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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Ex Parte No. 705

COMPETITION IN THE RAILROAD INDUSTRY

INITIAL COMMENTS OF

THE NATIONAL COAL TRANSPORTATION ASSOCIATION

This written statement is submitted on behalf of the Board of Directors of the National Coal Transportation Association ("NCTA"). The NCTA is a nonprofit corporation operating as an association consisting primarily of coal producers, electric utilities, and coal transportation product and service providers with over 140 geographically diverse corporate members doing business in the United States, Canada, and Australia. The mission of NCTA is to educate its members and the general public relative to the coal transportation industry and to facilitate the resolution of challenges within the coal transportation arena. NCTA members are vitally interested in the reliable, efficient, and economic transportation of coal by rail.

During calendar year 2010, according to the Energy Information Administration Report EIA-923 Power Plant Operations Report data for 2010, the member companies of NCTA received about 673 million tons of coal to power plants in the United States, which is about 72 percent of the total tons shipped to domestic power plants and large reporting industrial facilities. The chart below shows the breakdown of coal receipts by NCTA members by mode in 2010.

Coal Receipts by NCTA Members - 2010

Total (MMT)	Rail	Water	Conveyor	Truck
673,309,132	519,506,566	67,626,533	40,484,328	45,691,705
	77.0%	10.1%	6.1%	6.8%

In addition to the above tonnage, NCTA coal exporters shipped over 25 million tons of coal to export terminals, mostly by rail. For coal shipped by rail, NCTA members own or control over 80,000 railcars dedicated to coal service. This investment in railcars, primarily undertaken by utilities, has an estimated replacement value of over $5 billion, which is capital not required of railroads to transport coal. It is obvious that rail competition is a crucial subject to coal shippers.

Coal continues to be a reliable and cost-effective fuel for base load generation of electricity, and is the fuel of choice for generating almost one-half of the electricity used in the United States. Electricity remains an essential ingredient for a growing economy that creates jobs. Therefore, both regulated and merchant generators endeavor to procure energy inputs on a delivered basis at the lowest possible cost per BTU. The mines find themselves competing on the basis of coal quality, productivity, and the most efficient compliance with environment and safety regulations and laws. Shippers have multiple options in a competitive mining environment. The situation is not as sanguine for coal transportation by rail. By any reasonable analysis, if the locomotives serving a mine or utility always have the same paint job and lettering, either the mine or power plant, or both, are captive to the serving carrier.

According to the Association of American Railroads ("AAR"), the average distance for coal movements is 834 miles, which eliminates trucking as a viable alternative transportation mode for all but a few plants. The lengthy haulage distances and the reality of limitations faced by captive shippers point out the need for appropriate rail-to-rail competition.

RAIL INDUSTRY INFRASTRUCTURE

Rail carriers are partners in the coal supply chain and support the coal production and consumption industries with capital investment and public advocacy. NCTA has worked over thirty-five years with rail carriers to improve practices and gain efficiencies for all parties. Surely, creative ideas originate on both sides of the table, and technological improvement has shown increasing importance over the last two decades. Notable successes are the switch to aluminum coal cars, AC locomotives, improved communications for train management and customer planning, distributed power, increased lading in coal cars, rapid mine load-outs, longer trains, storage and loop tracks on the mine property, and faster unloading times and better facilities at the power plants. Coal producers, coal consumers, and rail carriers have all placed capital at risk to improve the efficiency of the rail networks. Coal's share of rail carloads transported annually is larger than any other carload segment of the rail business, and in 2010 accounted for over 45% of all carloads carried by U.S. railroads according to AAR.

The thirty years of post-Staggers Rail Act of 1980 ("Staggers") interpretations by the ICC and the STB accompanied by judicial decisions have culminated in an industry structure with most Class I Railroads located in regional parallel duopolies and numerous origins and destinations which are captive to a single carrier without feasible commercial recourse to alleviate the natural market dominance by the carrier. Today's structure arises, in part, from the effort of carriers to rationalize unwieldy rail franchises arising pre-Staggers by abandonment and merger or consolidation. The resulting geography and physical layout of the railroads bring us to where we are today in the rail marketplace for coal. Many coal origins and destinations are captive to a single carrier. This leads to market dominance that in some cases has caused or contributed to the idling or shutting down of power plants, inadequate and untimely service, higher residential, commercial, and industrial electricity bills, and the imposition of rigid, one-sided terms for coal transportation. It is simply not possible to achieve a "win-win" when one party has no alternative transportation or competitively priced alternative fuel.

In the ten years following the Staggers Act, the Class I railroads shed over 40,000 miles of rail, about half of which was sold to regional or short line railroads as "feeders" to the Class I rail carriers. The Class I rail carriers experienced huge gains in productivity. Using a metric of revenue ton-miles per constant dollar of operating expense, overall rail productivity rose 172% in the 25 years following Staggers. Rail labor productivity rose 128%, locomotive productivity rose 131%, track productivity rose 163%, and fuel efficiency increased 64%.[1] Some of this productivity was shared with shippers, which was only equitable considering the significant capital invested by them.

NCTA recognizes the need for a financially healthy rail industry that continues to attract talented employees and investors. NCTA has no desire for some sort of "re-regulation", an expression made from whole cloth by those that oppose reasonable policies

[1] Vantuono, William C., How Staggers "Saved the Freight Railroad Industry from Socialism", *Railway Age*, Nov. 2005

that would improve rail-to-rail competition and encourage the likelihood of commercial solutions between railroads and shippers. It may be noted that Class I carriers achieved more than adequate financial performance during every quarter throughout the recent recession. While many commodities and business segments of rail transportation reflected a decrease in volume of between 30 and 50%, coal deliveries decreased slowly by around 11%. The ability to differentially price coal movements, as allowed under Staggers, provided a margin to cover other non-coal business the railroads lost during the recession or other non-coal business with a lower margin.

From a regulatory standpoint, Class I carriers are neither fish nor fowl. The Staggers Rail Act has freed them from the heavy regulation accorded to a monopoly with a protected franchise, but neither do carriers have unfettered competitive access to any potential customer via the tracks of other rail carriers. The Surface Transportation Board has the challenge to devise or create a more balanced approach to improve the competitive rail arena for all shippers, through its rules, technology, enforcement of reasonable practices, or some new competitive access provisions. NCTA believes this proceeding provides an excellent and timely forum for the Board to collect factual information and policy suggestions from all stakeholders as a basis for a plan of action.

DUOPOLIES DO NOT GUARANTEE COMPETITION

There should be no misconception that a regional duopoly will guarantee a robust rail-to-rail competition for all business based on "buying" a market share. Many factors determine rational behavior of the two carriers, and they may feel it is not in their best interest to aggressively bid for new business. This explains, in part, why build-outs to gain dual service were prevalent in the 1990's, but reached an inflection point in 2003. No petitions for build-outs have been filed since 2003. Shippers who incurred the cost of constructing a rail build-out to create dual access in the 1990's could justify the expense because it would reduce transportation costs sufficiently to yield an acceptable return on the investment. After 2003, the ROI for the capital investment was no longer acceptable.

How did this happen? After the rationalization of the post-Staggers period coupled with a growing demand for coal, the carriers invested in assets and expanded track capacity. Capacity increases typically follow a "saw tooth" curve that causes periods of excess capacity. If a regional duopoly has excess capacity, the carrier with the most uncommitted capacity will aggressively seek new and expanded volume. However, Wall Street wants to penalize excess capacity and both rail carriers will restrict new investment to more closely match demand. Although neither carrier can dictate the market, the sum of rational actions will be to not invest in an overcapacity situation and not aggressively undercut the other carrier's business. Then the "competitive" bid for new business comes in slightly higher than the existing rate. Economic theory posits that duopolistic carriers with similar costs, operations and technology will tend toward competing at the level of their respective long run marginal costs. This is arguably not the competition between railroads envisioned by the drafters of the Staggers Rail Act.

Even if rail carriers aggressively compete at the origin or destination in a duopoly structure, the shipper may be faced with a "bottleneck" at the other end of the proposed coal movement. Developing a process or means to minimize the effects of bottlenecks would provide a salutary effect for movements with a captive shipper. The current law relying on a

Supreme Court decision rendered some 45 years prior to the Staggers Act provides little relief for the captive shipper to mitigate the effects of the bottleneck. It appears that a statutory or regulatory change is necessary to improve or replace the current situation that does not provide for practical, effective rail alternatives. The Notice for Ex Parte 705 suggests seven areas of focus, but NCTA believes the biggest positive impact to increasing the level of rail-to-rail competition will be made by re-addressing the bottleneck issue. NCTA is not offering specific proposals for resolving the bottleneck issue in these comments. However, NCTA will continue to offer education and disseminate information on rail-to-rail competition issues, and will provide venues for the entire industry to discuss resolution of industry challenges.

MARKET DOMINANCE DETERMINES MARKET REACH FOR COAL

Coal producers compete with each other aggressively based on their production costs and quality of reserves. Unfortunately, the coal producer's investment in productivity and its need to have production and sales that exceeds the mine's breakeven volume can be trumped by a delivery bottleneck or by shipping to a captive destination. Competition in coal market is based on delivering energy measured in BTU's, or its equivalent, to the power plant. The power plant observes that coal producers are located at different distances from the plant in different regions with coal being produced with different heating values and quality constituents. However, the plant needs to purchase BTU's on a delivered basis and the competition between supply regions and mines can be lost because of the lack of competitive rail alternatives. For example, if a utility power plant desires to procure coal from multiple U.S. coal producing basins, it can achieve competitive offers from the suppliers, but the plant will need to negotiate transportation rates for each of the potential hauls. The plant is probably captive to one destination carrier that also can directly originate coal from one of the coal producing regions. The destination carrier now has a form of market control that allows it to reduce the field of potential coal producing basins and suppliers based on the level it sets pricing at on its segment of any two-line haul. In such case, this destination carrier is the principal determinant of the successful coal producing basin or origin. If the power plant does not agree to the rate for the destination segment of a two-line haul, the destination carrier can offer a Rule 11 tariff rate that is even higher. The utility may then file a large coal rate complaint case at the Board. This is a daunting undertaking and it effectively provides a "free loan" to the rail carrier as the time-consuming and costly process of resolving the complaint proceeds. (A "free loan" is created when the market dominant carrier established an unreasonably high tariff rate, with the awareness that the STB interest rate used for refunds is significantly below the internal railroad cost of borrowing money.) Although this example may not be defined as a classic bottleneck, the result is the same – a captive destination plant has its coal sourcing, transportation rates, and market access controlled by a carrier with market dominance.

SUMMARY

NCTA commends the Surface Transportation Board commends for initiating this proceeding to address difficult and challenging issues. Coal shippers' needs are not being adequately met with the current state of rail-to-rail competition. Coal is a reliable fuel source for base load electricity generation, and cost-effective transportation is needed for it to remain a reasonably priced fuel and a significant element to restore and grow the U.S. economy.

The CEO of one of the Class I railroads recently stated that commercial competition is the key to growing the economy and jobs. We agree. NCTA desires that the stakeholders develop some creative approaches to reduce the limitations on rail competition. NCTA is always ready to work with the Board, its staff, and the railroads to facilitate any resolution process to improve the U.S. rail arena for the benefit of the public, whom such lack of competition ultimately affects.

Respectfully submitted,

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