not Decline

NPRC and Sanzillo both reach the conclusion that there is no market demand for Otter Creek coal by citing reports of recent declines in production, recent short-term energy forecasts, and more gradual projected rates of long-term growth in PRB demand in more recent long-term forecasts than in older long-term forecasts. None of these are evidence that there will be declining long-term demand for PRB coal and, correspondingly, no market for Otter Creek

³¹ Sources: Subbituminous coal consumption calculated from EIA 923 annual final data for years 2011, 2012 and 2013 at <http://www.eia.gov/electricity/data/eia923/> using Tab 1, electric fuel consumption, filtered for Reported Fuel Type Code = “SUB” and Sector Name = “Electric Utility or NAICS-22”. Subbituminous coal receipts from EIA electricity data browser at <http://www.eia.gov/electricity/data/browser/#/topic/12?agg=2,0,1&fuel=f007&geo=g&sec=008&freq=A&start=2008&end=2014&ctype=linechart<ype=pin&rtype=s&maptype=0&rse=0&pin=>

(Tongue River) coal. In fact, recent long-term forecasts still show substantial long-term growth in demand for PRB coal.

NPRC and Sanzillo emphasize the fact that EIA has reduced the growth of PRB coal demand in its Annual Energy Outlook (“AEO”) long-term forecasts in recent years compared to older forecasts. From this fact, they imply that EIA is forecasting declining demand for PRB coal, which is not the case. EIA forecasts growing long-term demand for PRB coal, even though its short-term outlook shows little growth in 2015 and 2016. Moreover, EIA has released a new AEO 2015 forecast³² since NPRC filed its supplemental comments, which projects higher growth for PRB coal than in its AEO 2014 forecast cited by Mr. Sanzillo.

Exhibit 5 shows EIA’s long-term forecasts for PRB coal³³ for the period 2012 – 2030 from its Annual Energy Outlook forecasts in 2013, 2014 and the recent 2015 AEO.³⁴ As shown in Exhibit 5, all of these forecasts project growing demand for PRB coal after 2016 (when EIA projects a drop in demand due to plant retirements to comply with EPA regulations). The most recent 2015 AEO projects that PRB coal production in 2020 will be 58 million tons greater than actual production in 2012, which is 15 million tons higher than its AEO 2014 forecast. By 2025, EIA projects in its most recent 2015 AEO that PRB coal production will be 91 million tons greater than 2012. By any definition, this is a growing market for PRB coal.

³² See EIA “Annual Energy Outlook 2015” at <http://www.eia.gov/forecasts/aeo/>.

³³ Wyoming PRB subbituminous plus Montana subbituminous coal, using EIA’s definitions.

³⁴ The 2013 AEO forecast is not quite comparable to the 2014 and 2015 AEO forecasts. In AEO 2013, EIA included the Bull Mountains mine in Montana within the definition of Montana subbituminous coal. Actually, this mine produces bituminous coal and is not considered to be part of the PRB by EIA and most industry analysts. In the AEO 2014 and 2015 forecasts, EIA has created a separate category for Montana bituminous coal, which I have excluded from the calculation of PRB coal production. This change by EIA was part of the reason that the AEO 2014 forecast for this Montana subbituminous coal was lower than the AEO 2013 forecast, as this bituminous coal was incorrectly defined by EIA as subbituminous coal in the AEO 2013.

Exhibit 5: EIA Annual Energy Outlook Projections of PRB Coal Production³⁵



In April 2015, the Surface Transportation Board’s OEA released its DEIS for the Tongue River Railroad. Appendix C of the DEIS presents OEA’s analysis of “potential changes in coal production, coal markets, and rail transportation of coal that could occur if the TRRC were to construct and operate the Tongue River Railroad”.³⁶ The DEIS also analyzed “coal production and markets under the No-Action Alternative (denial of the railroad license application).”³⁷

OEA analyzed a number of scenarios, including various alternate options for the TRRC (no action, northern route, southern route), for coal production levels served by the TRRC (low, medium and high), and for coal export growth from existing levels (zero, medium and high). In all of the cases analyzed by OEA, PRB coal production was projected to grow significantly from current levels.

OEA found that PRB coal markets are expected to grow significantly even under the No-Action Alternative (no coal production from the area to be served by the TRRC). Even under the

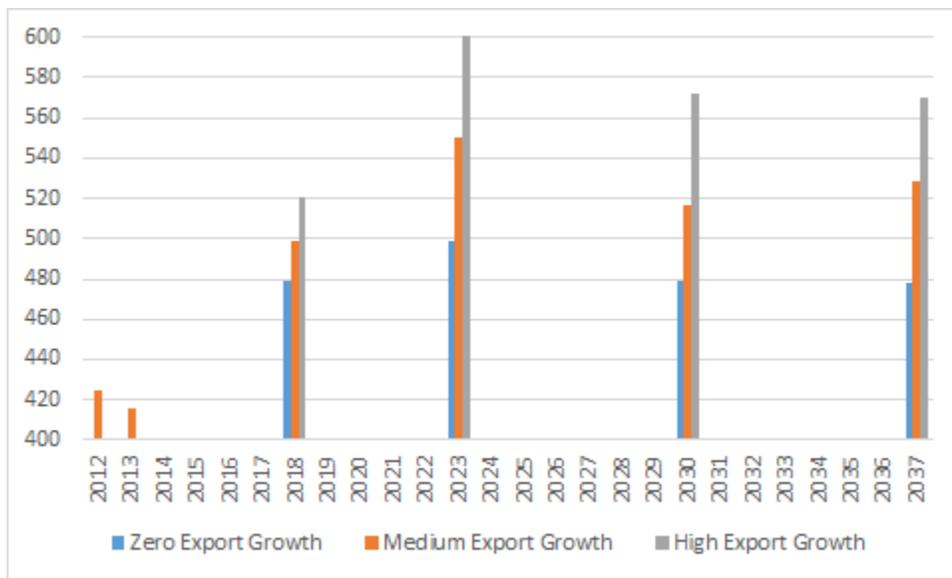
³⁵ Sources: Wyoming plus Montana subbituminous coal production for AEO 2013, AEO 2014 and AEO 2015 from EIA Annual Energy Outlook table browser at <http://www.eia.gov/oiaf/aeo/tablebrowser/>

³⁶ Surface Transportation Board, Docket No. FD 30186, Tongue River Railroad Company, Inc., Draft Environmental Impact Statement, Appendix C at 1.

³⁷ Ibid.

zero export growth scenario, the No Action Alternative had projected growth in PRB production from 2013 levels of 60 million tons by 2018 and 81 million tons by 2023.³⁸ Under the medium export growth case and assuming that the Tongue River Railroad is constructed and ships 20 million tons per year (the proposed production from the Otter Creek mine), OEA found that PRB coal production would grow by 83 million tons by 2018 and by 134 million tons by 2023.³⁹ As shown on Exhibit 6, the projected growth in PRB coal production is large under all export growth scenarios with the assumption that the Tongue River Railroad ships 20 million tons per year.

Exhibit 6: STB OEA TRRC DEIS Projections of PRB Coal Production, Low Tongue River Production Scenario⁴⁰



As the initial support for his conclusion that there is “no need or market demand for Otter Creek coal”, Sanzillo quotes a 2013 presentation by Wood Mackenzie,

³⁸ DEIS Appendix C Table 8-5. OEA only presented its forecast results for 2018, 2023, 2030 and 2037.

³⁹ Id. Table 8-9.

⁴⁰ Id, Table 8-9. OEA included the Bull Mountains Montana bituminous coal in its analysis of PRB coal production. Since this coal is included in the base and forecast years, its inclusion has little or no impact on the projected growth.

⁴¹ Sanzillo Statement at 5 and 29.

Wood Mackenzie's recent long-term forecast was published by CNX Coal Resources in its Form S-1 filing at the Securities and Exchange Commission. While Wood Mackenzie projects a slight decline in PRB coal production to 414 million tons in 2016, it projects strong growth to 457 million tons in 2020, 493 million tons in 2025, and 518 million tons in 2035.⁴⁴

Sanzillo also cites a forecast of US coal production published by SNL Energy dated December 31, 2014, stating "SNL estimates for the PRB show largely flat production levels".⁴⁵ Sanzillo has mischaracterized SNL's forecast. While the SNL forecast projected flat PRB production from 2015 to 2025, it started with a large increase in PRB production from 2014 to 2015, thus SNL was forecasting increased PRB coal production from current levels. SNL has revised its forecast since then, and its most recent long-term forecast dated March 31, 2015 shows lower production in 2015 (428 million tons compared to 445 million tons in the forecast cited by Sanzillo) and higher growth by 2025 (459 million tons compared to 442 million tons in the earlier forecast).⁴⁶

42

Ibid.

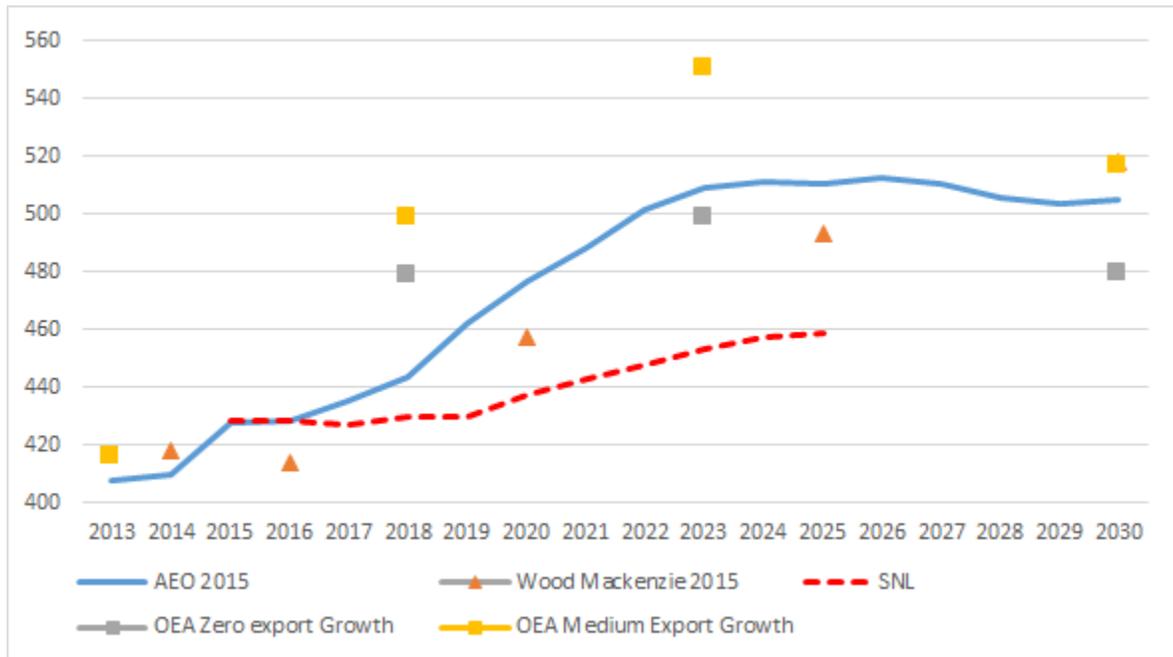
⁴⁴ CNX Coal Resources LP, SEC Form S-1 dated April 1, 2015 at 115 at <http://www.sec.gov/cgi-bin/browse-edgar?company=CNX&owner=exclude&action=getcompany>.

⁴⁵ Sanzillo Statement at 30, citing Appendix I to his statement.

⁴⁶ SNL Coal Supply Forecast as of March 31, 2015 at <https://www.snl.com/SNLWebPlatform/Content/Commodities/EnergyMarkets/CoalForecastDetails.aspx?key=6339d5ca-afa1-4bb4-970b-75933aec7224&keypage=208409>.

In summary, all of the long-term forecasts by the official government agencies (EIA and OEA) as well as private forecasters cited by Sanzillo (Wood Mackenzie and SNL) show significant growth in PRB coal production. Exhibit 7 shows a comparison of these four forecasts, including two scenarios from the OEA forecast (zero export growth and medium export growth).

Exhibit 7: Comparison of Long-Term Forecasts of PRB Coal Production (million tons)



Sanzillo incorrectly claims that “Export levels are expected to stay flat or drop through 2030 according to a host of investment bankers and analysts (... J.P. Morgan, Morgan Stanley, Bernstein Research and Citigroup).⁴⁷ None of the research reports cited by Sanzillo are **long-term** forecasts of U.S. coal export levels through 2030; all of these reports are **short-term** forecasts, projecting coal markets no farther into the future than 2015. In summary:

- The Bernstein Research report, dated June 2013, (cited in Sanzillo Statement at 31-32) does not forecast U.S. coal exports at all; Bernstein analyzes coal markets

⁴⁷ Sanzillo Statement at 26. Actually, Sanzillo never quotes Morgan Stanley; he meant to refer to Goldman Sachs.

in China through 2015⁴⁸ (with several charts on coal consumption and power generation through 2020⁴⁹) and analyzes public coal companies listed in China, not the U.S. While Bernstein mentions coal demand in India also, there is no mention of world coal exports or U.S. coal exports at all and no forecast of any market past 2020, let alone through 2030.

- The Goldman Sachs report, dated July 24, 2013, (cited in Sanzillo Statement at 32-33) does provide a projection of world thermal coal markets and U.S. thermal coal exports, but only through 2017⁵⁰ (although they do make one statement that seaborne thermal coal demand could peak in 2020⁵¹).
- The J.P. Morgan report, dated June 29, 2014, (cited in Sanzillo Statement at 33-34) projects world coal exports only through 2015, with prices in 2016 as well.⁵² Rather than projecting that export levels will be flat or drop through 2030, J.P. Morgan actually states: “We continue to expect more demand for US coal exports in the medium to long term due to the forecast for growth in demand for coal as

⁴⁸ Bernstein Research, “Asian Coal & Power, Less, Less, Less”, July 2013 (cited in Sanzillo Statement, footnote 62) at 12. Available at http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CB4QFjAA&url=http%3A%2F%2Fwww.fossil.energy.gov%2Fprograms%2Fgasregulation%2Fauthorizations%2F2013_applications%2Fsierra_club_13-69_venture%2FEx._110_-_Bernstein_peak_coal_report.pdf&ei=JQcTVbPiJqblsASR6oHYCA&usg=AFQjCNE87qzDcOc_8deqxSAyQTgSZbTE9Q&bvm=bv.89217033,d.cWc.63 IndexMundi, Coal, Australian Thermal Coal, IndexMundi.com

http://www.fossil.energy.gov/programs/gasregulation/authorizations/2013_applications/sierra_club_13-69_venture/Ex._110_-_Bernstein_peak_coal_report.pdf

⁴⁹ Id at 6 and 8.

⁵⁰ Goldman Sachs, “The window for thermal coal investment is closing”, July 24, 2013 (cited in Sanzillo Statement, footnote 106) at 10. Available at <http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CB4QFjAA&url=http%3A%2F%2Fdivestinvest.org%2Fwp-content%2Fuploads%2F2014%2F01%2FGoldman-Sachs-Rocks-and-Ores-2013.pdf&ei=hQkTVd-GazisATC7II4&usg=AFQjCNHCv0D3bT2qtx2wf1hItQxpg7W6A&bvm=bv.89217033,d.cWc>

⁵¹ Id at 13.

⁵² J.P. Morgan, “Global Coal Update”, June 29, 2014 (cited in Sanzillo Statement, footnote 61) at 2 and 22. Available at http://pg.jrj.com.cn/acc/Res/CN_RES/INDUS/2014/6/29/37603388-1ecd-419e-8cbd-bd7d51fc5902.pdf

an affordable energy source.”⁵³ Further, in the same report, J.P. Morgan stated: “Both the IEA [International Energy Agency] and BP [British Petroleum] highlight that coal demand remains strong.”⁵⁴

- The Citigroup report, dated September 4, 2013, (cited in Sanzillo Statement at 34) never projects world coal markets or the demand for thermal coal exports, let alone U.S. coal exports. It projects power generation and coal demand in China only through 2020.⁵⁵

Sanzillo similarly uses the changes in ACI’s internal short-term PRB supply forecasts to assert that “Even ACI sees no market for Otter Creek coal”.⁵⁶ This is not true.

C. Recent Declines in World Coal Prices are Largely due to the Strength of the US Dollar

Sanzillo and NPRC cite the decline in world coal prices from 2011 to 2015 as evidence that “there is no international market for Otter Creek coal”.⁵⁸ Sanzillo also quotes a number of

⁵³ Id at 3.

⁵⁴ Id at 23.

⁵⁵ Citigroup, “The Unimaginable: Peak Coal in China”, September 4, 2013 (cited in Sanzillo Statement, footnote 111) at 19 and 22. Available at <https://ir.citi.com/z5yk080HEXZtoIax1EnHssv%2Bzm4Pc8GALpLbF2Ysb%2FI21vGjprPCVQ%3D%3D>

⁵⁶ Sanzillo Statement at 35,

⁵⁷ Ibid.

⁵⁸ NPRC Comments 2015 at 20 – 25; Sanzillo Statement at 19 – 34.

investment analysts as downgrading their outlook for the global thermal coal market.⁵⁹ Sanzillo also references Wood Mackenzie as having “reversed its outlook on Asian demand for United State coal exports”.⁶⁰ Finally, NPRC reminds us that “the prospect of an Asian market for coal has fooled investors before”, citing the example of the Los Angeles Export Terminal, which was developed in the late 1990’s.⁶¹

These opinions fail to mention the principal cause of the fluctuations in world thermal coal prices and the competitiveness of US coal exports: the relative value of the US dollar compared to other sources of coal exports. When the US dollar is strong relative to other countries, world coal prices in US dollars are low and supplies from other countries are relatively more economic than US coal exports. When the US dollar is weaker, US coal exports are more economic and coal exports rise.

As mentioned by Sanzillo and NRPC,⁶² the price of Australian coal, FOB⁶³ the origin port of Newcastle is a global benchmark for thermal coal (or at least, a benchmark for Asian coal markets). The Newcastle price is a benchmark because this was the largest source of thermal coal exports in the world market (now second after Indonesia) and is a price index which is widely traded on the futures market. There has long been a strong correlation between the Newcastle coal price and the currency exchange rate between the Australian dollar and the US dollar.

Exhibit 8 shows the historical values of the Australian coal market price (dollars per metric ton FOB Newcastle) and the currency exchange rate between the US dollar and the Australian dollar. When the US dollar declines in value (a “weaker” dollar), as it did in the

⁵⁹ Sanzillo Statement at 30 – 34.

⁶⁰ Id at 27 – 29.

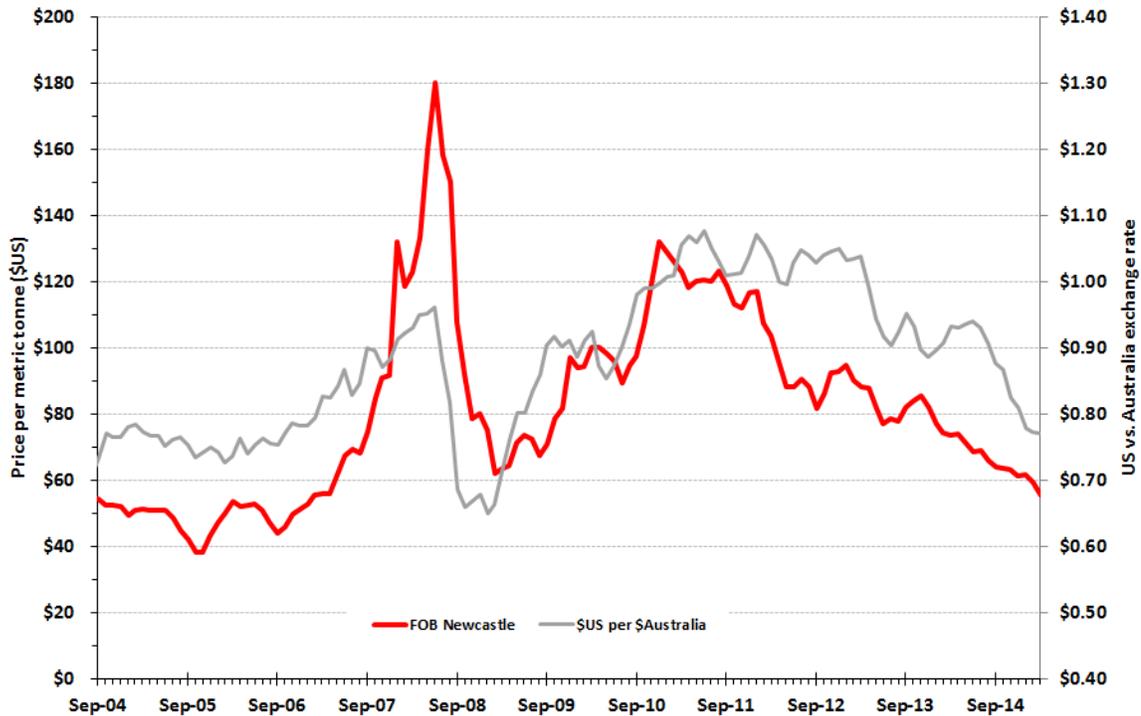
⁶¹ NPRC Comments 2015 at 24.

⁶² Sanzillo Statement at 21 – 23 and NPRC Comments 2015 at 25.

⁶³ Free On Board; loaded in a vessel at the point of origin.

periods 2005 – 2008 and 2009 – 2011, the world coal market price rose. In periods when the US dollar increased in value (a “stronger” dollar), such as 2008 – 2009 and 2011 – 2015, world coal prices declined.

Exhibit 8: Australian Coal Prices and Currency Exchange Rates⁶⁴



The recent rise in the value of the US dollar is generally attributed to stronger US economic growth than other countries and the prospect for higher interest rates in the US. Historically, the relative value of the US dollar versus the value of the currency of other countries has been cyclical. The long-term outlook for the relative value of the US dollar is uncertain. The large US trade and budget deficits are factors which could lead the US dollar to resume its prior path of weakening against other currencies. This uncertainty is the reason that the investment analyses cited by Sanzillo are all short-term forecasts, which have little relevance to the long-term prospects for US coal exports.

Sanzillo’s citation from Wood Mackenzie’s 2013 forecast as support for his opinion that there is no export market for Otter Creek coal is particularly misleading.

⁶⁴ Newcastle 90-day forward prices from Platts *Coal Trader International* and US/Australian dollar exchange rates from OANDA at <http://www.oanda.com/currency/historical-rates/>.

Mackenzie's recent forecast of strong future growth in world thermal coal demand was cited by CNX Coal Resources LP in its recent filing at the Securities and Exchange Commission:⁶⁶

“Wood Mackenzie projects consumption of seaborne coal to increase from 936 million metric tons in 2014 to approximately 1.9 billion metric tons by 2035, a compounded growth rate of 3.3%. Growth in international import demand has resulted primarily from increased demand for thermal coal for electricity generation by emerging global economies, particularly by countries in the Pacific market where coal is the primary fuel source for new power generation. According to Wood Mackenzie, seaborne imports to China are expected to grow from 198 million metric tons in 2014 to 592 million metric tons in 2035, a compounded annual growth rate of 5.4%. In 2014, China's imports accounted for 21% of total seaborne demand. Between 2014 and 2035, India's seaborne thermal coal imports are estimated to rise from 142 million metric tons in 2014 to 462 million metric tons in 2035, a compounded annual growth rate of 5.8%. India's share of the seaborne thermal coal market is estimated to increase from 15% in 2014 to 25% in 2035.”

Sanzillo concluded that “EIA data on exports show a weakening market for United States coal exports both on a short and long-term basis”⁶⁷, yet his own testimony shows that the EIA forecast is for **increasing** long-term US thermal coal exports, not “weakening”⁶⁸. In fact, EIA's most recent AEO 2015 projects US thermal coal exports to double from 2014 to 2030, with US thermal coal exports to Asia doubling as well, as shown on Exhibit 9.

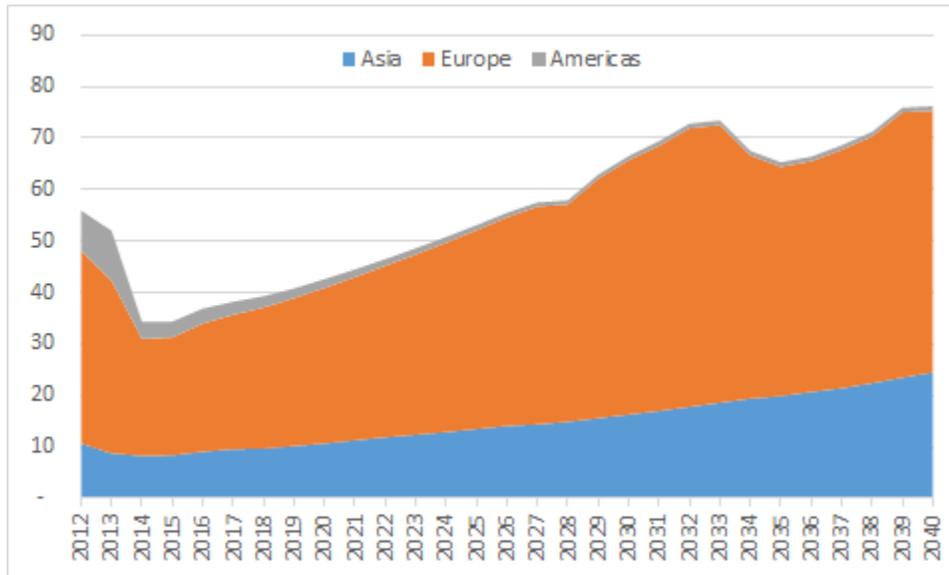
⁶⁵

⁶⁶ CNX Coal Resources LP, SEC Form S-1 dated April 1, 2015 at 114 available at <http://www.sec.gov/cgi-bin/browse-edgar?company=CNX&owner=exclude&action=getcompany>.

⁶⁷ Sanzillo Statement at 26.

⁶⁸ Ibid, Figure IV.

Exhibit 9: EIA AEO 2015 Forecast of US Thermal Coal Exports (million tons)⁶⁹



OEA found that PRB thermal coal exports to Asia would be economic under all of the scenarios that it studied, up to the maximum amount of export terminal capacity available.⁷⁰ Under the high growth case for expanded terminal export capacity, OEA projected that PRB coal exports would reach 122 million tons per year by 2023.⁷¹ OEA analyzed the sensitivity of PRB coal exports to international coal production costs and found that it would take a 40% reduction in international production costs for PRB coal exports to no longer be competitive.⁷²

NPRC refers to the development of the LAXT terminal, which started coal export operations in 1997 and closed in 2003 as evidence that “the markets do not justify the investment for new port construction”.⁷³ NPRC’s explanation of the reason why the LAXT terminal failed is incorrect. It was not due to a “decline in Asian imports” in 2003; actually Asian coal imports

⁶⁹ EIA Annual Energy Outlook table browser at <http://www.eia.gov/oiaf/aeo/tablebrowser/>, world steam coal flows by importing regions and exporting countries.

⁷⁰ DEIS Appendix C at 8-27.

⁷¹ Ibid at 7-10.

⁷² Ibid at 8-48.

⁷³ NPRC Comments 2015 at 24.

were rising rapidly, not falling at that time.⁷⁴ The reason for the decline in US coal exports was the unusual strength of the US dollar against the Australian dollar, which reached a record high of just \$0.50 (one Australian dollar was worth just \$0.50 US) in 2001, as shown on Exhibit 10.

Exhibit 10: Australian vs. US Dollar Currency Exchange Rate⁷⁵



The LAXT coal export terminal investment was made when the US dollar was relatively weak in the mid-1990's (the Australian dollar was worth about \$0.80 US) and the terminal closed when the US dollar was very strong in 2003 (the Australian dollar was worth under \$0.60 US). While the US dollar has strengthened recently, history has shown that the currency exchange rate is likely to fluctuate and the long-term trend toward a weaker US dollar is likely to return.

D. The Sodium Content of Otter Creek Coal Does not Obstruct its Development

NPRC repeats its earlier contention from its 2013 comments that the high sodium content of the Otter Creek coal will make it difficult to fit this coal into the domestic market.⁷⁶ However,

⁷⁴ International Energy Agency, *Coal Information 2014* Table 3.10: World steam coal imports.

⁷⁵ See <http://www.oanda.com/currency/historical-rates/>

⁷⁶ NPRC Comments 2015 at 14 – 16.

in my previous 2013 testimony, I analyzed the limits of the sodium content on the marketability of Otter Creek coal in the domestic market and found that the potential domestic market for PRB coal that could be supplied by Otter Creek, taking into account the impact of its high sodium content, was 118 million tons per year.⁷⁷ This would be more than adequate to accommodate the development of the Otter Creek mine at 20 million tons per year. Further, it should be noted that NPRC does not contend that the sodium content would limit the marketability of Otter Creek coal in the export market.

OEA also considered the potential impact of sodium content on the marketability of coal which would be shipped by the Tongue River Railroad and found: “OEA concludes that sodium content is not a factor that would prevent the coal from being sold.”⁷⁸

II. Otter Creek is Likely to be Developed Because It Is a Low-Cost Coal Reserve

NPRC does not mention and Sanzillo only briefly addresses the primary factor in support of the future development of the Otter Creek coal reserve, which is that it will have lower mining costs than the existing PRB coal mines and this economic advantage will grow over time. As is typical of any natural resource deposit, coal mining in the PRB over time has proceeded from the most economic coal reserves to steadily less economic reserves. The principal measure of mine economics for surface mines is the strip ratio (the amount of rock, in bank cubic yards, which must be removed per ton of coal produced). The mines in the Wyoming PRB are mature operations; most of them began production before 1980 and the newest operating mine, Dry Fork, began producing coal in 1990.⁷⁹ These mines all started production near the eastern outcrop, with strip ratios below 2:1, but have mined their lowest-cost reserves and most of these

⁷⁷ STB Docket No. 30186, June 2013 Verified Statement of Seth Schwartz at 16 – 17.

⁷⁸ DEIS, Appendix C at 3-15.

⁷⁹ The North Rochelle mine was developed in 1999 by Triton Coal, but was subsequently merged into ACI’s Black Thunder mine in 2004. The mine facilities were later sold to Peabody and are included in the North Antelope Rochelle mine.

mines now have strip ratios near 4:1 or higher. As coal mining continues toward the west, the strip ratios will continue to grow and production costs will increase over time. The map from the United States Geological Service on Appendix 1 shows the strip ratios for the Wyoming PRB reserves and how mining has steadily progressed to the west into higher cover.⁸⁰

In contrast, the coal reserves in the Ashland area of the Tongue River (Otter Creek and other coal properties in this area) are undeveloped reserves. The reserves with the lowest strip on these properties still have not been mined. The costs of production at Otter Creek will remain unchanged (in constant dollars) until its development, while the costs of mining in the Wyoming PRB will grow with increasing strip ratios.

Sanzillo acknowledged that the Norwest appraisal, prepared in 2006, estimated that the price for production from Otter Creek would be much less than his estimate of the future cost of production at ACI's Black Thunder mine. Sanzillo estimated that the cost advantage would be \$5.00 to \$5.60 per ton in 2020.⁸¹ However, Sanzillo dismisses his own calculations as being based upon an almost ten-year-old estimate and lacking any solid foundation.⁸² Sanzillo ignored the more recent (September 2011) report by John T. Boyd Company, which he referenced in a footnote, which projected a cost of Otter Creek production in 2020 to be \$8.96 per ton (in 2011 dollars) and a cost advantage for ACI of \$4.00 per ton in 2020.⁸³ Sanzillo dismisses the idea that Otter Creek would replace higher cost mines, stating that this is without foundation, that TRRC should support this with a business plan, and that the business plan should have updated operating costs certified by ACI preferably with independent corroboration.⁸⁴

⁸⁰ USGS Assessment of Coal Geology, Resources, and Reserves in the Gillette Coalfield, Powder River Basin, Wyoming p. 101 <http://pubs.usgs.gov/of/2008/1202/pdf/ofr2008-1202.pdf>

⁸¹ Sanzillo Statement at 24.

⁸² Ibid.

⁸³ Id at 23, footnote 76.

⁸⁴ Id at 25.

Sanzillo ignores the independent corroboration provided by two large mining engineering firms, Norwest and JT Boyd, who were hired by independent entities (Montana State Land Board and Xcel Energy), that had no interest in the approval of the TRRC application. JT Boyd projected that the Otter Creek mine would be developed in 2018 with initial strip ratios of 2.3:1 and would have a cost advantage over ACI's Black Thunder mine of \$4.16 per ton.⁸⁵ Further, JT Boyd projected that the Montana PRB coal price would be \$16.80 per ton in 2020 (in constant 2011 dollars), which would provide Otter Creek with a profit margin of \$7.84 per ton.⁸⁶

I previously testified in my June 2013 Verified Statement and my August 2013 Rebuttal Verified Statement regarding the factors that are causing production costs and market prices for the Wyoming PRB mines to increase over time and will make development of the Otter Creek property economic to replace higher cost production, if not to supply growing demand, including:

- Increasing strip ratios at the existing Wyoming PRB mines;
- Declining labor productivity (tons per hour worked) at the Wyoming PRB mines; and,
- Increasing mine prices for the Wyoming PRB mines relative to the Montana PRB mines.⁸⁷

None of these points were rebutted by Sanzillo and I will not repeat them again with updated supporting data as there is a new study in this proceeding that confirms all of these points.

In the 2015 DEIS, OEA analyzed the costs to produce Tongue River coal from the Otter Creek mine and other coal deposits. According to OEA⁸⁸:

⁸⁵ John T. Boyd Company, *Powder River Basin Coal Resource and Cost Study*, September 2011 (cited in Sanzillo Statement, footnote 76) at 4-25 and Table 4.2. Available at <http://www.xcelenergy.com/staticfiles/xe/Regulatory/http://www.xcelenergy.com/staticfiles/xe/Regulatory/Regulatory%20PDFs/PSCo-ERP-2011/8-Roberts-Exhibit-No-MWR-1.pdf>

⁸⁶ Id at 5-12.

⁸⁷ June 2013 Schwartz Verified Statement at 33-41; Aug. 2013 Rebuttal Schwartz Verified Statement at 11-18.

“The analysis indicates that the Tongue River Railroad would transport economically produced coal.”

“This analysis highlights one difference with the three previous proposals to build the Tongue River Railroad. Namely, Powder River Basin coal prices and production costs at existing mines have increased to the level of the production costs for Tongue River coal. In particular, the rising overburden ratios in the Powder River Basin now make Tongue River coal more economically competitive than in the past.”

OEA’s analysis concluded that the price needed in the first year of production for the Otter Creek mine to cover all operating and capital costs as well as a reasonable profit (real, after-tax capital charge rate of 15%) would be \$10.80 per ton.⁸⁹ The DEIS stated that this production cost would enable the Otter Creek Mine to be profitable, and as a result, the Tongue River Railroad would have sufficient rail traffic.⁹⁰ The DEIS stated that the factors which suggested this conclusion included the facts that:

- Otter Creek’s production costs (including profit to develop a new mine) were comparable to current and historical PRB spot prices;
- Otter Creek’s production costs (including profit to develop a new mine) were lower than forward PRB prices; and,
- Otter Creek would have a lower strip ratio (at 3 bank cubic yards per ton) than competing Wyoming PRB mines (increasing to about 5 bank cubic yards per ton), which would make a greenfield mine like Otter Creek economically viable, even competing against existing Wyoming mines with sunk capital costs.⁹¹

The OEA analysis satisfies all of Sanzillo’s conditions: it has an updated detailed mine plan with operating costs certified by an independent entity, it uses a realistic market price for coal, and it includes the full cost of capital to develop the mine.

⁸⁸ DEIS, Appendix C at 6-1.

⁸⁹ Id, Table 6-6.

⁹⁰ Id at 6-3.

⁹¹ Ibid.

Sanzillo contends that “Price signals undermine what little support there may be for opening Otter Creek”, citing “low coal prices in the region”.⁹² He claims that coal producers would lose money at the then-current spot price of \$10.95 per ton (although he admits that producers sell most of their coal at higher contract prices).⁹³ However, his analysis does not “undermine” the support for the Otter Creek mine, as OEA’s analysis is that a sales price of just \$10.80 per ton would cover the full cost of production and a return on capital for the Otter Creek mine.⁹⁴

NPRC contends that ACI would not open a new mine at Otter Creek while the existing Black Thunder mine was operating well below capacity. Even Sanzillo testified that Otter Creek would have costs much lower than ACI’s existing PRB mines, using studies by Norwest and JT Boyd to estimate that Otter Creek would have costs anywhere from \$4.00 to \$5.60 per ton below ACI’s existing PRB mines.⁹⁵ Further, the operating cost advantage of Otter Creek will rise in the future as the production costs at existing PRB mines rise because their reserves will be depleted and they will face increasing strip ratios. In previous work, Sanzillo agreed with this view, stating:

“As demonstrated by high bids from coal producers on the BLM leases in the PRB, as well as these producers’ aggressive and increasing interest in BLM lease activity, the long-term prices of coal from the PRB will continue to increase. This is occurring despite currently low domestic coal prices and the prospect of generally diminished use of coal for electric generation in the United States. **Long-term price increases specific to the PRB are being driven by the rise in production costs**, domestic demand, and exports. Coal producer activity anticipates a period of long-term price increases and profitability.”⁹⁶

⁹² Sanzillo Statement at 18.

⁹³ Ibid.

⁹⁴ DEIS, Appendix C, Table 6-6.

⁹⁵ Sanzillo Statement at 23 – 24.

⁹⁶ Tom Sanzillo, *The Great Giveaway: An analysis of the costly failure of federal coal leasing in the Powder River Basin*, June 25, 2012 at 37, emphasis added, available at <http://ieefa.org/study-almost-30-billion-in-revenues-lost-to-taxpayers-by-giveaway-of-federally-owned-coal-in-powder-river-basin/>.

NPRC's previous expert witness, Thomas Michael Power, also agreed with this view. In his testimony before the Georgia Public Service Commission in 2013, he testified that:

"The real price increase in my projected Wyoming PRB mine-mouth price is associated with several economic forces:

- Declining labor productivity in the PRB mines as those mines have to go deeper and deeper to obtain that coal and then haul the extracted coal further for processing and loading.
- Projected increased costs as the mines expand or relocate requiring the movement of roads and, potentially, rail lines.
- Rising labor, fuel, explosives and machinery costs.
- Increasing competition among PRB mining companies to obtain the most attractive additional coal tracts onto which to expand or build a new mine. This has led the upfront bonus bids paid to the owner of the coal, which is mainly the Federal Government, which can run to hundreds of millions of dollars, to rise dramatically in recent years.
- The continuing demand for PRB coal in the southeastern U.S. as is evidenced, for instance, by Georgia Power's proposal to use PRB coal to fuel McIntosh 1.
- The new demand for PRB coal in export markets *if* port and rail infrastructure are available to facilitate those exports.
- That demand for PRB coal allows the market price to follow the cost of producing the coal."⁹⁷

Besides the huge operating cost advantage, there is another major reason why ACI would open the Otter Creek mine even if it had excess capacity at its existing PRB mines (Black Thunder and Coal Creek) – ACI has already purchased the Otter Creek coal reserves, while it will have to replace its depleting federal coal reserves at its other PRB coal mines. ACI reported that its flagship PRB Black Thunder mine has 1,262.6 million tons of assigned reserves

⁹⁷ Georgia Public Service Commission, Docket Number 36498, Testimony and Exhibits of Thomas Power Ph.D., on behalf of the Sierra Club and Coosa River Basin Initiative, May 10, 2013
<http://www.psc.state.ga.us/factsv2/Document.aspx?documentNumber=147826>.

remaining at the end of 2014.⁹⁸ While this may sound like a lot of coal, Black Thunder produced 101.2 million tons in 2014 (even operating 30 million tons per year below its capacity).⁹⁹ Even at its current reduced production rate, the Black Thunder mine would deplete all of its reserves before the end of 2027. In reality, without more coal reserves, production at Black Thunder would decline even sooner. ACI stated in its 2014 Form 10-K that: “Without the addition of more coal reserves, the current reserves could sustain current production levels until 2020 before annual output starts to significantly decline, although in practice production would drop in phases extending the ultimate mine life.”¹⁰⁰ Thus, ACI faces a choice even if it only wants to continue to maintain its current level of PRB coal production (not increase production): buy additional federal reserves to extend the life of Black Thunder mine or develop the new Otter Creek mine.

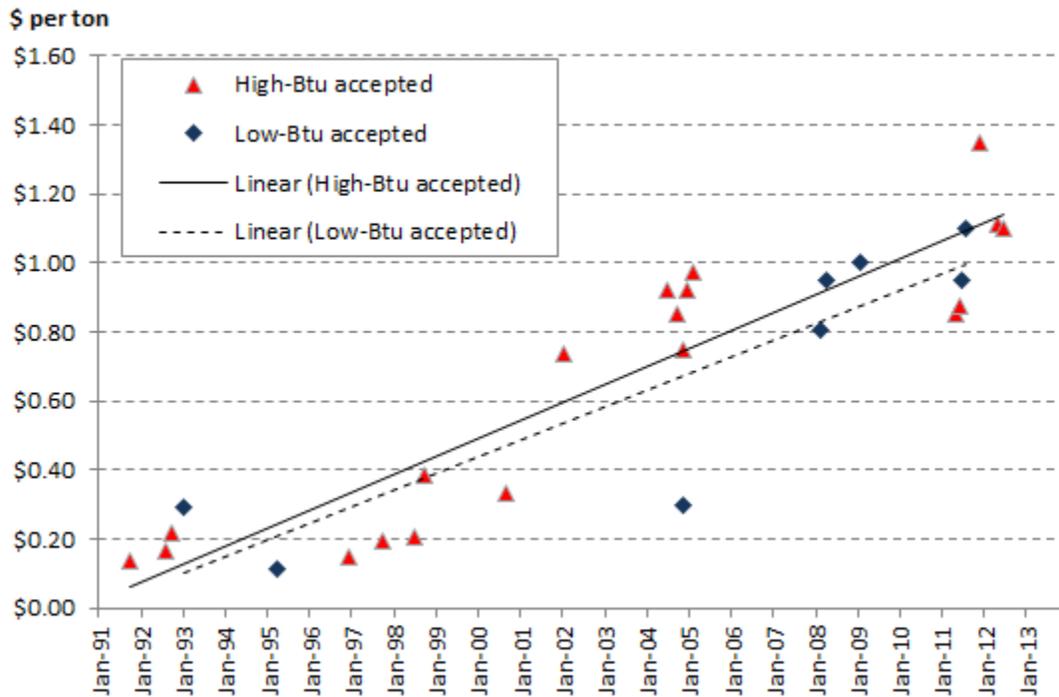
The cost of purchasing new federal coal leases in the Wyoming PRB has risen steadily over the last 20 years of the lease-by-application (“LBA”) process. Coal producers, such as ACI, can apply to the Bureau of Land Management (“BLM”) for a new coal lease to extend the life of existing mining operations. The producers purchase these leases in a sealed bid process, where the highest bid is accepted only if the bid price for the LBA exceeds the undisclosed minimum fair market value established by the BLM. The cost of purchasing coal reserves under successful LBA’s is shown on Exhibit 11 (rejected bids are not shown). The most recent accepted bids have ranged in price from \$1.10 to \$1.35 per ton of coal reserves.

⁹⁸ Arch Coal Inc. 2014 Form 10-K at 14, available at <http://investor.archcoal.com/phoenix.zhtml?c=107109&p=irol-sec>.

⁹⁹ Ibid.

¹⁰⁰ Id at 15.

Exhibit 11: Wyoming PRB Lease Bonus Bids¹⁰¹



The most recent lease bonus price for federal coal in the Wyoming PRB was about \$1.10 per ton of coal reserves.¹⁰² ACI’s most recent lease purchase in the Wyoming PRB (December 2011) was \$1.35 per ton (\$300 million to purchase 222.7 million mineable tons for the South Hilight lease).¹⁰³ OEA estimated the initial capital cost to develop the Otter Creek mine to be \$336.3 million¹⁰⁴ (2012 dollars) to produce 454 million tons from Tract 2¹⁰⁵. Thus, the entire capital cost to develop the Otter Creek mine would be less than the cost of purchasing federal coal reserves in the Wyoming PRB to extend the life of ACI’s Black Thunder mine to produce the same amount of coal. As producers deplete their existing leases in the Wyoming PRB and

¹⁰¹ See http://www.blm.gov/wy/st/en/programs/energy/Coal_Resources/coaltables.html.

¹⁰² Ibid. In June 2012, Peabody paid \$793.3 million for 721.2 million tons of mineable coal at the North Porcupine lease.

¹⁰³ Ibid.

¹⁰⁴ DEIS, Appendix C, Table 6-6.

¹⁰⁵ Id, Table 6-1.

face the need to purchase new federal leases, the relative capital cost advantage of developing the Otter Creek reserves will become more important.

While NPRC assumes that it would be lower cost to expand production at ACI's mines operating "far below capacity"¹⁰⁶ than to develop the Otter Creek mine, Sanzillo does not make that claim presumably because he knows better from his prior work. In 2012, Sanzillo published a report titled "*The Great Giveaway: An analysis of the costly failure of federal coal leasing in the Powder River Basin*".¹⁰⁷ In this paper, Sanzillo argued that, as the title suggests, BLM "has sold PRB coal for below fair market value"¹⁰⁸ and that the cumulative "loss of actual cash income from bonus payments between 1982 and 2011 totals \$7.1 billion."¹⁰⁹ Sanzillo contends that "Eighty percent of the coal in the PRB belongs to the U.S. government, granting the federal government an effective monopoly on western coal."¹¹⁰ Sanzillo argues that, as a monopolist, the federal government has charged below fair market value for PRB coal leases in order to provide low cost coal.¹¹¹ His first recommendation stated: "In the short-term, it's imperative that: 1. The Department of the Interior should implement an immediate moratorium on the sale of federal coal leases in the Powder River Basin."¹¹²

Thus, Sanzillo clearly believes that the state and private coal leases held by ACI at Otter Creek will have increasing value in the future, as he thinks that the federal government should charge much higher prices for new coal leases in the PRB and should stop selling new PRB coal leases at all. Given his prior opinions, it is disingenuous for him to now testify that the Otter Creek property has no market and will not be economic to develop. If the federal government

¹⁰⁶ NPRC Comments 2015 at 24.

¹⁰⁷ Available at <http://ieefa.org/study-almost-30-billion-in-revenues-lost-to-taxpayers-by-giveaway-of-federally-owned-coal-in-powder-river-basin/>.

¹⁰⁸ Id at 3.

¹⁰⁹ Id at 30.

¹¹⁰ Id at 7.

¹¹¹ Id at 44.

¹¹² Id at 42.

were to adopt his recommendations, Otter Creek would be the lowest-cost coal reserve in the PRB, and perhaps the only game in town.

III. Arch Coal's Current Financial Condition does not Affect the Long-Term Prospects for Development of the Otter Creek mine

NPRC and Sanzillo assert that Arch Coal ("ACI") is in poor financial condition and that ACI will not be able to make the capital investment to develop the Otter Creek mine.¹¹³ While Sanzillo has exaggerated ACI's current financial condition,¹¹⁴ ACI's current financial condition will not impair the development of the Otter Creek mine. If the Otter Creek project is an attractive investment opportunity (and it is), it will be developed, either by ACI or another company. ACI may develop Otter Creek itself. Alternatively, ACI may sell the Otter Creek project to another company, as it has sold other profitable assets in the last few years to raise capital.

A major economic advantage of Otter Creek compared to other PRB investment opportunities is that ACI has already made the investment to purchase the coal leases. In 2009 and 2010, ACI paid a total of \$158.9 million to the State of Montana and to Great Northern Properties to purchase the lease rights to mine 1.4 billion tons of coal reserves at Otter Creek.¹¹⁵ To the extent that ACI has limited capital, the cost to develop the Otter Creek mine would be less than the cost of purchasing federal coal reserves in the Wyoming PRB to extend the life of ACI's Black Thunder mine to produce the same amount of coal. As Sanzillo acknowledged,¹¹⁶ in 2014 ACI withdrew its application for the West Jacobs Ranch LBA, which would have added 957 million tons to the reserves of the Black Thunder mine.¹¹⁷ Why should ACI invest over \$1

¹¹³ NPRC Comments 2015 at 4; Sanzillo Statement at 5.

¹¹⁴ See, e.g., note 12 above.

¹¹⁵ Arch Coal 2011 SEC Form 10-K at F-14, available at <http://investor.archcoal.com/phoenix.zhtml?c=107109&p=irol-sec>.

¹¹⁶ Sanzillo Statement at 19.

¹¹⁷ See http://www.blm.gov/wy/st/en/programs/energy/Coal_Resources/PRB_Coal/lba/west_jacobs_ranch.html

billion to purchase a new reserve for Black Thunder when it already owns 1.4 billion tons at Otter Creek?

IV. Sanzillo's Criticism of My Previous Testimony is Unfounded

Sanzillo offers a criticism (adopted by NPRC) of my testimony in my earlier 2013 Verified Statement and Rebuttal Verified Statement that the market for PRB coal (including Montana PRB coal) is a huge market which has been growing and is projected to grow by EIA.¹¹⁸ Essentially, these criticisms fall into the following areas:

- I did not acknowledge that EIA's forecasted growth in demand for PRB coal in the AEO 2013 was lower than previous years (AEO 2011). In Mr. Sanzillo's view, this is a downward trend, not robust growth¹¹⁹, and EIA's projections show "very slow growth for the PRB region, if any."¹²⁰
- The EIA forecast of growth in Montana PRB coal demand is not sufficient to support the new Otter Creek mine in 2020, especially given competition from existing mines.¹²¹
- I "essentially disregarded the precipitous drop in PRB coal production in 2012 by arguing it was the result of twin anomalies of mild weather and a temporary decline in natural gas prices."¹²²
- I ignored actual data showing declining production in 2013, which was evidence that the market was not going to turn around in 2013.¹²³

¹¹⁸ Sanzillo Statement at 8 – 18; NPRC Comments 2015 at 16 – 18.

¹¹⁹ Sanzillo Statement at 13.

¹²⁰ Sanzillo Statement at 14, quoted by NPRC Comments 2015 at 16.

¹²¹ Sanzillo Statement at 14 – 18; NPRC Comments 2015 at 18.

¹²² Sanzillo Statement at 9, paraphrased by NPRC Comments 2015 at 17.

¹²³ NPRC Comments 2015 at 17, citing Sanzillo Statement at 10 – 11 and 13.

- My testimony was at odds with a presentation made by a partner at my firm in January 2013.¹²⁴

The first criticism is simply not relevant. I referenced the most recent EIA forecast in my testimony, which was the AEO 2013. I did not file testimony prior to 2013 and had no reason to reference earlier forecasts by EIA. Forecasts are projections of future events, made with a great deal of uncertainty, using the best information available at the time. The fact that EIA's AEO 2013 forecast was for lower growth than its AEO 2011 forecast simply reflects the best information that EIA had in 2013 was different from what it was in 2011. Sanzillo implies that the fact that EIA's 2013 forecast had declined from earlier forecasts that future EIA forecasts will be even lower and that the result will be very slow growth for the PRB region, if any. Sanzillo cites the subsequent AEO 2014 forecast (which he acknowledged was published after my 2013 testimony), in which EIA reduced its forecast of PRB coal production in 2030 by 47 million tons to 493 million as evidence of a continued decline in EIA's forecasts.¹²⁵ Sanzillo would be chagrined to learn that the AEO 2015 forecast, published 3 weeks after his testimony was filed, **increased** the projection of 2030 PRB coal production by 19 million tons from 486 million to 505 million.¹²⁶

Every forecast published by EIA has shown growing demand for PRB coal. Just because EIA's more recent forecasts project lower growth rates than older forecasts, does not make them

¹²⁴ Sanzillo Statement at 10, quoted by NPRC Comments 2015 at 17.

¹²⁵ Sanzillo Statement at 12. Sanzillo incorrectly cited the AEO 2014 forecast for 2030 to be 493 million tons. It was 498.3 million tons, including all production from Wyoming PRB and Western Montana, to be comparable to the AEO 2013.

¹²⁶ Sources: Wyoming plus Montana subbituminous coal production for AEO 2014 and AEO 2015 from EIA Annual Energy Outlook table browser at <http://www.eia.gov/oiaf/aeo/tablebrowser/>. The difference between the 2030 forecast of 486 million tons in AEO 2014 and the 498.3 million tons quoted above is that Sanzillo included the Montana bituminous coal forecast of 12 million tons in his use of the EIA forecast for PRB coal, which I have excluded as this is not PRB coal. Prior to AEO 2014, EIA did not break out Montana bituminous from subbituminous coal.

“declining demand projections”¹²⁷. Sanzillo conceded that I was “technically correct to portray the EIA’s scenario as a growth scenario”,¹²⁸ because EIA projects growing PRB coal demand in every one of its long-term forecasts.

Further, a total annual PRB coal market of 400 – 500 million tons per year is a huge market by any definition. To put this in perspective, the entire projected reserve of the first mine at Otter Creek (Tract 2 with 453 million tons) is being mined in the PRB every year.

The assigned coal reserves at the existing mines in the PRB are being steadily depleted, due to the rapid rate of production. As a result, new reserves will have to be acquired to extend the life of existing mines or to develop new mines. The total recoverable reserves at surface mines in Wyoming and Montana (which includes the PRB plus two smaller bituminous coal mines in southwest Wyoming) were 8,043 million tons at the end of 2013.¹²⁹ At a production rate of only 400 million tons per year (the lowest rate since 2003), the entire existing reserve base in the PRB would be depleted in less than 20 years. Clearly, companies will need to acquire or develop new coal reserves in the PRB to meet demand, even if demand does not grow as fast as EIA’s latest forecast. The Otter Creek reserve is an attractive prospect because the cost of acquiring the reserve has already been expended and the 3:1 strip ratio is much lower than any new reserves that could be acquired in the Wyoming PRB (all of the new Wyoming PRB coal leases since 2009 have had strip ratios between 4.1:1 and 5.0:1).¹³⁰

Sanzillo contends that the EIA forecast of future demand for Montana PRB coal does not support the development of the Otter Creek mine, because forecasted demand growth is not as large as 20 million tons per year by 2020 and because other Montana mines have excess capacity

¹²⁷ NPRC Comments 2015 at 19.

¹²⁸ Sanzillo Statement at 11.

¹²⁹ EIA Annual Coal Report 2013, Table 15, available at <http://www.eia.gov/coal/annual/>.

¹³⁰ See June 2013 Schwartz Verified Statement, Exhibit 4.

and plans to expand.¹³¹ EIA has consistently projected growing production of Montana coal, in all of the AEO forecasts, including the most recent AEO 2015 forecast. In the AEO 2014 and AEO 2015 forecasts, EIA distinguishes between Montana low-sulfur subbituminous coal (which would include Otter Creek as well as the existing Spring Creek and Decker mines) and Montana low-sulfur bituminous coal (the Bull Mountain mine), while these categories were combined in the AEO 2013 forecast. In the AEO 2015 forecast, EIA projects that production of Montana low-sulfur subbituminous coal will grow from 20.5 million tons in 2013 to 30.9 million tons by 2020 and 35.3 million tons by 2023 and staying between 35.3 and 38.7 million tons through 2034 before declining to 33.9 million tons by 2040.

Sanzillo contends that this is not enough demand growth to open a 20 million ton per year mine at Otter Creek in the 2020 period, especially considering that the Spring Creek and Bull Mountain mines have excess capacity and plan to increase production for export markets.¹³² However, the Bull Mountain mine is not Montana subbituminous coal; it is bituminous coal. EIA has a separate forecast for this product in AEO 2015 which has production growing to the 12 million ton per year level by 2017. Thus, the EIA forecast that Montana low-sulfur subbituminous coal production will grow by 10.4 million tons from 2013 to 2020 and by 14.8 million tons by 2023 applies only to the existing Spring Creek and Decker mines as well as new growth from the Tongue River area (i.e., Otter Creek). While Sanzillo asserts that Spring Creek is producing below its historical capacity, the highest production level in Spring Creek's history was 19.3 million tons in 2010, which declined slightly to 17.7 million tons in 2013,¹³³ so there is very little excess capacity at Spring Creek mine. Cloud Peak, the owner of Spring Creek,

¹³¹ Sanzillo Statement at 14 – 18.

¹³² Ibid.

¹³³ Mine Safety and Health Administration Form 7000-2 data at <http://www.msha.gov/drs/ASP/MineAction70002.asp>

reported 274 million tons of remaining reserves at the end of 2014,¹³⁴ thus at its current production level Spring Creek would deplete its remaining reserves by 2030.

The other existing Montana low-sulfur subbituminous coal mine is the Decker mine, which produced 3.1 million tons in 2013. According to the JT Boyd report cited by Sanzillo, Decker “mine production has declined in recent years as long-term sales contracts have expired and economically viable coal resources have depleted.”¹³⁵ Because the Decker mine has higher strip ratios than other PRB mines, JT Boyd stated “we believe the Decker mine will not be economically viable. We have projected the mine will be idled or closed around 2014.”¹³⁶ Cloud Peak, a former 50% owner of Decker, sold its ownership share in 2014 for no cash, just the transfer of reclamation liabilities, after years of operating losses.¹³⁷

In sum, it is reasonable to expect that all of the growth in Montana low-sulfur subbituminous coal production projected by EIA (14.8 million tons by 2023) plus the closure of the Decker mine (3.1 million tons) would be supplied by a new mine at Otter Creek, not by existing mines. This equals projected supply of 17.9 million tons per year, which supports the conclusion that EIA’s latest forecast anticipates a market for a new Otter Creek mine.

I hardly disregarded the drop in coal demand in 2012, as it was the subject of a section of my prior testimony.¹³⁸ I was not the only analyst to attribute the decline in the market to the extremely mild weather and the low price for natural gas. For example, EIA released an article in May 2012 which stated: “Warm weather kept electric system load low across the East Coast and helped dampen the need for coal-fired generation. Natural gas generation was up

¹³⁴ Cloud Peak 2014 SEC Form 10-K, page 40, available at <http://investor.cloudpeakenergy.com/sec-filings>.

¹³⁵ John T. Boyd Company, *Powder River Basin Coal Resource and Cost Study*, September 2011 at 4-8, see footnote 85.

¹³⁶ *Id* at 4-9.

¹³⁷ Cloud Peak 2014 SEC Form 10-K, page 85, available at <http://investor.cloudpeakenergy.com/sec-filings>.

¹³⁸ August 2013 Schwartz Rebuttal Verified Statement at 5 – 7.

significantly to take advantage of low natural gas prices.”¹³⁹ Monthly natural gas prices in April 2012 fell below \$2.00 per million Btu for the first time in 13 years, since March 1999.¹⁴⁰ The 3-month period January – March 2012 was the warmest winter on record in the 121 years since the US began keeping temperature data in 1895.¹⁴¹ Yes, it was my opinion at the time of my testimony and it is still my opinion now that the extremely mild winter was an anomaly which caused low demand for electricity and very low prices for natural gas, both of which caused a large decline in coal burn in 2012 which was not likely to be repeated.

In fact, coal burn (demand) did increase in 2013 over 2012 as I predicted in my testimony. Sanzillo and NPRC believe that PRB coal demand declined in 2013 from 2012 because they do not understand the difference between supply (production) and demand (consumption). Because the decline in consumption in 2012 was a surprise to power companies, the power companies had purchased significantly more coal for delivery in 2012 than they actually burned. The excess PRB coal production was delivered and stored at the power plants as stockpiles (see Exhibits 3 and 4 above). In 2013, power companies purchased much less coal than they consumed as they burned the excess inventory. As a result, demand (consumption) in 2013 grew from 2012 levels while supply (production) fell. This phenomenon was recognized by others in the market, including EIA.¹⁴² The criticisms by Sanzillo and NPRC that demand was declining based upon actual production data through 2Q 2013¹⁴³ reflect a misunderstanding of the difference between production and consumption.

¹³⁹ EIA, “Warm weather and low natural gas prices dampen spot electricity prices this winter”, May 18, 2012 at <http://www.eia.gov/todayinenergy/detail.cfm?id=6330>.

¹⁴⁰ EIA, Henry Hub Natural Gas Spot Price at <http://tonto.eia.gov/dnav/ng/hist/rngwhhdm.htm>

¹⁴¹ US National Climate Data Center at [http://www.ncdc.noaa.gov/temp-and-precip/climatological-rankings/index.php?periods\[\]=3¶meter=tavg&state=110&div=0&month=3&year=2012#ranks-form](http://www.ncdc.noaa.gov/temp-and-precip/climatological-rankings/index.php?periods[]=3¶meter=tavg&state=110&div=0&month=3&year=2012#ranks-form)

¹⁴² EIA, “Increased U.S. coal consumption met by burning through stockpiles”, July 18, 2013 at <http://www.eia.gov/todayinenergy/detail.cfm?id=12151#>

¹⁴³ Sanzillo Statement at 10 and 13, NPRC Comments 2015 at 17.

Contrary to the opinions of Sanzillo and NPRC,¹⁴⁴ my testimony was totally consistent with the presentation in January 2013 by my partner, Ms. Emily Medine, at the Coaltrans conference. Ms. Medine's presentation, titled "Coal-Gas Switching", stated:

- "Low natural gas prices caused an estimated 170 million tons of reduced coal burn in 2012 compared to non-switching baseline.
- Coal gas switching is unlikely to be a permanent phenomenon as gas price increases are likely."¹⁴⁵
- "Natural gas prices will not stay below \$5.00 per MMBtu.
- Coal prices are not expected to increase at the same rate as natural gas prices.
- Remaining coal plants should generally be economic in the future subject to carbon policy."¹⁴⁶

These opinions are totally consistent with my previous testimony, which was that the decline in coal demand in 2012 was caused by the unusually mild weather and unusually low natural gas prices and that future gas prices were likely to increase which would lead to increased coal burn. In fact, that is exactly what happened in 2013 and 2014 as gas prices recovered and coal burn grew. Customer stockpiles were reduced and PRB coal production grew in 2014. However, the winter of 2015 was mild again and, coupled with growing natural gas production, caused gas prices to fall again in 2015. As a result, coal demand is now expected to fall in 2015 and demand growth will require higher natural gas prices.

¹⁴⁴ Sanzillo Statement at 10, quoted in NPRC Comments 2015 at 17.

¹⁴⁵ Emily S. Medine, *Coal-Gas Switching*, Energy Ventures Analysis, Inc., January 31, 2013 at 1, attached as Exhibit TS-7 to the Sanzillo Statement.

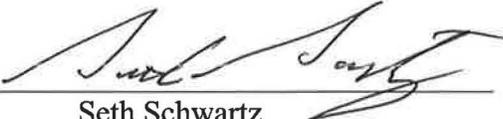
¹⁴⁶ Id at 22.

Sanzillo also noted that I incorrectly described the AEO 2013 forecast of Montana coal production as a forecast of domestic demand.¹⁴⁷ His criticism is correct; the AEO 2013 forecast is of total Montana coal production, not just domestic demand.

¹⁴⁷ Sanzillo Statement footnote 44 at 15.

VERIFICATION

I, Seth Schwartz, hereby verify under penalty of perjury under the laws of the United States of America that the foregoing is true and correct to the best of my knowledge and belief.


Seth Schwartz

Dated this 14th day of May, 2015

SCHWARTZ
APPENDIX 1

Appendix 1: Strip Ratios of the Wyoming PRB Coal Reserves

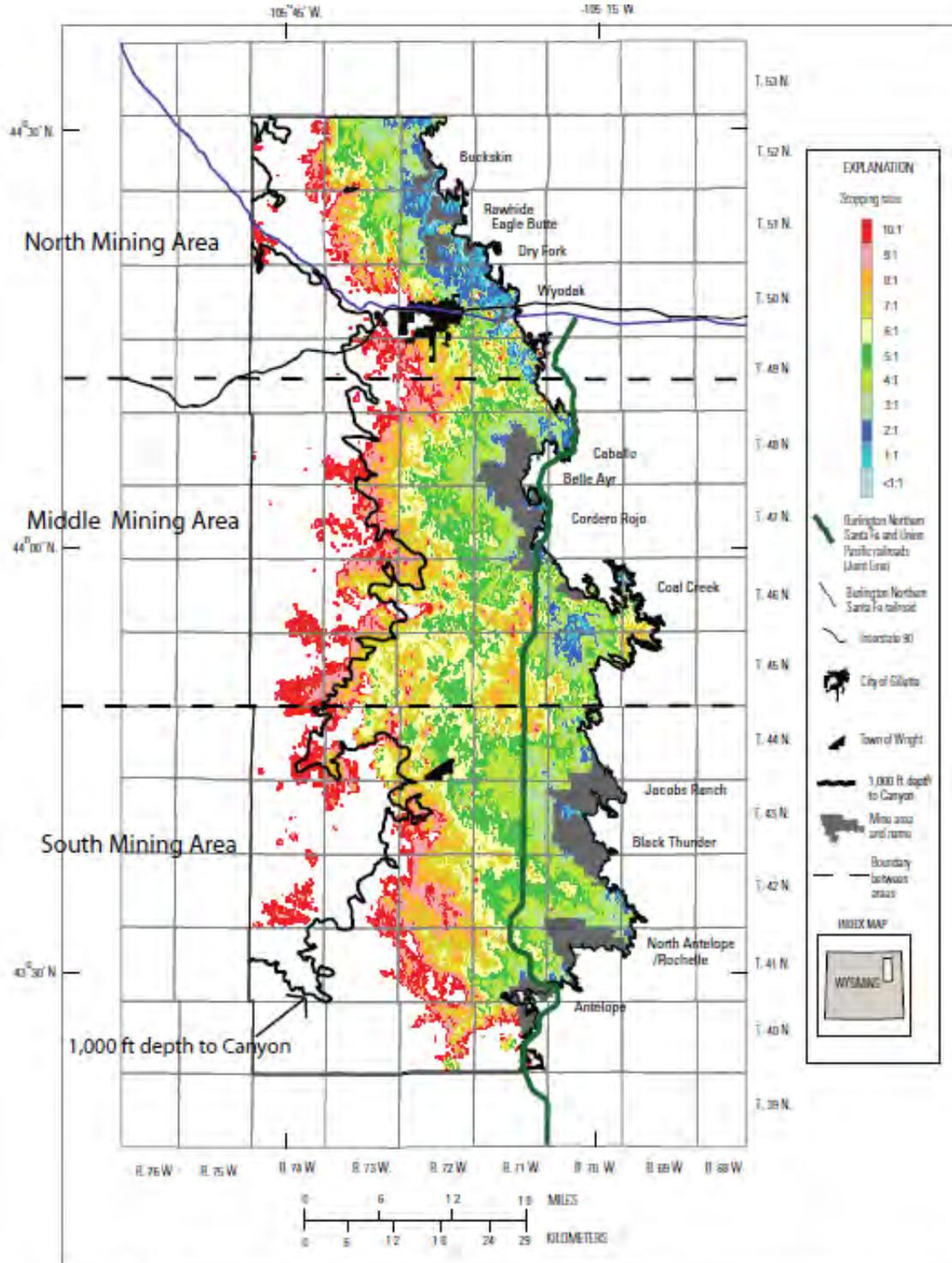


Figure 62. Map showing the stripping ratio for the six coal beds for which reserves were calculated. Waste rock includes the volume of overburden above the uppermost coal bed, volume of rock between coal beds, and volume of partings within the coal bed. Coal includes all coal from the top of the Roland coal bed to the bottom of the Canyon coal bed.

CERTIFICATE OF SERVICE

I hereby certify that on this 14th day of May 2015, I have caused a copy of the public version of the foregoing Supplemental Reply of Tongue River Railroad Company, Inc. to the Supplemental Comments of NPRC and of SMART-386 to be served by first-class mail, postage prepaid, on each of the parties of record in STB Finance Docket No. 30186.

A handwritten signature in cursive script, reading "David H. Coburn", is written over a solid horizontal line.

David H. Coburn