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219005

April 4, 2007

BY HAND DELIVERY

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
Attn: STB Ex Parte No. 671
395 E Street, SW
Washington, D.C. 20423-0001



Re: Ex Parte No. 671, Rail Capacity and
Infrastructure Requirements

Dear Secretary Williams:

Please find enclosed an original and ten (10) copies of the Statement of the Western Coal Traffic League in the above-referenced proceeding. We have also enclosed discs including Statement in electronic (WordPerfect) format. Please also note that the exhibits to this Statement are in color.

We have enclosed an additional copy of this Statement. Please indicate receipt and filing by time-stamping this copy and returning it with our messenger.

Thank you for your attention to this matter.

Sincerely,

Peter A. Pfohl
An Attorney for the Western
Coal Traffic League

Office of Proceedings
U.S. Surface Transportation Board
Washington, D.C.

Enclosures

**BEFORE THE
SURFACE TRANSPORTATION BOARD**



219005

**RAIL CAPACITY AND
INFRASTRUCTURE
REQUIREMENTS**

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Ex Parte No. 671

**STATEMENT OF
THE WESTERN COAL TRAFFIC LEAGUE**

Of Counsel:

**Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, D.C. 20036**

Dated: April 4, 2007

By:

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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

**RAIL CAPACITY AND
INFRASTRUCTURE
REQUIREMENTS**

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Ex Parte No. 671

**STATEMENT OF
THE WESTERN COAL TRAFFIC LEAGUE**

In accordance with the Notice served by the Board in the captioned proceeding on March 6, 2007 (“Notice”), the Western Coal Traffic League (“WCTL” or “League”) submits this Statement to express its views regarding the Board’s examination of issues related to rail traffic forecasts and infrastructure requirements. This Statement supports and supplements the points that will be raised by WCTL’s designated representatives during the Board’s hearing scheduled for April 11, 2007.

IDENTITY AND INTEREST

WCTL is an association formed in 1976 whose membership is composed of shippers, receivers, and consumers of coal mined from sources west of the Mississippi River. WCTL members collectively consume more than 140 million tons of coal annually that is moved by rail. Its members include investor-owned electric utilities, rural electric cooperatives, state power authorities, municipalities, and a non-profit fuel supply cooperative.¹

¹ See the listing of WCTL members in Exhibit 1.

The topic of this hearing, rail capacity and infrastructure requirements, is of considerable interest to the members of WCTL. WCTL members rely on the railroads to construct, maintain, and operate adequate systems to help ensure the timely and efficient transportation of coal that meets coal customers' requirements and maintains electric system reliability. Accordingly, WCTL has a direct and substantial interest in this proceeding.

SUMMARY

While freight capacity is a complex, multifaceted issue that involves many factors, there should be no capacity constraints as concerns western coal traffic given the consistent and predicted traffic growth rates and the western railroads' own assertions that they have implemented all investments necessary to meet demand. At the same time, the railroads are enjoying record profits, and profit-contributions from western coal customers have been steadily growing. The railroads have sufficient financial resources to meet their capital investment needs in their coal corridors.

Unfortunately, despite the considerable contributions from western coal customers and the carriers own statements that they are making the investments necessary to satisfy coal demand, the western carriers have had recurring coal service problems. These service problems ultimately have cost consumers hundreds of millions of dollars in added electricity expenses in recent years. These problems appear to be in part attributable to railroad management decisions that are unrelated to overall levels of capital spending, such as on where investments are being targeted, the timing of the investments,

traffic prioritization, the aggressive imposition of force majeure notices, the carriers' other supply/demand practices, etc.

The carriers continue to seek additional contributions from coal without any demonstration that these additional contributions are fair, reasonable, or necessary. Meanwhile, these carriers have helped bring about supply and demand imbalance through their management decisions and have used that imbalance as a means to drive up customer prices and further enhance system profitability – without any demonstrated improvements in service. WCTL cautions the Board to closely examine the carriers' "infrastructure needs" assertions as a guise to obtain additional profit contributions from their coal customers. Railroad management decisions should be focused on ensuring efficient and reliable coal transportation which is essential to maintaining electric system reliability. Additional attention also should be paid to the considerable problems associated with railroad duopoly pricing and service abuses.

WCTL suggests that any rail infrastructure policies or programs that might be pursued by the railroads in the form of tax incentives or other public support should be required to adequately protect consumers and the public rather than principally benefit the carriers' bottom lines and the carriers' dominant positions in the marketplace. WCTL further submits that the history of competition in the movement of western coal (until recently) shows that pursuing pro-consumer and pro-competitive policies is the best means of helping to ensure that improved innovations, efficiencies, and adequate railroad infrastructure programs are brought to fruition.

DISCUSSION

The Board's Notice explains that, in regulating the railroad industry, the Board is called upon "among other things, to ensure the development and continuation of a sound rail transportation system with effective competition and coordination between rail carriers and other modes." Notice at 2. The Board explains that the purpose of this hearing is to allow the submission of views and information from the public in the following five areas: "freight traffic forecasts; the extent of the capacity constraints and the ability of the railroads to meet the rising demand; the infrastructure investments needed to ensure that the Nation's freight rail system continues to operate in an efficient and reliable manner; possible solutions to the challenges presented by growing rail traffic and limited capacity; and the potential role of public-private partnerships and innovative financing tools in meeting these challenges." WCTL addresses each these five issues, in turn, below, and in the accompanying exhibits prepared for WCTL by L.E. Peabody & Associates, Inc.

A. Freight Traffic Forecasts

1. Western Railroad Coal Traffic Growth has Been Substantial, but Steady and Predicted

Coal is one of the most important business groups for the railroads. By far the largest coal producing region served by the western carriers that provide rail transportation service for WCTL members is the Wyoming Powder River Basin

("PRB").² As shown in Exhibit 2, Union Pacific Railroad Company's ("UP's") and BNSF Railway Company's ("BNSF's") growth in Wyoming PRB coal traffic has been strong recently, and has grown at a higher rate than any other traffic group except intermodal. At the same time, the PRB traffic growth has been steady and consistent. See Exhibit 3 (reflecting UP's and BNSF's Wyoming PRB coal traffic growth since 1995). It is well known that, beginning in 2005, the western railroads experienced significant service problems in delivering coal to their customers. Utility coal stockpiles dwindled and the carriers rationed service and curtailed new business. The Federal Energy Regulatory Commission held a hearing in 2006 to address deficient railroad service and the impact of that service on electric system reliability. These railroad service failures cost western coal shippers hundreds of millions of dollars in added electric generation costs.

The carriers have intimated that at least some of the service difficulties they have experienced in moving their traffic is attributable to unanticipated demand. However, that is certainly not the case for UP and BNSF's Wyoming PRB coal traffic. This traffic growth has been expected and forecasted both by governmental entities such as the Department of Energy's Energy Information Administration (e.g., through EIA's 25-year Annual Energy Outlook forecasts), as well as by coal producers, the railroads

² While this statement focuses on Wyoming PRB coal traffic, the discussion also applies to coal traffic from other major western coal producing regions such as Montana, Colorado/Utah, and New Mexico from which WCTL members' coal traffic also originates.

themselves, and their expert consultants. See, e.g., UP and BNSF Joint Release, “UP, BNSF Announce Southern Powder River Basin Joint Line \$100 Million Capacity Expansion Plan” (May 8, 2006) (“[f]or many years, CANAC, a Montreal-based rail engineering firm, has been evaluating [for UP and BNSF] PRB coal production forecasts and both railroad and mine infrastructure capacity needed to support forecasted production”). Additionally, as also shown in Exhibit 3, consistent with past trends, governmental forecasts continue to predict steady and consistent Wyoming PRB traffic growth well into the future.

In sum, there have been no unanticipated demand “spikes” in Wyoming PRB coal traffic that may have inhibited the carriers’ ability to plan and implement appropriate capital investment programs to meet expected demand.³ Existing and anticipated future Wyoming PRB traffic growth has been predicted and is expected to continue at a steady pace, and the carriers have been well informed and positioned to plan for and make, in a timely manner, all of the necessary investments required to meet demand.

³ In fact, there is some evidence that UP and BNSF may have somewhat overestimated Wyoming PRB growth in at least one year. See, e.g., Southern Powder River Coal Basin, BNSF/UP Joint Line, Towards Sustainable Operations of 500 MNT, Andy Cebula, CANAC, presentation to the National Coal Transportation Association, Feb. 22, 2006, at p. 5 (CANAC in 1999 anticipated 359.0 million net tons of PRB Joint Line coal deliveries in 2004, with actual Joint Line deliveries totaling 322.1 million net tons in 2004).

B. The Extent of the Capacity Constraints and the Ability of the Railroads to Meet the Rising Demand

1. Capacity is a Complex Multifaceted Issue

The railroads themselves have recognized that the issue of capacity is complex and multifaceted. BNSF's CEO testified to Congress on this issue several years ago, explaining:

Railroad capacity is a function of a myriad of inputs, including tracks, rolling stock, yards, repair facilities, customer support capabilities, dispatching and signal technology, equipment and infrastructure maintenance levels, and workforce productivity. All these factors, together, determine the amount of freight railroads can handle and the service levels that can be provided.

Oversight Hearing on the State of the Railroad Industry, Subcommittee On Surface Transportation and Merchant Marine, Committee on Commerce Science, and Transportation, United States Senate, S. Hrg. 107-1052 (May 9, 2001) at 118.

UP's CEO also testified to Congress at the same hearing on the meaning of capacity:

Capacity in the rail industry includes track, terminal, repair shop and workforce capacity, as well as the size and condition of locomotive and car fleets. Lack of capacity in any of these areas directly reduces a railroad's ability to provide reliable service. Without consistent and reliable service, a railroad cannot attract the traffic volume and revenues needed to support the large capital investment a railroad requires. Without increased capacity, a railroad would obviously be unable to accommodate growth in the general economy, such as in the demand for the transportation of coal needed for generation of more electricity. Without increased capacity, a

railroad would certainly be unable to expand its transportation of premium products, such as intermodal business.

Id. at 114.

WCTL understands that no public modeling of the national rail network has ever been conducted, and may not even be possible. However, UP and BNSF have been able to model several of their PRB coal corridors to determine the best course of action necessary to support system fluidity in the short- and long-term. WCTL is also aware that, even among experts, there may not be agreement on whether there are substantial capacity problems in the carriers' networks.

In a paper presented to the Transportation Research Board last year, the former long-standing chief planning officer for Norfolk Southern Railroad Company (and currently a private planning consultant) emphasized that “[t]he reality is that there is plenty of capacity on most of the track network much of the time.” Railroad Capacity Issues, presented by James McClellan, Woodside Consulting Group, to the Transportation Research Board, April 5-6, 2006 at 2. He further stated that “[w]hile we tend to think of capacity as an infrastructure issue, rolling stock, motive power, employees and operating strategies (size of trains, speed of trains, timing of trains, etc.) are all part of the equation.” Id. He added that, while there may be individual “choke” points in the carriers systems that create capacity problems at certain times, “[b]uilding more tracks . . . may not be the best alternative.” Id.

This planner further explained:

[u]nderpowered trains will play havoc with track capacity. Too many trains running at different speeds will have the same impact (which is why some railroads are taking a harder line about faster schedules for UPS and other premium intermodal customers). If the yards are congested then trains are held on line of road and that reduces line-of-road capacity and ‘burns’ crew availability. And so it goes.”

Id. Thus, in many instances so-called “capacity problems” may have little to do with actual physical track capacity investments, but much to do with operational matters and management priorities.

For example, it is well known that railroads prioritize their traffic. Trains are given a specific priority that is built into the carriers’ computer-aided dispatching systems. UP has stated that it uses the following priorities:

- 1. Amtrak**
- 2. Priority Intermodal**
- 3./4. Other intermodal and automotive**
- 5. Manifest**
- 6. Bulk, including rock and cement; local trains**

See Letter from Arvid E. Roach II and J. Michael Hemmer to the Hon. Vernon A.

Williams, Ex Parte No. 573/Service Order No. 1518 – Rail Service for Construction

Materials in Texas (filed July 28, 1998) at 3. Therefore, Amtrak and intramodal traffic that are considered time-sensitive are given top priority and other bulk commodities that are not considered as time sensitive such as coal are given lowest priority (much to the detriment of WCTL members who are asked to pay premium rates for their coal transportation service).

Management decisions on traffic prioritization have, at times, created considerable system operating and fluidity problems. For example, in the spring of 2004 UP admitted that it had been experiencing considerable system delays that were in part attributable to its prioritization of certain premium intramodal traffic. UP had previously highlighted in its 2003 financial reports an aggressive service guarantee provided to United Parcel Service (“UPS”). UP guaranteed to UPS coast-to-coast train service in 60 hours. It had touted this guarantee as an example of its ability to respond to its customers’ service needs. However, the aggressive UP service promise apparently wreaked havoc on system fluidity that spread across UP’s system, costing UP tens of millions of dollars. See Company News; Union Pacific to Shift Some U.P.S. Cargo to Trucks, N.Y. Times, Apr. 1, 2004. To address the situation, UP announced in March, 2004 that it would attempt to ease system delays by hiring truckers and shifting a portion of the UPS service from railroad to trucks. Id.

This episode reinforces the point that railroad system service reliability problems often may be more directly related to carrier management decisions than to the overall level of capital spending being made. This issue is further addressed below.

2. There Should Be No Capacity Constraints in the PRB

As pertains to the Wyoming PRB, there should be no particular capacity constraints that have not been addressed by the railroads. As stated above, PRB coal traffic growth, while significant, has been steady and predicted. UP and BNSF stress that they have studied PRB coal growth and have implemented all recommendations received

from their expert planning consultants (including the allocation of an additional \$100 million in PRB Joint Line investments in 2006 and 2007). See UP and BNSF Joint Release, “UP, BNSF Announce Southern Powder River Basin Joint Line \$100 Million Capacity Expansion Plan” (May 8, 2006).

UP and BNSF also have sufficient incentives to reinvest in their infrastructure. As stated by UP’s CEO: “the real key to service is investment. Capital investment in the rail industry is like food to the human body. Without it we will wither and die.” Oversight Hearing on the State of the Railroad Industry, Subcommittee On Surface Transportation and Merchant Marine, Committee on Commerce Science, and Transportation, United States Senate, S. Hrg. 107-1052 (May 9, 2001) at 6.

In his testimony before the Senate in 2001, UP’s CEO stressed the importance of the carriers’ coal corridor investments, and described in detail the positive aspects of infrastructure investments made in UP’s principal coal corridor:

[A] good example of how capacity enhancements can improve the overall performance of a railroad is our recent investment of over \$300 million in upgrading and adding a third main line to our 110-mile route between North Platte and Gibbon, NE (which is the busiest section of railroad in the country).

* * *

[T]riple tracking this segment of line cost \$327 million. Was it worth it? Absolutely. . . . [P]rior to the triple-track project, we were able to get 107 trains a day over this segment of line, and our average speed was 23.8 mph. Today we are running over 140 trains a day over that line at an average speed of 36.4 mph. That is a 30% increase in trains and a 53%

increase in speed. This also has allowed us to cut our recrew rate by 80%. (The recrew rate is how many times we have to change the crew on the locomotive.) This makes us more efficient, with our customers being the ultimate beneficiaries.

Id. at 6, 114. It is clear from the above testimony that adequate coal corridor investments are vital to UP's ability to run a more efficient and productive railroad system. It therefore makes sense to make whatever investments are necessary to keep coal operations running efficiently.

3. Railroads have Sufficient Financial Resources to Meet their Capital Investment Needs

The facts show that the railroads are able to meet their investment requirements through both internally generated and privately raised resources. For example, in its 2002 SEC 10-K filing, BNSF stated that it has and will in the future have no trouble generating cash and obtaining financing when needed to meet all of its investment needs:

For 2003 and the foreseeable future, the Company expects that cash from operating activities, access to capital markets and bank revolving credit agreements will be sufficient to enable the Company to meet its obligations when due. The Company believes these sources of funds will also be sufficient to fund capital additions that are necessary to maintain its competitiveness and position the Company for future revenue growth.

BNSF 2002 Form 10K, at 18. Since then, BNSF has experienced the same financial growth and stability seen throughout the railroad industry.⁴ UP has likewise stated that it is making substantial capital investments, including in its coal corridors, and it is “confident that our business returns will support these investments.” UP 2006 Annual Report, at 3.

By almost any measure the railroad industry is faring remarkably well. The railroads themselves declared back in 1998 that “[t]he pricing and routing freedoms of the Staggers Act have enabled railroads to rationalize their systems, reinvest in productive rail infrastructure, generate higher levels of service and dramatically increase productivity.” See Hearing on Rates, Access, and Remedies, Testimony of Karen Borlaug Phillips on Behalf of the Association of American Railroads, U.S. House of Representatives, Committee on Transportation and Infrastructure (May 13, 1998) at 2-3.

Railroads frequently point out to regulators and Congress that their revenue per ton-mile has been falling over time -- intimating that they are losing ground financially. But the railroads’ operating expenses per ton-mile have remained consistently and substantially below revenues, allowing the railroads to become more financially secure. The same applies to the carriers’ coal traffic.⁵

⁴ BNSF has made a similar statement in its 2006 Form 10K indicating that for 2007 and the foreseeable future it will have sufficient cash to cover necessary investments.

⁵ In addition, many investments in track and equipment (railcars) that have traditionally been made by the railroads have been shifted to shippers in the case of PRB
(continued...)

Exhibit 4 shows the western carriers' aggregate revenues and contributions from coal. The western carriers' revenues from coal alone are approaching \$6.0 billion dollars. Coal contributions are significant, and have been growing dramatically. The railroads' costs for western coal moves have been declining, which makes sense given the increasing density, productivity improvements, and cost savings realized by the carriers.⁶ At the same time, the carriers' annual revenues have stayed consistently and substantially above the cost of providing service, and the differentials are growing.

Overall, the differential between revenues and costs has produced significant coal shipper annual contributions to BNSF's and UP's bottom lines. Between 2000 and 2004, coal contributions to the western carriers were approximately \$1.95 billion. In 2006, coal contributions reached \$2.84 billion, or a 46% increase from 2004 levels.

The significant contribution from coal enjoyed by the western railroads has helped the railroads to substantially and steadily improve their financial performance, as well as their standing in the financial markets. For example, as Exhibit 5 shows, the equity returns on railroad stock are far greater than market returns as a whole over the last

⁵(...continued)

coal movements. Most PRB coal cars are provided by shippers, and the shippers (and the coal producers) have invested many millions of dollars in track at the origin and destination to improve loading and unloading of coal unit trains.

⁶ As stated above, in many cases, the cost savings realized by the railroads were funded by the shippers they serve.

seven years. A company's stock price is an important forward-looking indicator of the financial health of the business, reflecting current operations and the market's expectations of future earnings. Since 2000, the prices of Class I railroad stocks have increased an average of 193%, compared with a decline of 1.3% for the S&P 500 index over the same period. See Exhibit 5.

Railroad revenues are at all-time highs today, with the railroads enjoying record revenues on a consistent, quarterly basis.⁷ Both UP and BNSF have also substantially raised their quarterly dividends in recent years and have been engaged in significant stock re-purchase programs, spending billions of dollars in repurchasing their shares from the market. Clearly the carriers' officers and shareholders would not allow them to substantially increase dividends or engage in such enormous stock repurchase programs if they believed they did not have the wherewithal to do that as well as make the capital investments needed to sustain projected coal and other traffic levels.

Additionally, the conclusions reached in a rail infrastructure study prepared by the American Association of State Highway and Transportation Officials ("AASHTO") with respect to western coal movements confirm that there should be no railroad profitability concerns with regard to the important PRB coal corridor.⁸ The

⁷ In 2006, operating revenues for the UP, BNSF, NS and CSXT were \$15.6, \$15.0, \$9.4, and \$9.6 billion respectively, and were record revenues for each company. See Companies' Annual Reports to Shareholders.

⁸ The study is entitled "Transportation – Invest In America, Freight-Rail Bottom
(continued...)"

AASHTO Study described the PRB coal corridor, which “extends from the low-sulfur coal fields of the Powder River Basin in northeastern Wyoming to the power plants throughout the Midwest and South . . . [as] the single largest rail market in the country” with current traffic levels expected to grow significantly over time. *Id.* at 117. The AASHTO Study found that the railroads will be able to make all necessary capital investments in the PRB corridor over the next twenty years because railroads “will remain effective at attracting, retaining, and financing unit train business.” *Id.* at 93. The AASHTO Study confirms that the railroads are earning substantial profits on their coal traffic which have been more than enough to finance infrastructure growth, and will continue to do so in the future.

C. *Infrastructure Investments Needed to Ensure That the Nation’s Freight Rail System Continues to Operate in an Efficient and Reliable Manner*

1. The Railroads have Been Investing in Their Infrastructure

As Exhibit 6 shows, the UP and BNSF have been investing in their infrastructure in recent years. This exhibit also reflects investments made by BNSF specifically in coal capacity projects. As pertains to coal, there may be some serious BNSF coal investment voids, at least in certain years. For example, BNSF reports that it made no investments for coal traffic in 2001 and only \$2 million in 2002. This issue may warrant additional investigation by the Board. Additional railroad management issues

⁸(...continued)
Line Report” (Jan. 2003) (“AASHTO Study”).

(e.g., railroad practices concerning the timing of investments made, etc.) are discussed below.

While railroad investments overall are substantial, the investments are certainly not out of line with those of other capital-intensive industries. For example, the railroads assert that they pour more back into their infrastructure than any other industry. However, as shown in Exhibit 7, a recent study performed by a New York University Stern School of Management professor shows a number of other industries that are similar in structure to the railroads (e.g., trucking, maritime, network industries) that have reinvested in themselves at higher levels. Thus, railroad investments are not out of line with those other comparable industries.

Finally, even after paying for their investments, the railroads still have been able to generate enormous amounts of cash. As shown in Exhibit 8, UP and BNSF have generated significant free cash flow of between \$1.2 and \$2.5 billion annually in the last six years. This is cash available to the carriers after providing for all capital investments, and it is a very strong indicator that the carriers have more than sufficient cash to pay for their capital investment initiatives.

D. Possible Solutions to the Challenges Presented by Growing Rail Traffic and Limited Capacity

1. Carrier Infrastructure “Needs” Arguments Should not be Permitted to be Used as a Means to Obstruct Customer Rate Protections

The railroads have publicly claimed that, as private companies that must invest in their own systems, still more revenues and increased rates will be required from customers in the future in order to provide capacity to meet expected increases in demand for rail service. WCTL submits that, at least with regard to western coal service, nothing could be further from the truth. As explained above, coal contributes significantly to the railroads’ bottom lines, and market dominant carriers do not need to extract heightened revenues from their coal customers under the guise of “capacity” investment requirements. Even if there were arguably some additional contribution needed from coal customers (which the carriers have not in any way shown is necessary) one need only look to the manner in which the carriers are behaving in the marketplace to understand that the carriers’ market behavior is unreasonable.

2. The Existing Market Environment has Inflicted Serious Harm on Shippers

a. Intense Railroad Consolidation has Helped Enable the Carriers to Exert Undue Control Over Pricing and Supply

The railroad industry has aggressively consolidated in recent years, which has enabled the railroads to consolidate their market power and improve their financial position. Since 1980, the number of major Class I railroads in the U.S. has shrunk from

35 to 4. The result: there are now only two large carriers in both the West (UP and BNSF) and the East (CSX Transportation, Inc. and Norfolk Southern Railway Company), and many customers are served by only one railroad.

Most railroad customers, and all western coal shippers, are now either captive to a single railroad at destination or, at best, subject to railroad duopoly pricing and service power. This concentration in railroad market power has, in the words of the railroads, allowed them to expand their “market reach” and become “stronger.” See Hearing on Inter-Carrier Transactions, Construction and Abandonments, Testimony of Karen Borlaug Phillips on Behalf of the Association of American Railroads, U.S. House of Representatives, Committee on Transportation and Infrastructure (May 6, 1998) at 6.

The consolidation has emboldened, and, in fact, facilitated and enabled the major carriers in recent years to and impose substantially higher rates on their coal customers through “public pricing” initiatives and other means.⁹ The railroads have been insisting that they should be allowed to extract huge mark-ups from their coal customers. A prime example of abusive monopoly behavior involves carrier pricing actions relating to Laramie River Station in Wyoming, owned by not-for-profit cooperatives serving 1.8

⁹ WCTL appreciates that the Board has recognized the threat to competition caused by the carriers’ new hybrid pricing programs by recently initiating a rulemaking proceeding on this subject. See Ex Parte No. 669, Interpretation of the Term “Contract” in 49 U.S.C. 10709, (STB Notice of Proposed Rulemaking served March 29, 2007) at 5 (recognizing that “a carrier’s hybrid pricing mechanism may not contain the same protections against collusion as do traditional confidential transportation contracts”).

million rural customers in the Great Plains that is captive to its serving carrier. Transportation for Laramie River is arranged by WCTL member Western Fuels Association. The involved carrier has more than doubled Laramie River's already profitable rates, and is demanding that it pay astronomical rate increases of \$1 billion over time. The rates are 500% greater than the involved costs of service.

The market power resulting from industry consolidation has also helped the carriers in other ways that impact system reliability by facilitating and exploiting supply/demand imbalances. The railroads have made it clear that they not only have the ability to add capacity to meet future demand, but control its timing. In the east, CSX's CEO stated that "from a 'physical plant perspective,' we do not see any major constraints to handling additional traffic. We firmly believe that 'we can produce free capacity by operating our network more efficiently.'"¹⁰ In the west, BNSF's CEO stated that "we don't bring capacity on sooner than we need it, so we always have a natural tightness."¹¹

This railroad "just in time" capacity investment strategy appears to have substantially contributed to recent railroad service failures as the carriers now appear to be engaging in significant invest "catch-up" activities. See Exhibit 6. The strategy also appears to have helped bring about a railroad system that has become increasingly

¹⁰ W.C. Vantuono, Fluidity, Velocity, Capacity, Consistency, Railway Age, Dec. 2004, at 15-19.

¹¹ Id.

incapable of handling periodic events (e.g., severe weather storms) that occur in the regular course of railroading.

UP and BNSF also have recently been using their dominant market power over their coal business in other ways as a means of controlling supply. UP put in place a long-standing PRB service embargo from July 2005 until March 2007 as an excuse not to take on new coal business or to add traffic under its existing contracts. Railroad embargoes are generally designed to be temporary in nature, and are prohibited as a measure to control traffic.

Additionally, UP issued a force majeure notice on its Wyoming PRB coal customers in May 2005, which it held in place until November 2005 as an excuse not to perform under its rail transportation agreements. BNSF similarly issued a force majeure notice on Wyoming PRB traffic beginning in May 2005 to excuse performance under its transportation contracts, but BNSF's force majeure period totaled only three weeks. Both UP and BNSF have increased the number, frequency, and duration of force majeure notices in recent years. These collective actions by UP and BNSF are clearly designed to control supply and limit carrier service liability claims to the detriment of coal consumers.

Further, in response to recent service problems that erupted in the spring of 2005, particularly on Western coal movements, UP and BNSF each announced they would curtail demand for service by increasing prices, which, at a minimum, displays the carriers' current attitude that railroads exist not to serve customers' needs, but rather, customers exist to serve carriers' needs. These actions also indicate that these duopolists

recognize their shared economic interest in refraining from competing for service.¹²

In sum, in addition to making adequate investments, the railroads need to be making other appropriate management decisions that are targeted at enhancing system efficiency and reliability. As pertains to their coal business, such decisions are fundamental to maintaining electric system reliability. Areas the Board might consider further exploring and addressing in this area are the extent to which the above-cited management decisions (e.g., the railroads' "just in time" philosophy with regard to implementing capacity investments, exactly where the investments are being targeted, railroad practices with regard to issuing force majeure and embargo notices, railroad market power pricing actions, etc.) have contributed to recurring service and reliability problems.

3. The Carriers' Investment Experience in the PRB

Any suggestion by UP and BNSF that they cannot afford to invest in their coal corridors at the competitive rate levels in effect until recently is belied by the carriers' actual experience in the PRB. The carriers assert that forcing them to compete effectively for service will result in a disincentive to continue to make needed capital

¹² The desire to protect and enhance their revenues often leads Class I railroads to make widely divergent statements to investors and regulators. For example, compare BNSF Second-Quarter 2004 Earnings Report (July 27, 2004) ("Record all-time volumes coupled with a 2-percent average price increase contributed to our third consecutive quarter of double-digit earnings growth") with BNSF "Fall Peak" demand letter to STB of June 23, 2004 ("we can not afford to invest for future demands when we have declining yields").

investments in their “infrastructure” to expand capacity, etc. This argument is disingenuous, and contradicted by the railroads’ own conduct.

The PRB coal fields in Wyoming were served exclusively by Burlington Northern Railroad (“BN”), BNSF’s predecessor in interest, until 1984, when UP and its predecessor, the Chicago and North Western Railway (“CNW”), gained access to ten of the largest mines. The result was head-to-head competition for many PRB coal originations, and (as both the railroads and the STB are quick to point out when it suits their purposes) a substantial decline in the rail rates for transporting this coal. Yet, notwithstanding this competition, both UP and BNSF invested huge sums of money -- hundreds of millions of dollars -- to expand the capacity of the lines leading to and from the Basin so that they could carry larger volumes of coal. This is clear evidence that rate reductions resulting from increased competition do not necessarily inhibit railroads from making capital investments that lead to traffic growth.

The railroads’ have argued that the PRB is a special case because of the large volumes of coal traffic carried over the lines, which has required enhancements in capacity. However, the railroads’ general “infrastructure” argument is that there is a general capacity problem in the industry today and that continued investment is needed to remedy this situation. If this is so, then the Powder River Basin is not, in fact, atypical.

If rail lines are at or approaching capacity, the carriers have two choices. One is to decline to handle some business at the lowest end of the profit spectrum -- something the railroads have thus far seemed unwilling to do. The other is to invest in

additional capacity. The Powder River Basin experience indicates that the latter is the railroads' choice in the real world, even in competitive situations where rates are declining. It is also the choice of growing companies in other industries, where competitive markets prevail. There is no reason why the railroads will not continue to make these same choices if they are required to effectively compete and provide service at reasonable rates.

As the ICC emphasized when it took action to protect the CNW's position as a participant in the joint line construction project to access the Wyoming PRB over the vehement objections of BNSF,¹³ competition for coal transportation is a vital public interest:

The public interest requires that these coal resources be made available to consumers under the most favorable terms possible. Ensuring competition for the transportation of coal is the best means to guarantee that result.

Finance Docket No. 28934, et al., Chicago and N. W. Transp. Co. -- Construction and Operation of a Line of Railroad, 363 I.C.C. 906, 927 (1981). In 1985, the ICC approved CNW's request to build a new rail line to access three additional PRB mines previously solely served by BNSF. BNSF's predecessor again strenuously opposed CNW's construction proposal. BNSF argued that the line construction, if approved, would cut

¹³ BNSF actually argued before the ICC that if CNW were allowed to enter the PRB in competition with BNSF, BNSF would dis-invest in PRB coal transportation. See e.g. ICC Finance Docket No. 28934, Verified Statement of Norman M. Lorentzen, President and CEO of Burlington Northern, Inc. (March 28, 1980) at 3. This of course, did not happen after CNW entered the PRB in competition with the BNSF.

into its profits, require it to raise rates elsewhere, and cause it other commercial harm.

The ICC rejected BNSF's arguments, finding that the public interest in competition outweighed BNSF's potential revenue losses. The ICC stated:

A railroad is an instrumentality of commerce that must earn and retain its traffic by providing efficient, effective, and competitive service. In addition, one of the cornerstones of the Staggers Rail Act of 1980 was the emphasis on increased railroad competition. Finally, BN has received handsome returns while it was the only railroad serving the PRB.

Finance Docket No. 29975, Chicago and North Western Transp. Co. -- Notes and Assumption of Obligations, 1985 ICC LEXIS 9, at *42 (Dec. 27, 1985) ("CNW Construction"). (CNW and BNSF subsequently agreed to extend the Joint Line 10 miles to the Caballo Mine, resulting in the new line never being constructed.)

Just as BNSF fought the opening up of its monopoly marketplace position in the Power River Basin 25 years ago, so too does the industry today fight competition as a threat to its private investment. However, intra-carrier competition in the PRB has been an absolute economic success for the railroads. The expansion of competition there during the 1980s and 1990s proves that marketplace competition, and not monopolization, should set railroad rates in the marketplace, and it is in the Nation's interest to have a sound railroad system built on reasonable, not predatory pricing and services practices.

E. *The Potential Role of Public-Private Partnerships and Innovative Financing Tools in Meeting These Challenges*

WCTL notes that the railroads have traditionally opposed any public funding in favor of private financing. The American Association of Railroads (“AAR”) CEO testified before Congress in 2003, emphasizing that the “business model” of the railroads is to “rely on private funds for almost all of their infrastructure investment” and that “[t]hat business model is working, and it is far preferable to moving to a system relying on government subsidies.” National Rail Infrastructure Financing Proposals, Subcommittee on Railroads, Committee on Transportation and Infrastructure, U.S. House of Representatives, Hrg. 108-36. (June 26, 2003) at 15.

To the extent the railroads have supported public funding, the industry has focused on “public-private partnerships,” such as the CREATE project being implemented in Chicago, Illinois. The carriers have argued that such public-private partnerships are not “subsidies,” as they result in private entities paying for private benefits that benefit the railroad economically, while the public pays for the portion of investments that yields primarily public benefits (e.g., reduced freight congestion, improved safety, enhanced mobility).

The railroads also strongly supported the expansion of the Railroad Rehabilitation and Improvement Financing (“RRIF”) program that provides low-interest loans and loan guarantees to help finance railroad capital investments. The AAR testified in 2003 that RRIF program expansion was necessary as a means to “help both short line

and Class I railroads to continue to provide safe and efficient transportation service that enhances or nation's economic health and global competitiveness." National Rail Infrastructure Financing Proposals, Subcommittee on Railroads, Committee on Transportation and Infrastructure, U.S. House of Representatives, Hrg. 108-36 (June 26, 2003) at 120. The expanded RRIF program pursued by AAR was ultimately passed by the Congress and signed into law.

As the Board is well aware, the Dakota, Minnesota, & Eastern Railroad Corporation ("DM&E") has been seeking to construct approximately 280 miles of new rail line to reach the Wyoming PRB and to upgrade nearly 600 miles of existing rail line on its system. WCTL has long-supported the DM&E project as a means of providing additional rail capacity and helping to address recurring railroad service lapses that have cost WCTL members and the consuming public billions of dollars. DM&E sought a \$2.3 billion RRIF loan for its PRB rail project as provided for under the RRIF expansion legislation.

Given the Class I railroads' assertions that additional public financing is necessary to assist them in meeting forecasted traffic demands, one would have thought they would support the DM&E's rail line capacity expansion project. However, having previously strongly supported the RRIF loan expansion program, one of the Class I carriers, BNSF, abruptly changed its position. Once it appeared that the program could actually substantially enhance capacity by a potential competitor, the DM&E, and possibly threaten its PRB market power, BNSF reversed course. In 2005, BNSF's CEO

stated that “[DM&E’s] now turning to look for government money. You know, we continue to believe this would be very, very bad public policy especially now that the industry is really improving its returns and allowing more expansion capital to be put in.” BNSF CEO Matt Rose, BNSF 4Q05 Investors Conference. This episode provides yet another example of the incumbent PRB carriers’ conflicting positions on capacity and their hostility to market competition.

Additionally, the railroads have turned an about-face, and are now championing the very financing proposals they once eschewed as “public subsidies.” The Class I railroads are aggressively pursuing the enactment of the Freight Rail Capacity Expansion Act, legislation introduced in the 109th Congress that would provide the railroads with a 25 percent tax credit for qualifying capital expenditures in certain plant and equipment. Interestingly, the AAR now states that the public should support its investment tax credit proposal because the legislation would “stimulate much needed private investment” and that investment would result in “substantial public benefits.” See AAR Freight Rail Infrastructure Capacity Expansion Act (Information Sheet), Why the Legislation is Important, at 2. Those assertions are in conflict with the AAR’s previous statements that such railroad private investment decisions do not produce sufficient public benefits:

financial markets provide stern discipline to ensure that investments are made only where they will provide a reasonable promise of a direct economic benefit to the investing railroad. This focus on internal returns is necessary and appropriate in a free market economy. However, it

discourages investments that would yield primarily public benefits – such as reduced congestion, cleaner air, improved safety, and enhanced mobility – and have less clear direct monetary benefits to the railroads that would be financing the projects.

National Rail Infrastructure Financing Proposals, Subcommittee on Railroads, Committee on Transportation and Infrastructure, U.S. House of Representatives, Hrg. 108-36 (June 26, 2003) at 120.

The Government Accountability Office (“GAO”) has noted that “although new freight rail investment tax credits have been suggested, our past work has pointed out that it is difficult to target this approach to desired activities and outcomes and ensure that it generates the desired new investments as opposed to subsidizing investment that would have been undertaken at some point anyway.” Freight Railroads, Preliminary Observations on Rates, Competition, and Capacity Issues, Testimony of JayEtta Z. Hecker, Director Physical Infrastructure Issues, United States Government Accountability Office, United States Senate, Subcommittee on Surface Transportation and Merchant Marine, Committee on Commerce, Science, and Transportation, (June 21, 2006), at 25-26.

WCTL shares GAO’s concerns about whether it makes sense to support government subsidies for railroads through tax credits or otherwise where there are not sufficient demonstrable public benefits. These concerns are heightened by the railroads’ past statements that, where carriers are given discretion over spending, they are unlikely to “make investments that would yield primarily public benefits” – presumably such as

improved coal corridor fluidity. Additionally, as noted by GAO, it is entirely unclear whether tax credits would actually be supplemental rather than simply supplant the carriers' planned capital investment spending programs. Former STB Chairman Roger Nober had similar concerns about providing the carriers with discretion over possible new public financing, testifying to Congress that "if there were to be public funding . . . it should be targeted at gateways and choke points" where the carriers might otherwise be disinclined to invest. National Rail Infrastructure Financing Proposals, Subcommittee on Railroads, Committee on Transportation and Infrastructure, U.S. House of Representatives, Hrg. 108-36 (June 26, 2003) at 20.

CONCLUSION

WCTL appreciates the opportunity to present this statement to the Board and urges the Board to carefully consider its views.

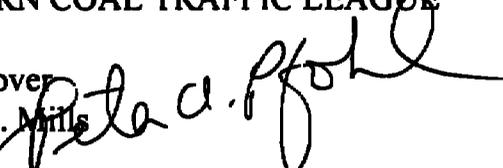
Respectfully submitted,

THE WESTERN COAL TRAFFIC LEAGUE

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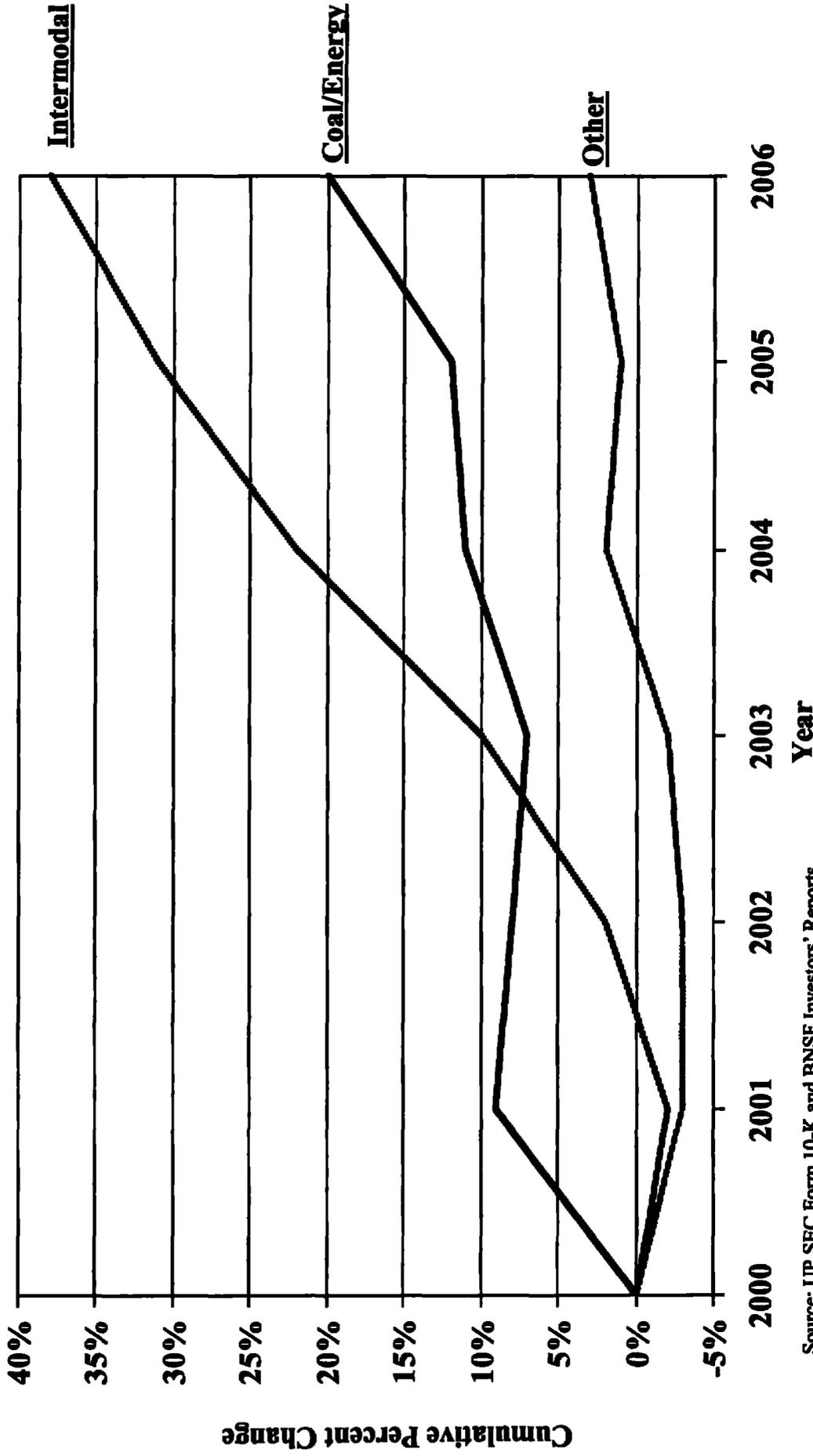
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Xcel Energy

Cumulative Change in UP/BNSF Carload/Units Transported

Exhibit 2

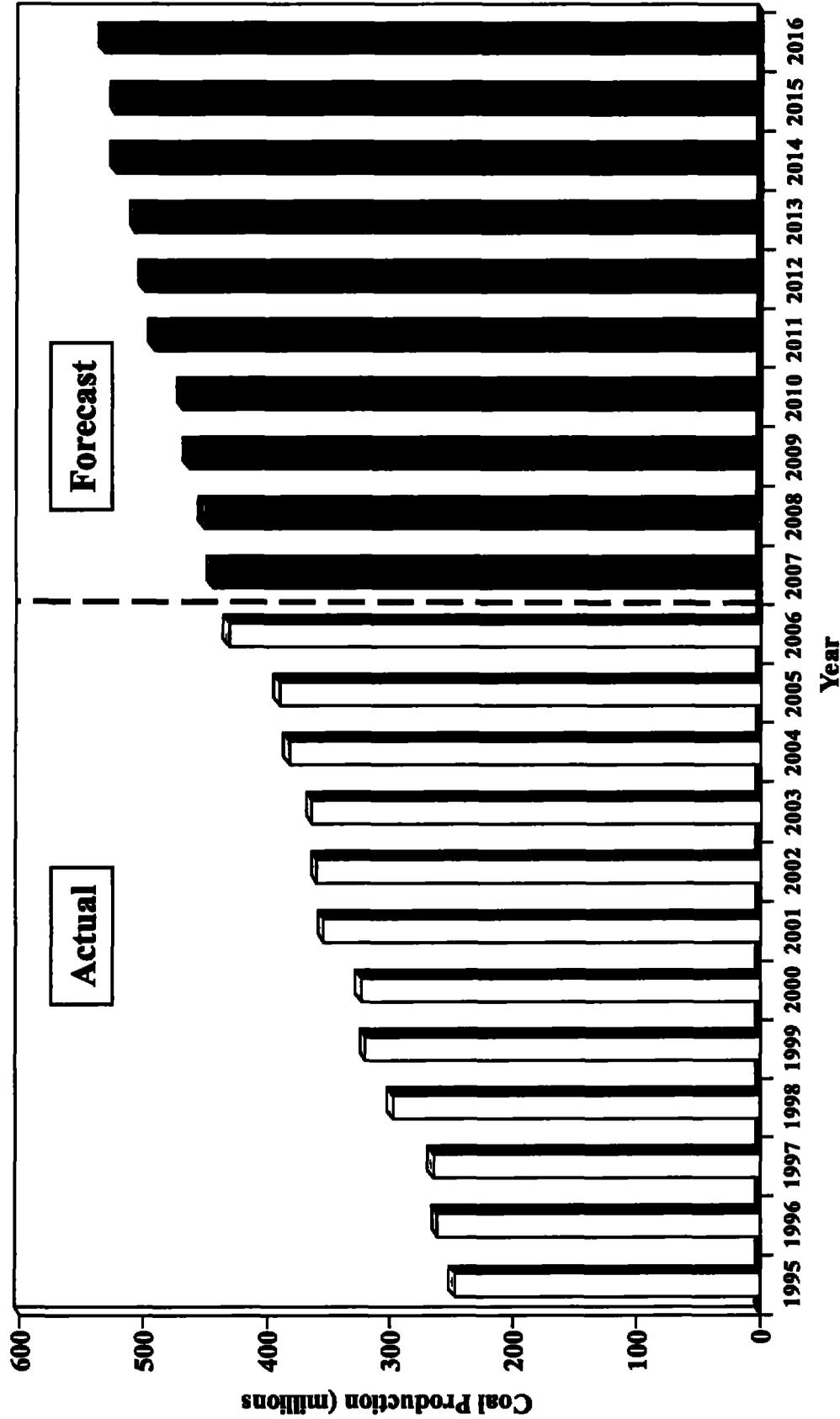


Source: UP SEC Form 10-K and BNSF Investors' Reports

Growth in PRB coal is well understood by the railroads and is expected to continue its past steady growth trend

Exhibit 3

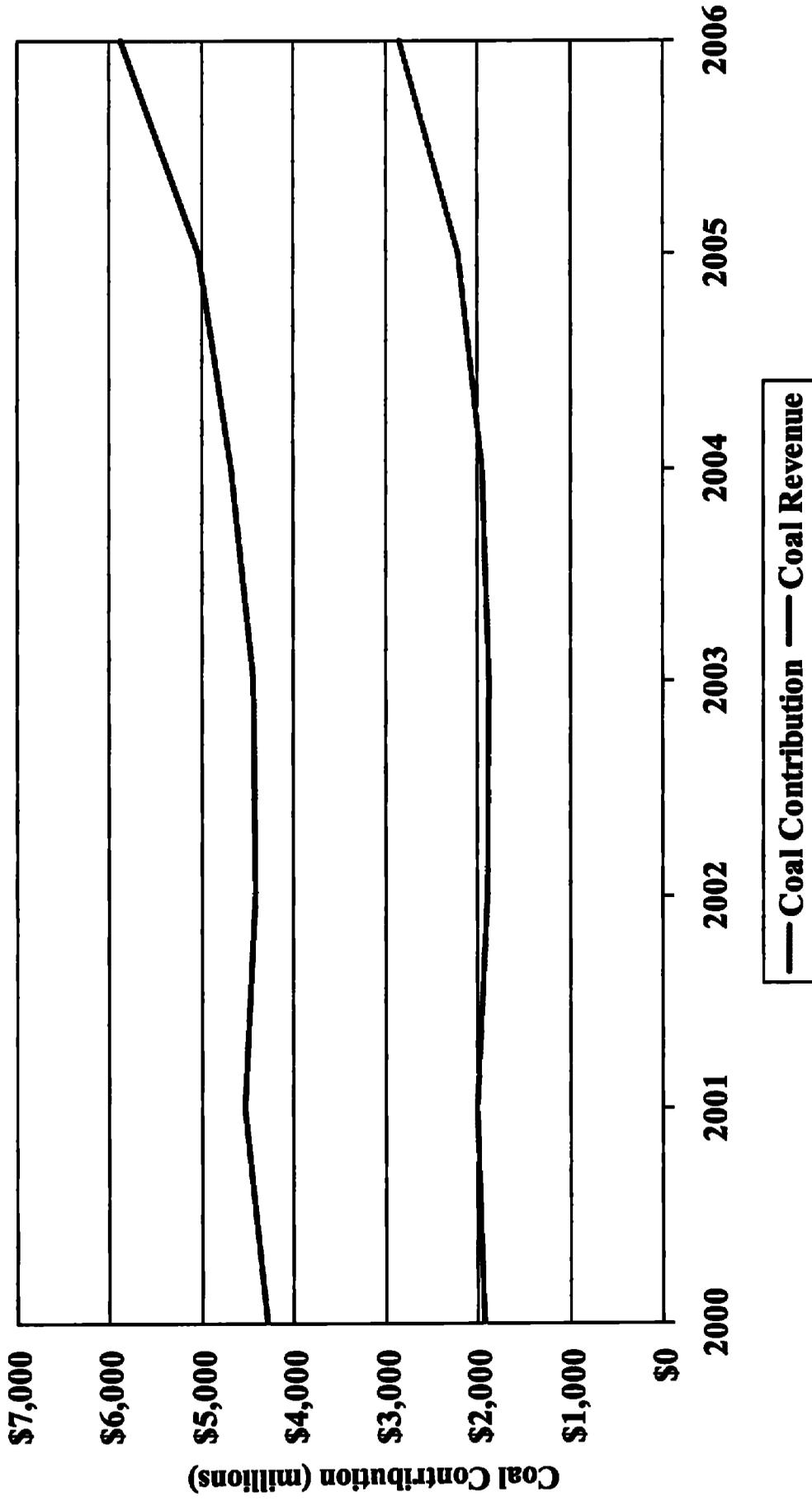
Actual and Forecasted Wyoming PRB Coal Production



Sources: Office of the Wyoming State Mine Inspector and Energy Information Administration

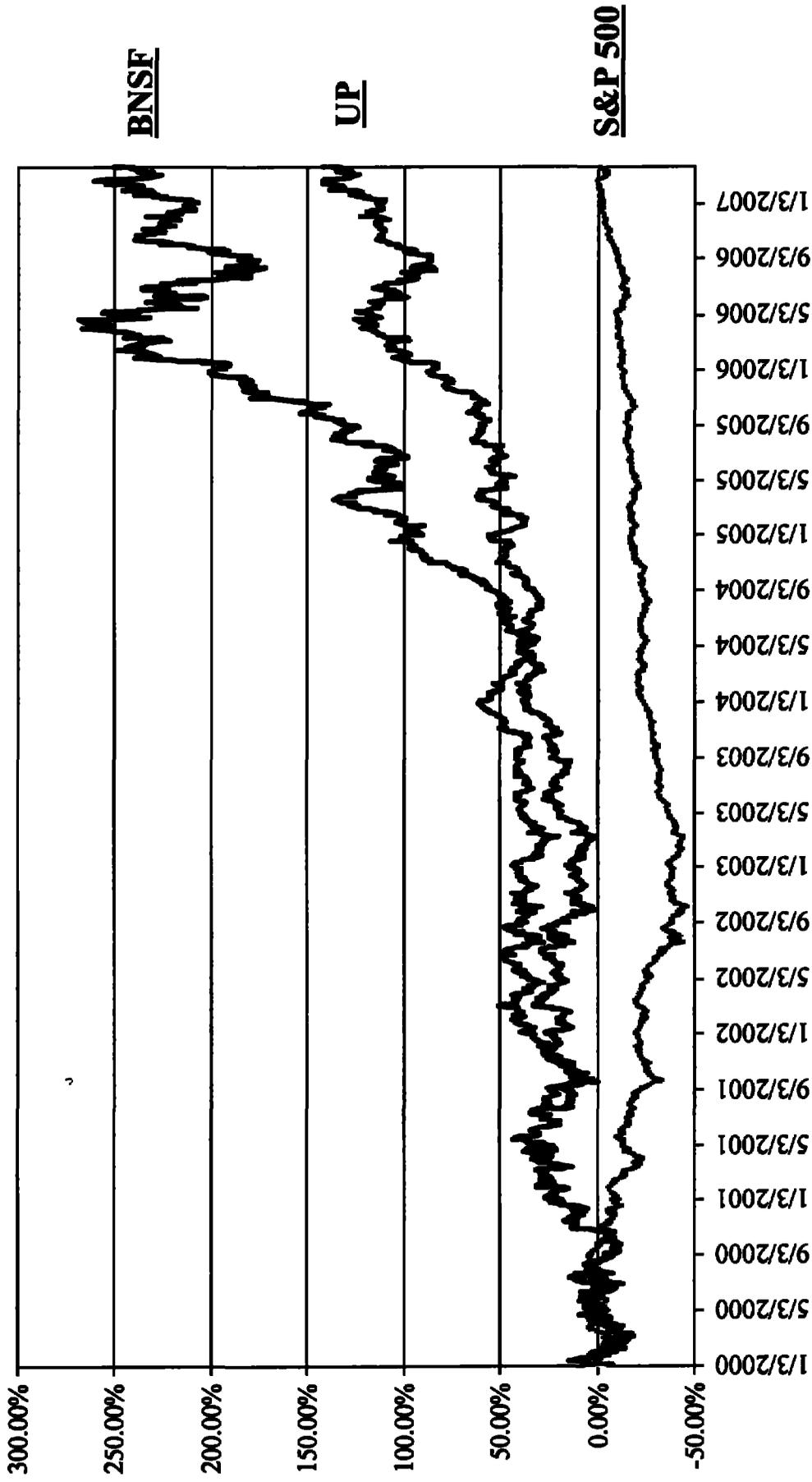
BNSF/UP Aggregate Coal Revenues and Contributions

Exhibit 4



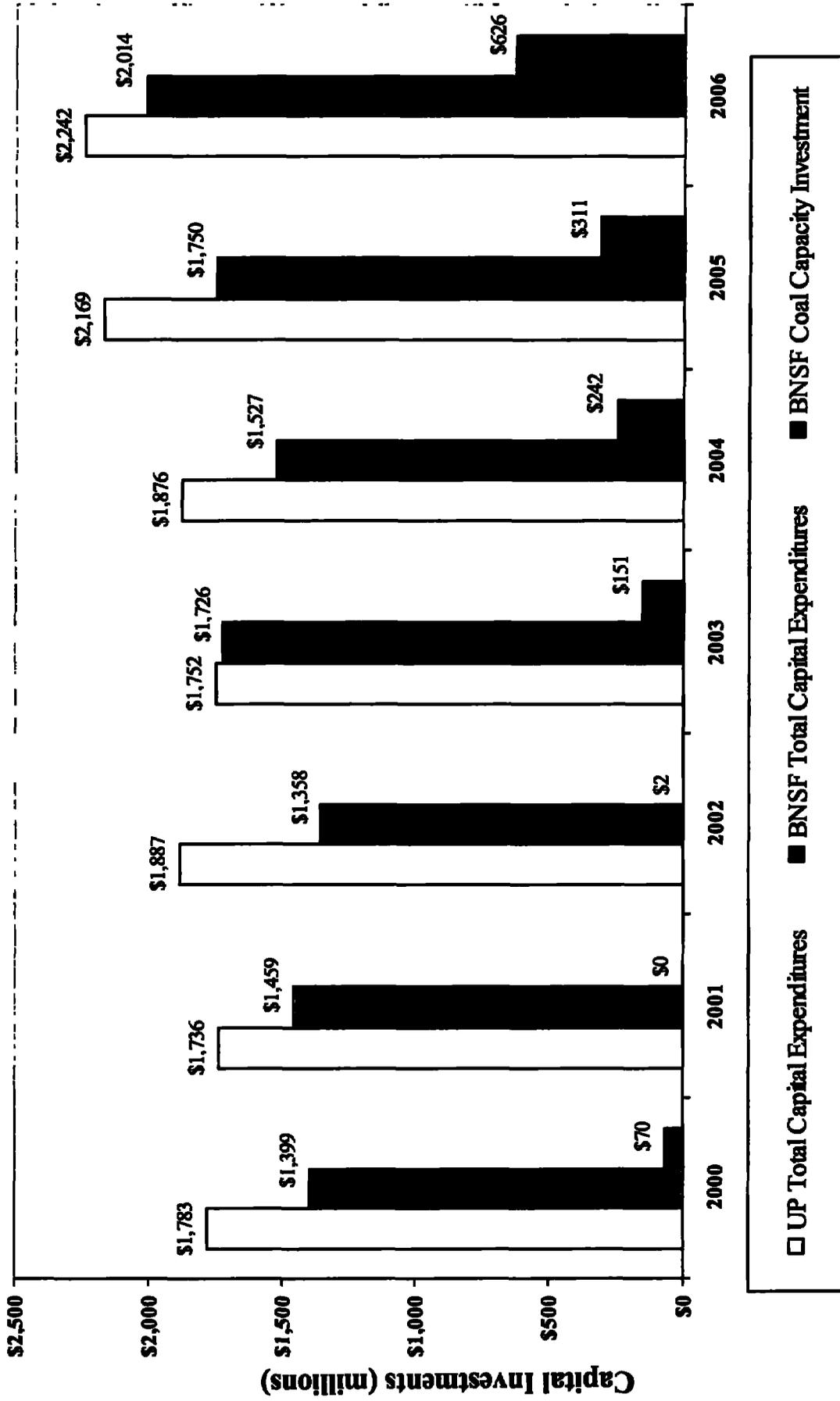
Since 2000, the UP's and BNSF's common stock has significantly outperformed the market as a whole reflecting the railroads' financial health

Exhibit 5



UP and BNSF Capital Investments

Exhibit 6

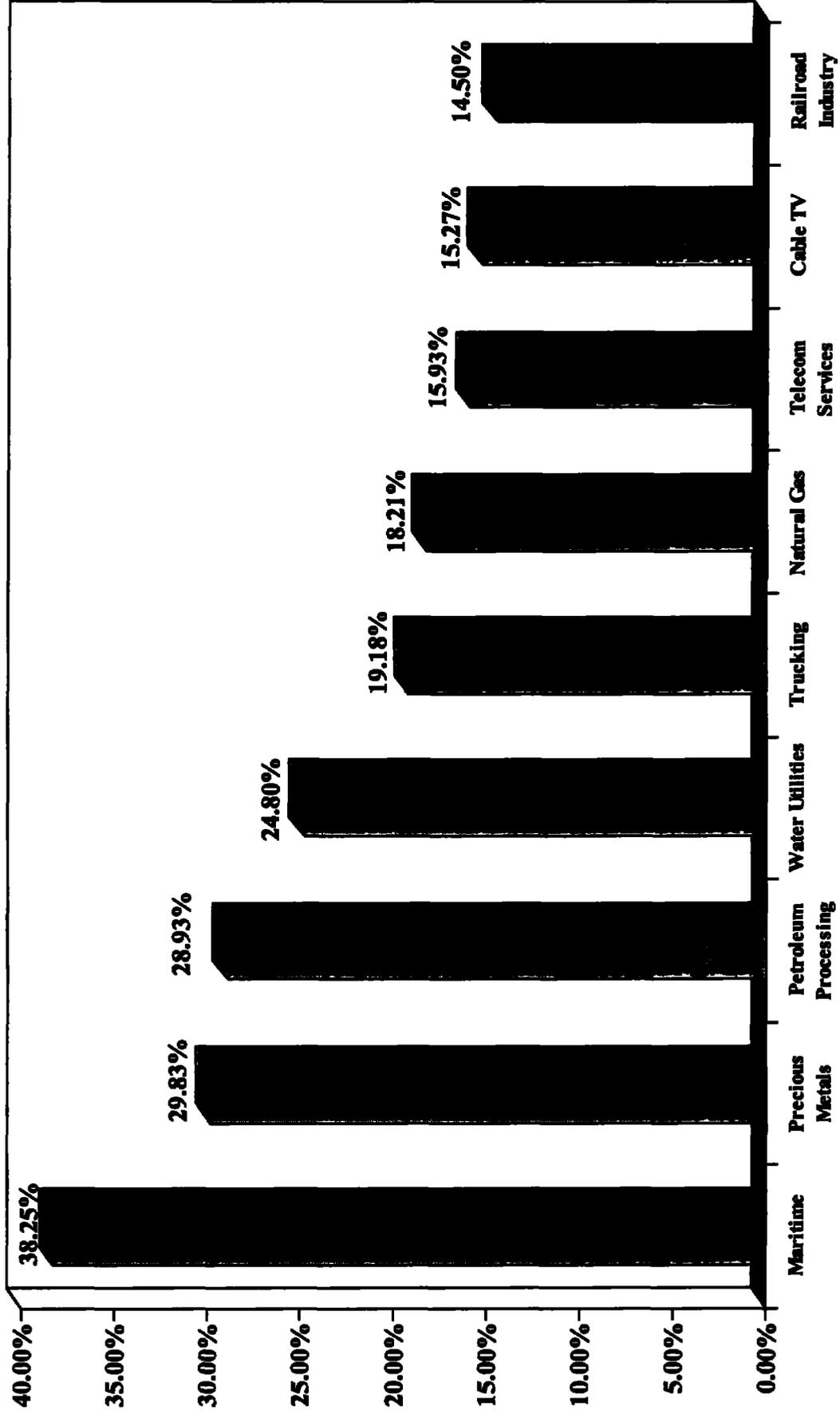


Sources: UP and BNSF Form 10-K, and the June 16, 2006 presentation by BNSF Executive Vice President and Chief Operating Officer Carl Ice to the Federal Energy Regulatory Commission.

The railroad industry as a whole has not reinvested in itself as much as other capital intensive industries

Exhibit 7

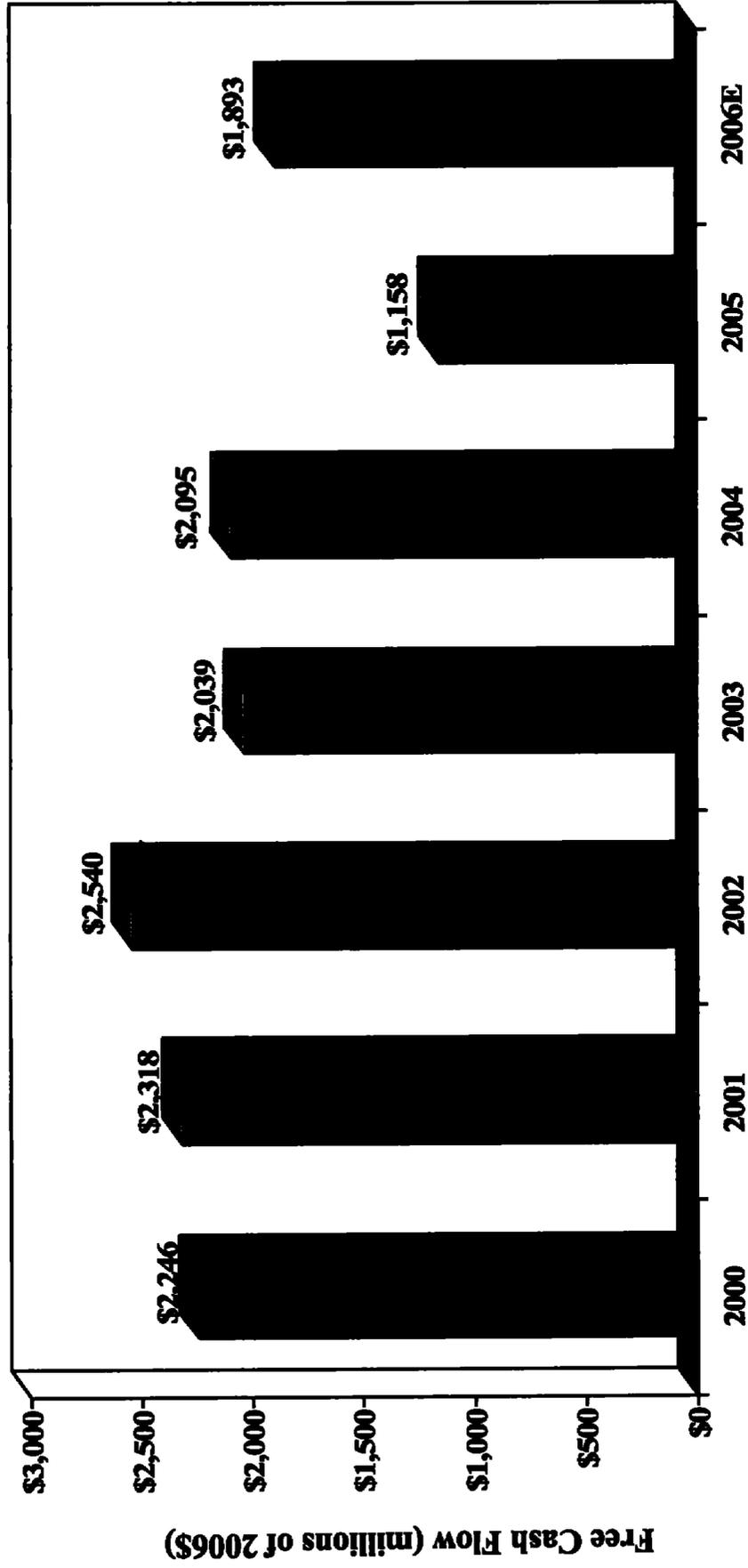
2006 Industry Capital Expenditures to Sales



Sources: New York University Stern School of Management

UP and BNSF Free Cash Flow

Exhibit 8



Source: Annual Report Form R-1. Free Cash Flow is defined as net cash from operating activities and fixed charges less net cash used in investing activities